GLOBAL LEGAL INSIGHTS

Corporate Tax

Third Edition

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Brazil

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Overview of corporate tax work over last year

In *Global Legal Insights – Corporate Tax*, 1st and 2nd Editions, this chapter presented an overview of Brazilian Corporate Taxation, introducing our reader to its main aspects, namely:

- How the corporate tax[1] burden is determined under the actual profit ("*lucro real*") or the presumed profit ("*lucro presumido*") regimes; how companies decide on one or another based on their profitability and future investment plans; and which entities are mandatorily subject to that first taxation regime.
- The Brazilian double taxation treaty (DTT) network.
- Special tax treatment for tax favourable jurisdictions, privileged tax regimes and sub-taxation regimes, under Brazilian law.
- Brazilian thin capitalisation and transfer pricing legislation.
- Brazilian taxation on remittance of funds overseas and on non-residents capital gains.
- General aspects of the social contributions incidence on gross revenues (PIS/Cofins)[2] arising from sale of goods and provision of services, under the cumulative and the non-cumulative regimes.

In the 2nd Edition, a special section drew attention to the deep changes in Brazilian accounting rules caused by the transition from Brazilian GAAP to International Financial Reporting Standards (IRFS). From 2008 to 2014, such modification was neutralised through a temporary tax regime ("*Regime Tributário de Transição*" – RTT) which has been finally abolished by Provisional Measure 627, recently passed by Congress through its transformation into Federal Law 12,973/2014.

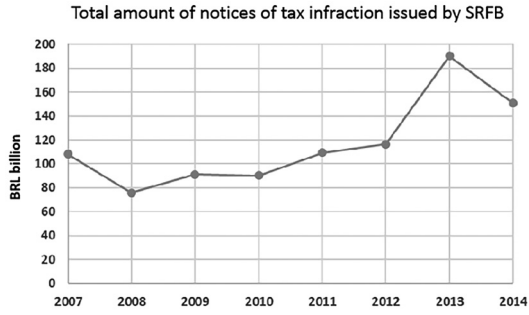
Therefore, 2014 and 2015 have been especially complex in dealing with Brazilian corporate taxation, since those changes are now fully applicable, generating a series of doubts and new disputes between taxpayers and state auditors.

On the top of that, economic and corruption crisis have been momentarily jeopardising Brazil's attractiveness to foreign companies – although Brazilian investment grade has been kept until now – causing the Federal Government to implement severe fiscal adjustments, which seem to be primarily based on the increment of tax collection, instead of cuts to public expenditure.

In light of all this, our reader will find in this 3rd Edition some relevant information and reflections about this reality, which may help corporations to survive in the "tax jungle" formed by the economic crisis, legislative changes and tax authorities' growing aggressiveness.

Types of corporate tax work

According to the Brazilian Internal Revenue Service ("S*ecretaria da Receita Federal do Brasil*" – SRFB), 2014 was the second best tax collection year (2013 was the first best collection year in SRFB history), exclusively taking into consideration notices of tax infractions issued against taxpayers, which totalled approximately BRL 150bn.



(Source: SRFB, 2015[3])

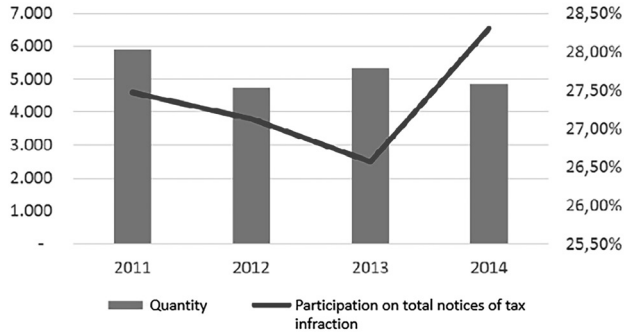
Referring to the assessed economic sectors, the audit results of SRFB were 97% concentrated on corporations, especially from the manufacturing segment (40.6%), being the big corporations responsible for over 30% of the total amount of tax credit charged by the Federal Government in Brazil.

