Guide to Doing Business in Brazil

A BUSINESS GUIDE

The LEGAL GUIDE TO DOING BUSINESS WITH BRAZIL, prepared by PINHEIRO NETO ADVOGADOS for the SÃO PAULO CHAMBER OF COMMERCE of the ASSOCIAÇÃO COMERCIAL DE SÃO PAULO, presents a comprehensive guide to the legal norms ruling foreign investments and corporate activity in the country, and constitutes an important support for foreign businesspeople willing to invest in Brazil.

Occupying a territory of more than 8.5 million km2 and with a population of nearly 180 million inhabitants, Brazil has a diversified economy offering great prospects for investment in all sectors: from infrastructure to telecommunications, from industry to agribusiness, from tourism to services. These investments can be made directly by the businesspeople and foreign companies or through partnerships with Brazilian entrepreneurs.
The ASSOCIAÇÃO COMERCIAL DE SÃO PAULO, through the SÃO PAULO CHAMBER OF COMMERCE, seeks to assist foreign businesspeople intending to make business with Brazil, whether it is supplying information, hosting groups and missions, fostering contacts or offering logistical support.

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BRAZILIAN ECONOMY

Brazil is one of the largest economies in the world, but it is still a developing country offering great opportunities for investment, partnerships and commerce. As a growing country it naturally faces some difficulties. Nevertheless, these do not reduce its market attractiveness. Experience has shown that the foreign capitals invested there have yielded compensatory returns even when the economy is not bubbling with dynamism. The fifth largest country in territorial extension, it covers an area in excess of 8.5 million km2 and its population has reached 180 million inhabitants. The Gross Domestic Product (GDP) in the area of US$ 500 billion places its economy among the biggest in the world, mainly when its production is measured by PPP (Purchasing Power Parity) - that reflects the purchasing power of the same currency in different countries. On this basis of comparison, the Brazilian economy is within the ten largest worldwide.

The country's regional economic development does not show a uniform distribution. The Southeastern region contributes 58% to the total production, with the State of São Paulo being accountable for a third of the country's Gross Domestic Product. In this state the product per capita is US$ 4.353 whereas the Brazilian average is US$ 2.8l5. Such regional economic concentration has been gradually reduced with the increase of industrial investments in the Northern /Northeastern regions and the growth of agribusiness in the Central/Western regions, stimulated by the expansion of agricultural frontiers within the economy of Brazil.

In the agro-cattle breeding sector, grain production is higher than 110 million tons, reflecting the wealth of the Brazilian agribusiness and ranking it as the biggest exporter of beef and chicken in the world. Within the agro-industry one can note the big opportunity for investment in the sugar-alcohol sector. Besides the favourable conditions of the world sugar market, Brazil can become a large ethanol supplier to developed countries that search for alternative forms of fuels in order to reduce pollution. Dual energy vehicles are currently being produced in Brazil, running either on petrol or alcohol, or even with a mixture of both fuels. Taking into account the attention given to environmental issues by all the nations, this market is likely to grow sharply in the next few years and Brazil, more than any other country, has exceptional conditions to become a large world supplier as it can make use of available land and highly developed technology in the sector.

Information technology, which is comprised of hardware, software and telecommunications, counts on a vast and ever-increasing internal market. The country is also geared to the export market with a great possibility of success.

There is still a lot to be accomplished in the infrastructure area to cover the needs of a continental country with a great deal of deprivation. Yet, it presents the investor with unlimited possibilities, specially in this moment when Brazil is reorganising its economy and undertaking a liftoff for sustainable development, thus returning to its historical levels and, consequently, bringing forth good results to investments.

The industrial sector bears a significant role in the composition of the total production of the country accounting for 39% of the GDP, with a diversified industry - provided with a high degree of technology in some sectors - enabling it to export to the various parts of the world.

The export of industrialised products represented 70% of the total exports of the country, which should reach US$ 90 billion in 2004, with manufactured products accounting for 54% of the total and basic products accounting for 29% of foreign sales. Regarding imports, in the area of US$ 60 billion, raw materials, intermediate products and capital goods represent 75% of that value. Among the exported products, listed in order of importance, there were soya bean and its by-products, automobiles, buses, tractors and its components, iron ore and is concentrates, airplanes, transmitter radios, wood chemical paste, footwear, iron & steel laminated products, coffee, sugar, tobacco, orange juice and raw aluminium.

