

Brazilian Tax System Overview **(updated January, 2014)**

Brazilian tax legislation is intricate. There are a large number of taxes and pulverized rules currently in force, issued almost daily by the three levels of Government: federal, state and municipal. Below, we briefly address the main taxes that are levied in the businesses conducted in Brazil.

Corporate Income Tax (“IRPJ”)

Brazilian companies are subject to Corporate Income Tax (“IRPJ”) levied over the net profit at the rate of 15%; if net profit exceeds R\$ 240,000 per year, an additional 10% is charged. Under some circumstances taxpayers can opt to be taxed by IRPJ in a simplified way, the Presumed Profit Regime¹, which takes as taxable basis a percentage of the gross revenues, being the applicable percentage different depending on its activity.

In addition to IRPJ, Brazilian legal entities must pay the IRPJ twin tax, the social contribution on the net profit (“CSLL”). The most common current rate is 9%, but financial institutions pay 15%². The taxable basis is usually the same as the IRPJ’s and in case the taxpayer opts for the Presumed Profit Regime, such option is valid for these two taxes, as well as for the PIS and the COFINS taxes addressed below.

Profit distribution – Profit can be distributed without further taxation to shareholders, whether they are legal entities or individuals. Despite being of great use for Brazilian domiciled taxpayers, this exemption can cause some hurdle to the shareholder trying to offset taxes paid in Brazil with their consolidated tax in its country of origin.

Conventions to avoid double taxation – Brazil has entered into conventions with a great number of countries to avoid double taxation. Notable exceptions among the most important trade partners are the Unites States and the United Kingdom. However, the Brazilian income tax regulations expressly allow that income tax levied in these countries can be offset with the Brazilian correspondent by means of recognizing that those countries have a reciprocal treatment with the Brazilian income tax. In spite of Brazil not being a member of the OCDE, almost all the conventions it has entered into follow the OECD’s models, but some interpretations by Brazilian tax authorities tend to diverge from the OECD’s formal understanding on the same subjects.

¹ Article 516 of the Income Tax Code (Decree # 3.000/99).

² Law # 11727/2008

Transfer pricing – The rules dealing with Transfer Pricing in Brazil were introduced by Law # 9430/96. Such rules set forth the systems for calculation of the maximum amounts³ to be abated as expenditures, as well as the minimum amounts⁴ to be considered as taxable income of those Brazilian legal entities that transact with related parties abroad.

Interest on own capital – A peculiar feature of the income tax system is that the Brazilian companies may pay or credit interest on their own capital to their partners/shareholders provided that they have accumulated or accrued profit in such period⁵. The total amount of interest that may be paid or credited cannot exceed 50% of the company's profit accrued in such period or accumulated profit. The net worth is the basis for calculating the interest on own capital, with some adjustments.

The interest applied is established based on the long-term interest rate controlled by the government ("TJLP") and calculated on a *pro-rata* basis. The expenses with interest on capital are considered deductible operational costs for income tax and social contribution on the net profit purposes. Additionally, a 15% withholding income tax applies over the interest paid to the shareholders unless the shareholder is domiciled in tax heaven when a 25% rate applies.

Social Contribution on the Net Profit ("CSLL")

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Social Contributions on Revenues ("PIS" and "COFINS")

The Contribution for the Financing of Social Security ("COFINS") and the Social Integration Program ("PIS") are levied on the gross revenues of Brazilian legal entities, with just a few exceptions. In spite of being two different taxes, in most cases they share the same taxable basis and are referred to as if they were just one ("PIS/COFINS"), whose combined rate is 9.25% (COFINS - 7.6% and PIS - 1.65%) of the gross revenues. Some credits are allowed in a VAT-like system. When the taxpayer opts for the income tax Presumed Profit Regime, the combined rate drops to 3.65% (COFINS - 3.0% and PIS - 0.65%) but no credits are allowed.