Tax debts arising from audit proceedings, according to economic sector and compared with the previous year								
Corporations – economic sectors	2013		2014		%		Growth from 2013 to 2014 (%)	
	Notices of tax infraction	Total amount (BRL)	Notices of tax infraction	Total amount (BRL)	2013	2014	Notices of tax infraction	Total amount (BRL)
Trade	2,407	23,346,171,133	1,999	15,977,454,739	12.8	11.1	-17.0	-31.6
Services	2,626	17,174,748,861	2,112	18,632,505,639	9.4	13.0	-19.6	8.5
Industry	2,919	74,174,748,861	2,373	58,404,984,540	41.1	**40.6**	-18.7	-21.9
Transport	635	3,230,128,222	547	3,579,948,169	1.8	2.5	-13.9	10.8
Civil works	584	2,995,678,156	517	2,959,255,416	1.6	2.1	-11.5	-1.2
Communication, energy and water	90	1,512,255,577	70	1,529,132,531	0.8	1.1	-22.2	1.1
Financial services	316	42,149,106,100	230	17,056,212,354	23.2	11.9	-27.2	-59.5
Holding companies	172	5,120,020,265	134	15,795,299,256	2.8	11.0	-22.1	**208.5**
Others	1,315	5,445,217,415	1,028	5,539,507,692	3.0	3.9	-21.8	-1.7

Tax debts arising from audit proceedings, according to economic sector and compared with the previous year								
Corporations – economic sectors	2013		2014		%		Growth from 2013 to 2014 (%)	
	Notices of tax infraction	Total amount (BRL)	Notices of tax infraction	Total amount (BRL)	2013	2014	Notices of tax infraction	Total amount (BRL)
Subtotal	11,064	175,731, 887,818	9,010	139,474, 300,336	96.5	97.0	-18.6	-20.6
Fines	265	103,171 213	233	51,406,987	0.1	0.0	-12.1	-50.2
Review of tax returns	5,692	6,186, 568,301	5,055	4,311,421,822	3.4	3.0	-11.2	-30.3
Total	17,021	182,021, 627,332	14,298	143,837, 129,145	100.0	100.0	-16.0	-21.0

The numbers above indicate a major increase in the notices of tax infractions issued against holding companies. Such increase confirms that, in 2014, SRFB focused its audit proceeding on tax planning structures, issuing notices of tax infractions corresponding to more than BRL 7bn, in relation to: (i) abusive amortisation of goodwill generated on transactions among related companies; (ii) abusive transfer of premium/goodwill between companies; and (iii) transactions aiming to avoid corporate taxation on capital gain (such as merge of shares).

Last year has also registered a relevant number of criminal investigations related to tax audit proceedings, some of them resulting in more than BRL 9bn charged from taxpayers involved in special investigation cases with great media exposure.



(Source: SRFB, 2015)

Finally, from the total amount of approximately BRL 144bn of taxes charged on corporations: (i) 49.2% corresponded to Corporate Taxes; while (ii) 21.8% refer to social contributions on gross revenue.

Tax	Notice of tax infraction		Charged amount (BRL)	
Corporate taxes (IRPJ/CSL)	6,091	20.3%	70,967,163,367	49.2%

Tax	Notice of tax infraction		Charged amount (BRL)	
Social contributions on gross revenues (PIS/Cofins)	5,454	18.1%	31,404,350,578	21.8%
WHT	4,006	13.3%	13,518,804,882	9.4%
Federal Tax on Manufacturers (IPI)	841	2.8%	6,483,177,450	4.5%
Individual income tax	4,621	15.4%	4,447,032,686	3.1%
Social contributions for economic intervention (CIDE)	49	0.2%	2,155,650,390	1.5%
Total	30,040	71.1%	144,182,604,537	94.8%

(Source: SRFB, 2015)

It is important to note that these figures refer solely to tax assessments issued against taxpayers, and they do not include regular and voluntary collection of federal taxes or other Brazilian taxes charged by States and Municipalities.