Brazilian exports are getting diversified reaching practically all countries, but the European Union (25%) and the United States of America (23%) are still the main markets, followed by Asia with 16% and Latin America, including Mercosul, accounting for approximately 17% of the total exports.

Brazil accounts for approximately 1% of the world's commerce. However, the recent foreign trade performance points out an increasing participation of the country in the international commerce and related affairs. The trade current (exports plus imports) in relation to the GDP is in the area of 25.0 % and the export expansion has been the main responsible factor for the country's economic growth.

Foreign investment has played an important role in the country's development since the beginning of last century. Initially, it was concentrated in the infrastructure sector, mainly in the fuel and transport areas and, from mid-century onwards, it directed itself to manufacturing, helping to energise Brazil's sprouting industrialisation process. In the last years, the service sector has absorbed the largest slice of those investments, encouraged to a great extent by privatisation programs in the telecommunications, energy and transport areas.

The accumulated foreign capital stock in the country has reached the amount of US$ 161 billion, with the service sector absorbing 61.4% and the manufacturing sector 34.6% of this total. Such capital originated mainly from the United States of America, Holland and Spain, with 21.9%, 11.4% e 10.2% of the total invested, respectively.

The economic stability, the strengthening of political institutions and the potential consumer market place Brazil, among the emerging countries, as one the principal focus to attract foreign capital.

S U M M A R Y

INSIGHTS INTO BRAZIL

Brazil is a Federative Republic organized in three separate branches: executive, legislative and judiciary. Brazil is divided administratively into 26 states and the Federal District, in Brasília. Brazil has a codified legal system and, as a federative republic, its rules and regulations are established by the Federal Government, the States, the Federal District and the Municipalities.

Legislative authority at federal level is entrusted to Congress (the Senate and the House of Representatives). The Federal Senate is composed of representatives of the States and of the Federal District, each being entitled to elect three senators for a term of office of eight years. Representation of the States and the Federal District at the Senate is renewed every four years, on a rotating basis, by one- or two-thirds.

Legislative authority at state level is exercised by the State Assembly, whose members are elected for a four-year term. At the municipal level, the legislative branch is represented by the City Council, whose members are elected for a four-year term of office.

The Constitution currently in force was enacted on October 5, 1988. Being relatively recent, with certain concepts yet to become full-fledged precepts, the Constitution is committed towards the progress and development of Brazil. Brazil is politically stable and organized under a democratic system.

The President is elected by direct vote for a term of four years, reelection being permissible. The President has a broad range of powers, including the right to appoint ministers of state and top-echelon executives to selected administrative and political posts.

Executive authority at state level is entrusted to governors, who are elected for a four-year term, with the possibility of reelection. Executive powers at municipal level are exercised by mayors, who are also elected for a four-year term, reelection being permissible.

Doing Business in Brazil

The legal rules governing business activities in Brazil are basically laid down in federal legislation. However, the Constitution allows the Federal Government, the States and the Federal District to concurrently legislate on certain matters related to business activities, such as tax, financial and economic issues, liability for environmental and consumer damages, among others. In this case, the Federal Government's power is limited to enacting general rules on such issues, whereas the States and the Federal District have authority to legislate on a supplementary basis, in line with the general rules laid down in the federal legislation.

Brazil offers countless business opportunities for domestic or foreign investors, in light of its enormous economic potential, its diversified economy, and its huge domestic market, now considerably expanded as a result of several international trade agreements entered into with economic blocs and countries the world over.

Foreign Investment in Brazil

Under Brazilian law, *foreign capital* stands for "any goods, machinery, equipment, cash and financial resources that enter Brazil for the production of goods or services, or for investment in economic activities, provided that in either case they belong to individuals or legal entities resident, domiciled or headquartered abroad." Foreign capital is ensured the same treatment as that afforded to domestic capital, and any discrimination not expressly prescribed by law is prohibited.

In Brazil, the Central Bank is charged with registering, monitoring and following up on foreign investments, whereas the Ministry of Finance (through the Federal Revenue Office) focuses on the taxation of these foreign investments.

The Brazilian legal tender is the Real (R$). In order to validate their investments in Brazil, foreign investors must translate their foreign currencies into Brazilian currency by entering into a foreign exchange contract at any Brazilian financial institution authorized to deal in exchange by the Central Bank. The corresponding foreign exchange transactions must follow the Central Bank rules and regulations.