PIS/COFINS – Import – Additionally, Law# 10865/04 introduced the taxation of PIS and COFINS on imported goods and services. The rate here is always 7.6% for COFINS and 1.65% for PIS and the taxable basis is the custom value (freight and insurance and import duties included) for importing goods or on the gross amount charged for the service by a foreign companies when the result will be produced in Brazil⁷.

³ Article 18 of the Law # 9.430/96

⁴ Article 19 of the Law # 9.430/96

⁵ Law # 9249/95

⁶ Law # 11727/2008

⁷ The general tax rate of the PIS and COFINS - Import contributions are, respectively, 1.65% and 7.6% and the tax basis shall be as follows: value for customs purposes adopted as the tax basis in the import tax, plus the State Sales tax (ICMS) and the PIS and COFINS amounts. In the import of services the tax basis is the price of the service plus Service tax (ISS) and the PIS and COFINS contributions.

Contribution for Intervention in the Economic Domination ("CIDE")

This contribution is due by whoever imports, licenses to exploit rights involving transfer of technology (such as patents), know how or technical services, including administrative assistance and other similar services. The rate is 10% and, when it is due, the withholding income tax that was usually of 25% drops to 15%. The result is not the same because the taxpayer of the withholding income tax is the exporter and the taxpayer of CIDE is the importer, thus changing the taxable basis and making it difficult for the exporter to offset the CIDE against its own income tax.⁸

Tax on Industrialized Products – Excise Tax ("IPI")

The tax on industrialized products is a federal tax that is due on the first sale of a good after it is manufactured or suffers any kind of industrial transformation. The IPI tax rates vary widely according to the product's essentiality.

The IPI is due in each stage of the manufacturing process of the good in a VAT-like credit-debit system. It is also charged when a good is imported and when an imported good is sold locally for the first time.

Tax on Financial Operations ("IOF")

This is nickname of a broad tax that is levied upon several financial transactions such as insurance, loans, currency exchange and others. It is widely used with a non-fiscal intent, as a policy enforcement tool of the Government to control inflation, inflow and outflow of foreign currency and investments and also market interest rates applicable to loans and financial investments. The rate can be as high as 25%, but is usually very modest or even zero, unless during financial crisis situations.

Tax on the Circulation of Products and Services ("ICMS")

ICMS is basically the states' sales tax and works as a VAT. It is also charged over some few services such as telecom and intercity or interstate transport. In the same manner as the IPI, it is also charged on imports but it is due in every sale thereafter even if there is no manufacturing applied to the good sold.

The ICMS rates vary from state to state as well as according to the involved goods or services and their origin and destination. In most cases, the import and local sales rates range from 17% to 19% and the interstate rates are 7% and 12%.

According to the Federal Constitution, in order to grant an ICMS reduction or exception, any state should obtain the approval from all other states. In spite of this, many states try to attract investment to their territories by granting benefits to legal entities that can create jobs. This constant war is frequently object of litigation at the Brazilian Supreme Court and has caused some uncertainty to investors attracted by tax benefits. Therefore, any investment made on the basis of an ICMS benefit must be carefully analyzed to minimize risks, even when advantages are buffed by state authorities as often happens.

¹⁰ The tax rate of this contribution is 10% over the amounts paid, credited, delivered, used or remitted per month to non-resident beneficiaries or domiciled abroad as payments under the types of agreements mentioned above. The contribution whose taxpayer is the Brazilian legal entity is due on the last business day of the fortnight subsequent to the month in which the taxable event takes place.

Services Tax ("ISS")

ISS is a municipal tax levied on the supply of almost any type of services. The general rules are set by National Supplementary Law (LC) # 116/03 but each municipality must pass its own law to charge the tax. The rate ranges between 2% and 5%. As authorized by the LC some municipalities (but not all) charge the ISS on the purchase of foreign services, the Brazilian beneficiary thereof being liable for the payment of the tax. It can also be levied on exports of services when the results occur in Brazil, despite that the payment is made from abroad.