Significant deals and themes

While 2013 was a relevant year in terms of Corporate Tax cases ruled by judicial and administrative Courts, 2014 may be remembered as the beginning of a new era in terms of corporate taxation in Brazil, due to the great number of legislative modifications entering into force optionally in 2014 and mandatorily as of 2015.

Federal Law 12,973/2014 abolished RTT and imposed an obligation on Brazilian corporations to unify the use of IFRS for both commercial and tax effects. However, it has also introduced a series of changes to tax legislation that has been in force for decades, aiming to achieve a certain level of neutrality on some relevant issues, some of them commented below.

Federal Law 13,043/2014 and Provisional Measure 656/2014 (MP 656)[4] have also affected Brazilian Corporate Taxation considerably and will also be commented upon below.

Key developments affecting corporate tax law and practice

Domestic – cases and legislation

Changes brought by Federal Law 12,973/2014:

Tax treatment given to fair value adjustments (AVJ) – the accounting recognition of profits or losses arising from such adjustments does not affect Brazilian corporate taxes' basis of calculation, if the respective adjustment is shown in a sub-account linked to the relevant asset or liability. Failure to provide such demonstration shall result in taxation of any profit or the non-deductibility of any loss. Following these requirements, profits and losses deriving from AVJ may provoke tax effects to the extent that the corresponding asset is realised through depreciation, amortisation, exhaustion, disposition or write-off, or when the liability is settled or written off.

If the company migrates its corporate taxes calculation from presumed profit regime to actual profit regime, it might submit its AVJ to taxation under that first criteria during the taxable year following the modification of regime. Taxation may be deferred, however, if that sub-account registration is observed.

Tax treatment for present value adjustments (AVP) – 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.

Deductibility deferral for pre-operational expenses and deductibility of disassembling costs – pre-operational expenses may be deducted monthly from corporate taxes, observing a 5 (five)-year minimum period of time, which shall be initiated: (i) from the starting-up of operations or the full use of an industrial plant; and (ii) from the starting-up of new activities related to new installations deriving from industrial expansion. On the other hand, expenditures with fixed assets disassembling may be deducted whenever they are effectively incurred.

Capital losses offsetting – losses arising from sale of fixed assets, investments or intangibles may be off-set exclusively with capital gains occurred on future taxable years, limited to 30% of the corresponding taxable income.

Impairment test – losses deriving from impairment tests may be deducted for tax purposes only when the asset is disposed or written off.

Premium arising from acquisition of shares – the cost of a share acquisition must be split into: (i) the net equity value of the company in which the shares were acquired, proportional to the corresponding stake; (ii) the difference, positive or negative, between the fair value (as determined by a report issued by an independent appraiser) and the book value; and (iii) any future earnings premium (goodwill) or discount (gain from a bargain purchase), representing the difference between the acquisition cost and the sum of (i) and (ii).

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 included, as income, for tax purposes over a period of no more than five years.

Long-term contracts – Brazilian corporate tax legislation provides for deferral profits recognition whenever such profits arise from long term contracts. Such profits may be recognised for tax purposes according to the percentage of the contract already executed, which shall be determined based on the ratio between incurred costs and total estimated costs or based on technical appraisal report. According to Federal Law 12,973/2014, if the corporation uses any other accounting criteria to recognise the results arising from such contracts, the differences must be added or excluded from the corporate tax basis of calculation, whenever the company is subject to the actual profit method, in order to neutralise the difference's effect.

Subsidies for capital investment – they may not be taxed if registered as profit reserve, which shall be used only to absorb losses after other profit reserves or to increment equity capital.

Premium arising from debentures issuance – likewise the investment subsidies, such premium may not be taxed if registered as profit reserve, which shall be used only to absorb

losses, after other profit reserves are consumed, or to increment equity capital. Particularly in this case, another requirement for the non-taxation of the premium is that the owner of the debenture cannot already be a shareholder of the issuing company owning 10% or more of its shares.