Non-resident investments may be made in Brazil through the incorporation of a company; the opening of a branch; or other form of investment on the capital or financial markets, among others.

Nevertheless, participation of foreign capital in the following activities is prohibited: nuclear energy; health services; businesses abutting on international borders; post office and telegraph services; domestic flight routes; and the aerospace industry.[14]

Some restrictions apply to foreign investment in the ownership and management of newspapers, magazines and other periodicals, as well as in radio and television networks.[15]

There are also certain limitations on the presence of foreign capital in financial institutions, but these restrictions can be lifted in the national interest. Supplementary legislation must still be enacted to regulate this matter, including for insurance companies.

Companies

The most usual procedure for a foreign investor to do business in Brazil is by organizing a company in Brazil.

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[14] ***Referring to the launch and orbital positioning of satellites, vehicles, aircraft and related activities, excluding the manufacture or marketing of said items and their accessories.***

[15] ***Constitutional Amendment No. 36 was enacted on May 28, 2002, amending the provisions of article 222 of the Federal Constitution. Subsequently, this matter was regulated by Law No. 10610 of December 20, 2002. According to the new rules, at least 70% of the total and voting capital of newspaper and radio broadcasting companies must belong, directly or indirectly, to native Brazilians or persons naturalized for over 10 years, foreigners being entitled to hold up to 30% of the total and voting capital of such companies. Participation of foreign capital will only be indirect, through a legal entity incorporated under Brazilian law and headquartered in Brazil. Managerial and programming activities must also be entrusted to native Brazilians or persons naturalized for over 10 years.***

A foreign company may open branches in Brazil by submitting an application to the Brazilian Government for approval, which is granted in the form of a decree of the federal executive branch. Only after all the formalities have been fulfilled, which include publication in the official press and filing at the Register of Companies (*Registro Público de Empresas Mercantis*) of the documentation related to opening of the branch, will it be allowed to start up its activities. The foreign company must also appoint a representative — who need not be a Brazilian national, but must be resident in Brazil — to act on its behalf. The branch is governed by Brazilian law and, although it does not have a corporate capital of its own, the foreign company must allocate capital to the transactions to be performed in Brazil, for the branch is not an entity separated from the foreign company. This capital constitutes, just as subscription and payment of quotas or shares, an investment registrable with the Central Bank.

The corporate entities existing in Brazil are basically regulated by Law No. 10406 of January 11, 2002 (the Civil Code) and by Law No. 6404 of December 15, 1976 (the Corporation Law). Among the several types of corporate entities contemplated by such laws, the most widely used in Brazil are the limited liability company (*sociedade limitada*) and the joint-stock company (*sociedade por ações*).

The liability of partners both in limited liability companies and joint-stock companies is restricted to the amount which they paid for their quotas or shares, as the case may be. This feature gives the company the necessary assurances to concentrate its efforts on its business, without its partners' being held liable for any amount other than that disbursed to make up the company's capital, except in the case of illicit acts.

Regardless of the type of corporate entity, companies have some features in common. First, the company must have at least two partners, whether individuals or legal entities, who need not be domiciled in Brazil. However, if said partner is resident or domiciled abroad, it must have an attorney-in-fact in Brazil with powers to represent it as a partner in the Brazilian company. Moreover, individual or corporate foreign partners must be enrolled in the Federal Revenue Office in Brazil, which reports to the Ministry of Finance and is responsible for dealing with tax-related aspects.

In principle, there are no minimum corporate capital requirements.[16] The corporate capital may be distributed among the partners as they find proper.

Under Brazilian law, taxes and the respective rates are established in accordance with the size of the company, irrespective of the type of the corporate entity (ability to pay principle). Therefore, the type of company is not relevant for taxation purposes.

