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INVESTING IN BRAZIL

Tax Overview/Case Study

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BRAZIL AS OF TODAY (I)

- BRIC country
- Market of approximately 200 million people, concentrated in big business centers, such as São Paulo, Rio de Janeiro and Minas Gerais States
- Huge investments in the infrastructure and connected sectors, specially construction and energy:
  - ✓2014 World Cup
  - ✓2016 Olympic Games in Rio de Janeiro
  - ✓Oil and the “Pré-Sal”
  - ✓Bioenergy
- Economical stability:
  - ✓Low-impact upon the 2008/2009 global financial crisis
  - ✓Currency highly appreciated (the “Real”)
- Political stability, with the election of Lula´s successor Dilma Roussef

BRAZIL AS OF TODAY (II)

- Relevant data:
  - ✓Estimate economic growth for 2010: 7.6%
  - ✓Unemployment rate (Sep/2010): 6.2%;
  - ✓Estimate inflation rate for 2010: 5%
  - ✓Basic interest rate (Nov/2010): 10.75% p/y
  - ✓US Dollar : Brazilian Real => US$1: R$1,70 (Nov 2, 2010).

Has the "country of the future" finally arrived?!

… In any case, there are still several challenges and critical issues to be solved, such as the complex and anachronic Tax System!

BRAZILIAN TAX SYSTEM – OVERVIEW (I)

Corporate Income Taxes:

- Corporate Income Tax (“IRPJ”): 15% + 10% surplus = approximately 25%
- Social Contribution on Profits (“CSLL”): General 9%; Financial Institutions 15%
- Worldwide Income/Foreign Tax Relief (Credit Method)
- No fiscal consolidation
- Presumed Income Method vs. Actual Income Method
- Recent Thin-Capitalization Rules: General 2:1; Tax Havens: 0.3:1
- Deductibility of the so-called Interest on Equity
- NOLs: unlimited carry-forward in time, but limited to 30% of Taxable Income of each period
- Transfer Pricing Legislation
- 29 Double Tax Treaties, including several Asian countries, such as India, China, Japan, South Korea, Philippines and Russia, as well as several European countries, such as France, The Netherlands, Spain, Italy, Belgium and all Scandinavian countries

BRAZILIAN TAX SYSTEM – OVERVIEW (II)

Withholding Tax (WHT):

•Dividends: Tax exempt
•Interests: 15% (certain exemptions apply, such as export finance debts)
•Interests on Equity: 15%
•Royalties, Technical Services and Technical Assistance: 15%
•Capital Gains: 15%
•Beneficiaries domiciled in Tax Havens (black-listed jurisdictions): 25% (certain exemptions apply, such as dividends)

Other Taxes:

•Turnover Taxes (PIS and COFINS)
•Indirect Taxes: Federal VAT (IPI), State VAT (ICMS), Municipal Tax on Services (ISS)
•Other Material Taxes: Tax on Financial Transactions and Others (IOF), CIDE Tax on outbound payments of royalties, technical services and technical assistance

CASE STUDY: INDIAN BPO CO. INVESTING IN BRAZIL (I)

Corporate Structure:

•Limited Liability Company ("Ltda") vs. Corporation ("SA")
•Branches are not commonly used: its formation is highly bureaucratic, time-consuming and expensive

Inflow of Funds:

•Registration with the Brazilian Central Bank (the "Bacen")
•IOF Tax upon inflows in form of equity (exemption to inflows in form of debt)

Corporate Income Taxes (CITs) Method: Presumed Income vs. Actual Income:

•Under the Presumed Income Method, CITs are levied upon the application of presumed margins (fixed by the Tax law) over the gross revenues received by the taxpayer, irrespectively of any costs and expenses effectively incurred
•Under the Actual Income Method, CITs are levied upon the actual income (i.e., taxable revenues <minus> deductible expenses)

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CASE STUDY: INDIAN BPO CO. INVESTING IN BRAZIL (II)

The Presumed Income Method:

- Restrictions to adopt the Presumed Income Method
- The CITs of approximately 34% shall be due upon a presumed margin of 32% applies on the gross revenues received by the Brazilian legal entity ("BRACO"):

  => 100 X 32% x 34% = Effective rate of approximately 10.88% on the gross revenues

- The costs and expenses effectively incurred by BRACO, such as payroll, royalty/technical services fees, VATs and other taxes, etc, shall not impact the CIT´s Taxable Basis.
- From a pure tax perspective, BRACO shall be allowed to adopt the "cash basis" instead of the "accrual basis"
- Pis and Cofins shall be due under the cumulative method, with a combined rate of 3,65%
- Dividends Distributions shall be tax exempted, with no equalization tax

  => Participation exemption in India pursuant to the Treaty (articles 10.3 and 23.3)?

CASE STUDY: INDIAN BPO CO. INVESTING IN BRAZIL (III)

The Actual Income Method:

- The CITs of approximately 34% shall be due upon the actual income of BRACO: taxable revenues <minus> deductible costs/expenses
- Differently from the Presumed Income Method, the costs and expenses effectively incurred by BRACO, such as payroll, royalty/technical services fees, VATs and other taxes, etc, shall impact the CIT´s Taxable Basis
- BRACO shall be obliged to adopt the “accrual basis” (“cash basis” applies only in certain exceptional cases)
- BRACO shall have the possibility of paying the so-called Interests on Equity, a sort of deductible dividend
- Pis and Cofins shall be due under the non-cumulative method, with a combined rate of 9,25%
- Dividends Distributions shall be tax exempted, with no equalization tax.

=> Participation exemption in India pursuant to the Treaty (articles 10.3 and 23.3)?

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CASE STUDY – INDIAN BPO CO. INVESTING IN BRAZIL (IV)

Taxation on outbound payment of technical services and technical assistance:

- Taxes borne by the Foreign Service Provider:
  - ✓WHT Tax: 15%
    - **=> 25% tax sparing claim in India pursuant to the Treaty (articles 12.2.b and 23.2 and Protocol, Item 2)?**
  - ✓ISS Tax: 2-5%
    - **=> In principle, not entitled to Treaty reliefs (ISS is a tax on services!)**

- Taxes borne by the BRACO:
  - ✓CIDE Tax: 10% (non-recoverable)
  - ✓PIS and COFINS: 9.25% (recoverable, depending on a case-by-case basis)
  - ✓IOF Tax: 0.38% (non-recoverable)

Taxation on outbound payment of pure royalty fees (trademark, patents, licenses):

•Sound arguments to challenge the taxation of ISS, PIS and COFINS, depending on a case-by-case basis

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CASE STUDY – INDIAN BPO CO. INVESTING IN BRAZIL (V)

Taxation on outbound payment of technical services (Quick Simulation):

	Rate	Tax Basis	Amount
SERVICE AMOUNT			**100,00**
Tax	**Rate**	**Tax Basis for WHT, CIDE and ISS**	**100,00**
Withholding Tax (WHT)	15,00%	Gross Service Amount	15,00
Tax on Services (ISS)	5,00%	Gross Service Amount	5,00
CIDE Tax	10,00%	Gross Service Amount	10,00
Tax	**Rate**	**Taxis Basis for IOF**	**80,00**
IOF Tax - Currency Exchange Modality	0,38%	Amount effectively remitted	0,30
Tax	**Rate**	**Tax Basis for PIS/COFINS-Import**	**115,70**
PIS-Import	1,65%	Gross Service Amount + ISS + PIS/COFINS-Imp	1,91
COFINS-Import	7,60%	Gross Service Amount + ISS + PIS/COFINS-Imp	8,79
	Total Cost for the Brazilian Party		**121,01**
	Tax Cost for the Brazilian Party - CIDE, IOF, PIS/Cofins-Import		**21,01**
	Net Amount received by the Foreign Service Provider		**80,00**
	Tax Cost for the Foreign Service Provider (WHT, ISS)		**20,00**

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SEE YOU IN BRAZIL,

THANK YOU!

OBRIGADO!

Luiz Frederico Battendieri