Brazilian CFC rules – Brazilian CFC rules were first passed 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 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, Federal Law 12,973/2014 has also created new provisions aiming to resolve those disputes.

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 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 Tax Information Exchange Agreement (in the event that no agreement 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 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. 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 direct or indirect controlling company located in a tax haven or a country considered as having a privileged tax regime, or sub-taxation regime.

A holding company should fall under the Brazilian CFC regime if it holds equity of another foreign affiliated company and this stake is in excess of 50% while considered jointly with the holding stake of 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, Federal Law 12,973/2014 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.

Interest on net equity ("Juros sobre capital próprio" – JsCP) – JsCP is a 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 the 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). After Federal Law 12,973/2014 enters into force, JsCP shall be calculated based on some limited net equity accounts, namely: equity capital; capital reserves; profit reserves; treasury shares; and accumulated losses.

Stock option plans – maybe one of the few themes generating relevant administrative rulings during 2014, Federal Law 12,973/2017 stated that the retribution to employees or service providers paid through stock option plans must be added to the Corporate Tax basis of calculation. The retribution may be deducted only after its effective payment in money or other assets or after the definitive transfer of the shares ownership. Moreover, only after the definitive transfer of ownership the shares may be considered on the equity capital affecting the calculation of JsCP.

Changes brought by Federal Law 13,043/2014: Law 13,043 has passed an array of amendments as a result of the converting of Provisory Measure 651 into law, by the end of 2014. The main tax changes are the following:

Investments in financial assets – the manager of asset funds that receives financial assets as payment of quotas must withhold and pay the tax on capital gain accrued by asset funds on such subscription (premium payment as capital gain). Such capital gain is different to earnings accrued previously from financial assets. In this case, the withholding tax levied on such earnings comes under the responsibility of financial institution in charge of payment to the final beneficiary.

Progressive withholding tax rate – investment funds, which at least 75% of assets vary according to fixed index rates, are subject to the following withholding tax rates: (i) 25% for a 180-day renegotiation period; (ii) 20% for a renegotiation period ranging from 181 to 720 days; or (iii) 15% for a renegotiation period of over 721 days. In the case of a breach of the 75% limit during the period, a 30% withholding tax shall be levied. Exemption is granted to foreign investors in case the renegotiation period fund exceeds the 720-day period.

Securities renting transactions – this kind of transaction is considered a fixed rate investment and is subject to the following withholding tax rates: (i) 22.5% for a 180-day renegotiation period; (ii) 20% for a renegotiation period ranging from 181 to 360 days; (iii) 17.5% for a renegotiation period ranging from 361 to 720 days; or (iv) 15% for a renegotiation period of over 721 days. Dividends and other earnings accrued from rented securities are exempt from taxation for both residents and foreigners.

Exemption of capital gains on investments performed by Sovereign investment funds – sovereign investment funds are exempt to withholding tax on investments performed on equity of non-financial entities in Brazil.

PIS/Cofins on sale of shares – revenues accrued from the sale of equity are subject to social contributions on gross revenue, at a total 4.65% rate, whenever such equity is not registered by the selling part among its non-current assets. If the shares belong to current

assets, the company shall deduct the corresponding acquisition cost from the PIS/Cofins taxable base.

Changes brought by MP 656: MP 656 is a good example of the complex and confusing legislative process that takes place during the conversion of a Provisional Measure (which is issued directly by the President of the Republic) into a Federal Law duly approved by National Congress. In this case, during the discussions of the original content of MP 656, the Brazilian Congressmen had tried to introduce almost 400 amendments dealing with a series of matters, including tax issues.

The President of the Republic vetoed a large number of these amendments, especially those which aimed to introduce new tax rules concerning, for example: (i) no taxation of capital gain on the exchange of shares; (ii) co-validation of premium amortisation generated within transactions between related parties; (iii) full deductibility of interests related to capitation of funds through bonds issued by related companies resident in other jurisdictions; (iv) the use of tax losses for off-setting outstanding federal tax debts; and (v) special tax amnesty and a special instalment payment programme for sport associations.