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[16] ***According to Resolution 394/76, and Section 1, Chapter 2, Title I of the Central Bank's Manual of Rules and Regulations, financial institutions and other institutions authorized to operate by the Central Bank must pay, in Brazilian currency, upon incorporation or in capital increases, 50% of the subscribed capital; the remaining balance, if any, must be paid, also in Brazilian currency, within one year from subscription. Additionally, pursuant to Central Bank Resolution 2607/99, financial institutions and other institutions authorized to operate by the Central Bank must pay up a minimum amount of their capital stock. In the case of commercial banks, the minimum amount to be paid up is R$ 17.5 million. Pursuant to Resolution 73 of the National Private Insurance Council, insurance companies authorized to operate in the Brazilian segment of non-life insurance cannot have a paid-up capital lower than R$ 7.2 million.***

Limited Liability Companies

The limited liability companies (*sociedades limitadas*) contemplated by Brazilian law are very similar to the limited liability companies, limited partnerships and closely-held companies under the English and United States laws. In Brazil, limited liability companies are governed by the Brazilian Civil Code (which has a chapter devoted to them) and, in a subsidiary manner when applicable, by the Corporation Law. The liability of each partner is limited to the amount of its quotas, but all partners are jointly and severally liable for the total amount of the corporate capital until it is fully paid up.

Limited liability companies may take the form of a simple or entrepreneurial company. Under Brazilian law, entrepreneurial companies (*sociedades empresárias*) are those that perform economic activities in an organized and professional manner, with the goal of producing or marketing products and services. For their part, simple companies (*sociedades simples*) do not have a highly complex level of organization, and engage in intellectual, scientific, literary or artistic activities. Since simple companies are rarely adopted, emphasis will be given on entrepreneurial limited liability companies.

A limited liability company need not publish its accounts, amendments to articles of association, or other corporate documents, except in the events of capital reduction, merger, spin-off or consolidation.[17] But the articles of association are a public document, and third parties may obtain copies by application to the commercial registry with which these articles of association and their amendments must be filed.

Internal Organization of Limited Liability Companies

The two major aspects related to the internal organization of a limited liability company refer to: **(a)** partners' resolutions taken at meetings, general meetings, or via other documents or corporate acts; and **(b)** the company management.

Partners' Resolutions

A majority of the resolutions taken by partners of limited liability companies depend on the approval of partners representing 75% of the total corporate capital. Exceptions to this rule are provided for in the law, whereas others may be prescribed by the articles of association.

In addition to other matters that may be stated in the articles of association, the law provides that certain matters, such as those listed below, depend on a partners' resolution to be taken at a meeting (*reunião*) or general meeting (*assembléia*):

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[17] ***Bill No. 3741 of November 8, 2000 is being reviewed by the House of Representatives, and proposes to amend certain provisions of the Corporation Law, by extending to large-sized companies - even if organized as a limited liability company or otherwise - the obligation to publish financial statements. According to Bill 3741/00, with the wording given by the clean bill, the publication of financial statements will be mandatory for large-sized companies engaging in the production of goods and services, even if not organized as joint-stock companies. Under Bill 3741/00, large-sized company is defined as a company or group of companies under common control, which reported, in the preceding fiscal year, total assets exceeding R$ 240 million or an annual gross income higher than R$ 300 million. The House of Representatives is also reviewing, on a priority basis, Bill 2813/00, which proposes the mandatory publication of financial statements by limited liability companies whose gross income exceeds R$ 2,133,222.00.***

(i) approval of accounts;

(ii) appointment, removal and compensation of senior managers;

(iii) amendment to the articles of association;

(iv) merger, consolidation and winding-up of the company or discontinuance of its liquidation status;

(v) appointment and removal of liquidators, and review of their accounts; and

(vi) filing for debt rehabilitation (*concordata*).

Resolutions on these issues will be taken at a partners' general meeting, if the limited liability company has more than ten partners. Partners' general meetings call for more formalities when compared to partners' meetings, which are more flexible and involve fewer bureaucratic procedures. Partners' meetings or general meetings must be convened by the senior managers in the cases prescribed by law or by the company's articles of association.

Partners' general meetings must be convened by a notice published in the official press or in a widely-circulated newspaper, at least three times. Prior call notices may be waived when all partners are present in the general meeting or state in writing that they are aware of the place, date, time and agenda.

The law provides for the possibility of dispensing with a partners' meeting or general meeting to deliberate upon said matters, thus offering a more agile decision-making process for the company's internal affairs. This will apply whenever all partners approve a written resolution in lieu of a meeting or general meeting.

Partners may be represented at the general meetings by another partner or by a lawyer, upon granting of a specific power of attorney to that end. No partner may vote-either by himself or as an attorney-in-fact of another partner-on any matter in which he is an interested party.