Although relevant, the few corporate tax changes that were finally approved and passed into law, after the converting of MP 656 into Federal Law 13,097/2015, are: (i) *bad-debt reserve deductibility* – MP 656 facilitated the deductibility of bad-debts in cases where the debtor is not formally declared bankrupt; and (ii) *fine for irregular tax off-setting* – instead of charging a 50% fine over the amount of the tax credit used by taxpayer, the legislation was changed in order to provide for such penalty to be calculated over the amount of the debt irregularly off-set.

BEPS

Although Brazil is not an OECD member, its internal legislation is creatively driven to provide tax authorities with many tools to deal with international tax planning strategies.

Besides the Brazilian CFC rules mentioned above, Brazilian tax legislation also provides specific mechanisms regarding the following themes:

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 benefitting from privileged tax regimes.

Brazil accepts the best method approach in determining the parameter price, but the existing methods do not follow the OECD standards and are based on alternative comparison methods, as defined by Brazilian law:

TP methods for imports of goods, services or rights	TP methods for exports of goods, services or rights
Comparable independent price method ("*Preços Independentes Comparados*" – **PIC**): similar to CUP method. The parameter price is determined as the weighted average price for the year of identical or similar property, services, or rights on transactions between unrelated parties.	**General safe harbour**: no TP adjustment should be made if the average export price corresponds to at least 90% of the average price observed on domestic transactions with the same goods, services or rights during the same period of time and under similar commercial conditions.

TP methods for imports of goods, services or rights	TP methods for exports of goods, services or rights
Comparable independent price method ("*Preços Independentes Comparados*" – **PIC**): similar to CUP method. The parameter price is determined as the weighted average price for the year of identical or similar property, services, or rights on transactions between unrelated parties.	**Export sales price method** ("*Preço de Venda nas Exportações*" – **PVEx**): parameter price is obtained through the weighted average of export sales price charged on exports of identical or similar goods, services, or rights on transactions between unrelated parties.
Resale price less profit method ("*Preço de Revenda menos Lucro*" – **PRL**): parameter price corresponds to the weighted average price for the year of the resale of goods, services or rights, considering the following fixed gross profit margin: • **40%** for pharm-chemical and pharmaceutical goods, tobacco, optical equipment and instruments, photo and cinematographic equipment, machinery, devices and equipment for dental, medical and hospital use, and oil extraction, natural gas and oil-derivative products. • **30%** for chemicals, glass and glass products, pulp, paper and paper products and metallurgy. • **20%** for other economic sectors.	**Resale price method**: parameter price is determined as the weighted average wholesale or retail in the country of destination, reduced from taxes and fixed profit margins of 15% ("*Preço de Venda por Atacado no País de Destino, Diminuído do Lucro*" – **PVA**) or 30% ("*Preço de Venda a Varejo no País de Destino, Diminuído do Lucro*" – **PVV**).
Production cost plus profit method ("*Custo de Produção mais Lucro*" – **CPL**): parameter price is determined by the weighted average cost incurred for the year to produce identical or similar property, services, or rights, plus a fixed gross profit margin of 20%.	**Purchase or production cost – plus taxes and profit method** ("*Custo de Aquisição ou de Produção mais Tributos e Lucro*" – **CAP**): similar to CP method. Parameter price results from weighted average cost of acquisition or production of exported goods, services, or rights, plus a fixed profit margin of 15%.
Quotation price on imports method ("*Preço sob Cotação na Importação*" – **PCI**): applicable to products classified by SRFB as commodities. The parameter price corresponds to the average price of the product obtained before an international commodities exchange or on public prices informed by sectorial research institutions.	**Quotation price on exports method** ("*Preço sob Cotação na Exportação*" – **PECEX**): applicable to products classified by SRFB as commodities. The parameter price corresponds to the average price of the product obtained before an international commodities exchange or on public prices informed by sectorial research institutions.

Deductibility limitations for interests, royalties and technical, scientific, administrative or similar assistance (technical services) – in relation to international loans with related parties, the deductibility of interested is limited: (i) in case of loans denominated in USD with fixed rates, to the market rate of the sovereign bonds issued by the Brazilian Government on the external market and indexed in USD; (ii) for loans denominated in BRL with fixed rates, to the market rate of the sovereign bonds issued by the Brazilian Government on the external market and indexed in BRL; and (iii) for loans denominated in all other foreign currencies or with a floating rate, to the six-month London Interbank Offered Rate (LIBOR).

Royalties and technical services are expressly excluded from Brazilian TP controls, since its deductibility for corporate tax purposes is already limited to a maximum 5% or 1% of related revenues (trademarks). Such limited deduction also depends on the registration of the corresponding contract with the National Institute of Industrial Property (INPI).

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 benefitting from privileged tax regimes. Interests paid in connection with such financing are not deductible from Brazilian Corporate Tax when they relate to a principal amount that exceeds the following percentages:

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

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.

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 lower than 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 above.

Economic and operational substance of foreign company – Federal Law 12,249/2010, article 26, provides that any kind of expenses directly or indirectly paid to individuals or corporations resident in tax-favourable jurisdictions, subject to privileged tax regimes or sub-taxation regimes shall not be deductible for Brazilian corporate tax purposes, unless the following requirements are cumulatively met: (i) the beneficiary owner is duly identified; (ii) the operational capability of the foreign individual or corporation is proved to be effective; and (iii) there is written proof of the payment of the price and the receiving of the

goods, rights or services related to the transaction. Prove of operational capability is not necessary if the transaction was not performed with exclusive or main tax saving purpose.

DTT Brazilian 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 in 2002, which entered into force in 2013.

SISCOSERV – The Integrated System of Foreign Trade in Services ("*Sistema Integrado de Comércio Exterior de Serviços*") was created in 2011 originally to work as a statistics database system for international trade in services, intangibles and other transactions. It obliges Brazilian individuals and corporations to provide information regarding any kind of transactions with foreign-resident or domiciled persons, involving services, intangibles or any other transactions generating variations on the assets of individuals, legal entities or depersonalised entities. Later on, the use of SISCOSERV for tax audit control was officially recognised by Brazilian tax authorities, which may use such mechanism to track and control transactions performed by informal/non-registered economic entities in Brazil.

Tax climate in Brazil

The tax climate in Brazil is quite challenging, but may be seen as an opportunity for those who are more risk-taking and for those willing to challenge tax increases before the courts, aiming to create competitive advantages on a medium- to long-term basis.

In the beginning of 2015, Federal Government fiscal adjustments have already resulted into some relevant tax increases, based on some modifications on PIS and Cofins legislation, namely:

PIS/Cofins increase on the importation of goods – although originally designed to tax gross revenues, PIS and Cofins are also due on the imports of goods and services, with the objective of allegedly equalising imported goods and services to their local competitors. In this sense, due to a bidding ruling by the Brazilian Supreme Court considering the inclusion of State Sales Tax (ICMS) in the basis of calculation of PIS and Cofins on imports, the President of the Republic issued the Provisional Measure 668 simply increasing those social contributions rates to a total 11.75% (against 9.25% before that), in order to recompose the collection loss that would be caused by that Supreme Court ruling. Moreover, some specific economic sectors already subject to higher rates were also submitted to additional increases (pharmaceutical products; cosmetics and perfumes; machinery and vehicles; tires and inner tire tubes; car parts; and paper for printing purposes).

PIS/Cofins on financial revenues – as of July 1st, 2015, Federal Decree 8,426 re-established PIS and Cofins taxation on financial revenues obtained by those companies who are subject to non-cumulative regime of PIS/Cofins taxation. The total 4.65% taxation imposed by such decree shall reach every financial revenue, including those arising from hedge and any other instrument of exchange rate protection.