Minutes of each general meeting will be drawn up in the proper book and state all the resolutions then discussed and passed. These minutes must be filed at the Register of Companies within 20 days from the general meeting date.

If the resolutions taken at a partners' meeting or general meeting result in the amendment to the articles of association or merger with or into another company, the partners that dissented from such resolutions may withdraw from the company within 30 days following the respective meeting or general meeting.

Certain companies are required to hold general meetings at least once a year within the four months following the end of the financial year. The purpose of this annual general meeting is to review the management accounts, resolve on the balance sheet and income statements of the

company and, if applicable, appoint senior managers and deal with other matters of interest to the company.

Notwithstanding the limited liability of partners in limited liability companies, resolutions taken in breach of the articles of association or of the law result in unlimited liability of whoever expressly approved them.

Management

Limited liability companies are managed by one or more senior managers appointed in the articles of association or by means of other corporate documents. The senior managers need not be Brazilian, but must be resident and domiciled in Brazil. Nothing prevents the partners themselves from managing the company, provided that the requirements mentioned above are fulfilled. It is incumbent on the senior managers, among other duties, to represent the company before third parties and prepare the company's financial statements at yearend.

The condition of senior manager is not inherent to the position of partner, and even if the articles of association provide that all partners (if only individuals) have powers to manage the company, such powers will not automatically extend to partners that join the company at a later date.

Therefore, a limited liability company may be managed by its own partners or by non-partner third parties. The appointment of non-partner managers must be expressly set out in the articles of association, and is conditioned to the unanimous consent of all partners (if the corporate capital has not been fully paid up) or of partners representing at least two-thirds of the corporate capital (if it has been fully paid up).

Senior managers may be removed from office at any time, by resolution of the partners representing a majority of the corporate capital. However, if the company's management is under the responsibility of a partner so appointed in the articles of association, his removal from office will be conditioned to approval by one or more partners representing at least two-thirds of the corporate capital.

The powers of a senior manager are established when he is appointed. The partners may impose restrictions on such managerial powers, and even subject certain acts to previous approval of partners representing a given portion of the corporate capital.

The articles of association of a limited liability company may optionally provide for the establishment of administrative bodies such as the Advisory Council (*Conselho Consultivo*) and the Fiscal Council (*Conselho Fiscal*).

Corporate Capital and Distribution of Dividends

The corporate capital of a limited liability company is divided into quotas, allocated to its partners in any proportion. After the company is organized, as a rule there is no preset period under the law for payment of the corporate capital by its partners, ratably to the number of

quotas they subscribed for. However, if the quotas are not paid up at the time the company is organized, the articles of association must set out a time period to that end. Payment may be made in Brazilian currency, goods or rights, capable of being appraised in cash. According to the Civil Code, the corporate capital of limited liability companies can be increased only after the subscribed capital has been fully paid up.

As already stated, if a foreign-based partner remits funds to Brazil for payment of its corporate holdings, it must sign a foreign exchange contract for conversion of the foreign currency into Brazilian currency. This remittance will be made after the foreign partner obtains its investor status from the Central Bank. Any funds thus remitted will be entered in the corresponding registration. The Brazilian currency proceeds from such conversion will be used first to pay the corporate holdings already subscribed for by the investor, and any excess will serve to increase the investor's corporate holdings.

Holdings in a limited liability company are reflected in the articles of association, as the quotas in which the company's corporate capital is divided are not represented by certificates as in the case of shares. The articles of association must therefore be amended whenever quotas are assigned or transferred, or upon capital increase, so as to accurately reflect the ownership of a limited liability company's capital.

Limited liability companies may distribute accrued profits to their partners. If the partners are individuals or legal entities resident or domiciled abroad, dividends remitted at the commercial exchange rate are subject to prior registration with the Central Bank of the foreign investments initially made by the partners to pay up their corporate holdings.

As a rule, there are no restrictions on distribution and remittance of profits abroad. Profits and dividends distributed as from 1996 are not subject to income tax. Once the investment has been registered, the distribution, if in the same proportion as the registered investment, will not require prior registration.

Brazil has signed double taxation treaties with the following countries: Argentina, Austria, Belgium, Canada, China, the Czech Republic and Slovakia, Denmark, Ecuador, Finland, France, Germany, Hungary, India, Italy, Japan, Luxembourg, the Netherlands, Norway, the Philippines, Portugal, South Korea, Spain, and Sweden.