Developments affecting attractiveness of Brazil for holding companies

Besides the general information regarding this subject, which can be found in the 1st and

2nd Editions, holding corporations should be alerted to the following changes that may affect their investments in Brazil in the following years:

Dividends exemption – there will be some attempts to revoke corporate tax exemptions on dividends, which has been in force in Brazil since 1996. Currently, congressmen have been trying to eliminate such exemption through an amendment to Provisional Measure 665, providing for the taxation of dividends as of January, 2016: (i) companies distributing dividends to individuals resident in Brazil shall withhold 15%, as anticipation of the maximum 27.5% income tax rate to be paid by individual shareholder; (ii) dividends received by companies domiciled in Brazil shall be fully taxed by shareholder at 34%; and (iii) dividends paid to any beneficiary overseas shall pay a 15% or 25% (in case of tax-favourable jurisdictions) withholding tax.

CPRB – in the 1st Edition, it was written that the Brazilian government had initiated a significant change to the 20% Social Security Contribution on Payroll ("*Contribuição Previdenciária sobre Folha de Salários*" – INSS) allegedly aiming to reduce the corresponding tax burden of some specific sectors. Such segments had migrated from a payroll-basis to a new gross revenue basis contribution, named the Social Security Contribution on Gross Revenue ("*Contribuição Previdenciária sobre Receita Bruta*" – CPRB).

Since that happened, some economic activities have really benefitted from such migration, while others were overtaxed, in comparison to the previous payroll-basis taxation. Due to that, some companies challenged CPRB before Judicial Courts, arguing that the new regime should be declared unconstitutional or at least not mandatory.

In the beginning of 2015, the Federal Government proposed the modification of the current regime, imposing an increase on the CPRB rates, as well as providing for its express optional regime. This matter should be decided by National Congress within 2015.

Premium amortisation exam by tax authorities – finally, due to the changes on premium amortisation legislation, 2015 may the year when tax authorities will focus their attention on the evaluation of goodwill generated by the acquisition of company shares, possibly challenging the experts' appraisals on the amount of premium. This is an issue to be cautious about.

The year ahead

In our opinion, 2015 shall be marked by a considerable increase in litigiousness between corporations and the Brazilian Federal Government.

SRFB has already made public its tax audit planning for 2015, focusing on the issuance of notices of tax infraction in relation to: (i) amortisation of goodwill; (ii) inconsistencies deriving from RTT adjustments registered by taxpayers up to 2014; (iii) omission of revenues and incompatible financial transactions; (iv) taxable income related to Brazilian investments overseas; (v) international transfer of football players; and (vi) tax irregularities deriving from the Petrobras corruption scandal.

Furthermore, Federal Tax authorities have insisted on collecting taxes from any company belonging to the same economic group, trying to apply to tax law the same wide concepts provided by Brazilian labour legislation, but which should not be valid for tax purposes (by this time, jurisprudence has not allowed the tax authorities to do so).

Besides that, Brazilian Congress has passed a new Civil Procedure Code, which shall affect litigious relations between taxpayers and tax authorities as of 2016, especially because such legislation provides for an incidental procedure for the resolution of repetitive demands, which may cause tax controversy cases to be decided uniformly by Brazilian Courts. Such repetitive demands may possibly arise from that great number of legislative changes on

Corporate Taxation, to which companies in Brazil should be especially cautious about whenever they are challenged by any taxpayer, since the ruling obtained in his case may be applicable to any other taxpayer in equivalent situation.

Endnotes

1. Corporate Taxes comprise 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).
2. Gross Brazilian social contributions correspond to the Social Integration Program Contribution Tax ("*Contribuição ao Programa de Integração Social*" – PIS) and the Social Security Financing Contribution Tax ("*Contribuição para o Financiamento da Seguridade Social*" – COFINS).
3. Available at http://idg.receita.fazenda.gov.br/dados/resultados/fiscalizacao/arquivos-e-imagens/ 12015_03_05-plano-anual-da-fiscalizacao-2015-e-resultados-2014.pdf.
4. Which was converted into Federal Law 13,097/2015 on January 19th, 2015.

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