Joint-stock Companies

Joint-stock companies (*sociedades anônimas*) are governed by Law No. 6404 of December 15, 1976, as amended (the Corporation Law). The joint-stock company is the corporate form that most closely resembles the U.S. joint-stock company or corporation. Unlike limited liability companies, Brazilian joint-stock companies always take the form of an entrepreneurial company as expressly prescribed by the pertinent law. Each shareholder of a joint-stock company is liable only to the extent that the capital stock for which it has subscribed remains unpaid.

General Features of Joint-stock Companies

A joint-stock company may be formed by public or private subscription of its shares. In both cases, at least 10% of the capital must be paid up upon incorporation.

This type of company may be either publicly- or closely-held. A publicly-held company must be registered with the Brazilian Securities Commission (CVM) along with its securities, which may be traded on the stock exchange or on the over-the-counter market. The securities of a publicly-held company can be traded only after 30% of the issue price has been paid. The securities of a closely-held company are not available to the general public.

The capital may be either subscribed or authorized. For a company with subscribed capital, its bylaws must state the amount of capital actually subscribed for by the shareholders, although this capital need not necessarily be paid up. The bylaws of a company with authorized capital establish the limit for capital increases without an amendment to these same bylaws.

CVM is the body in charge of regulating and monitoring the capital markets in Brazil. In recent years, particularly as from 2003, CVM has changed certain rules that may foster even further the Brazilian capital markets, such as the Private Equity Funds and Tender Offers for shares in publicly-held companies. In early 2004, CVM has signaled its intention to go ahead with such changes, including as regards debentures and investment funds.

Shares

A company’s capital stock is divided into several kinds of shares, all of which have different advantages, rights or restrictions attaching to them.

Shares need not have a par value, and may be represented by certificates.

The bylaws of a closely-held company may restrict the circulation of shares, provided that they do not prevent their transfer. Should such restrictions be imposed by means of an amendment to the bylaws, they will only apply to the shares of those holders who have expressly agreed with them.

Shares may be paid up by means of contribution of assets, goods, credits, technology transfer or any other assets capable of being appraised in cash. Appraisal of the assets must be carried out by an expert or specialized company, and approved by the shareholders in a general meeting.

Common shares in a closely-held company may belong to different classes, depending on certain legal precepts. Shares of the same class confer on their holders equal rights. Each common share carries one vote at the general meetings.

Preferred shares in a publicly- or closely-held company may belong to one or more classes, and carry rights and/or privileges that may include the right to elect certain members for the company's administrative bodies, even if these preferred shares are granted no other voting

rights. Pursuant to law, the company may issue nonvoting preferred shares up to 50% of its total capital stock.[18]

Holders of preferred shares may be accorded the following privileges: **(a)** priority in the distribution of fixed or minimum dividends; **(b)** priority in capital repayment, at or without a premium; or **(c)** both advantages, on a cumulative basis.

In order to be traded on the securities market, preferred shares without voting rights or with restricted voting rights must confer on their holders at least one of the following privileges:

(i) priority in the payment of dividends corresponding to at least 3% of the share net equity value, in addition to the right to participate in the profit distribution on a par with common shares, after these have been ensured dividends equal to the minimum priority dividends; or

(ii) the right to dividends, per preferred share, at least 10% higher than those paid to each common share; or

(iii) the right to tag these shares along in a public offer for disposal of control, receiving dividends at least equal to those paid to common shares.

Should there be preferred shares without voting rights or with restricted voting rights, the advantages and privileges attributed to them must be properly described in the company's bylaws.

Companies to be privatized may create preferred shares of a special class (known as *golden shares*), which will be held by the privatizing entity on an exclusive basis. This class of share will be granted the powers set forth in the bylaws, including the power to veto resolutions passed by the general meetings on such matters as the bylaws may specify.

The bylaws may also confer on one or more classes of preferred shares the right to elect, by separate voting, one or more members of the company's administrative bodies, or even condition amendments to the bylaws to approval of the holders of one or more classes of preferred shares in a special meeting.

Preferred shares without voting rights or with restricted voting rights will be entitled to vote if the company fails to pay fixed or minimum dividends within the time period set forth in the bylaws (not to exceed three consecutive financial years), retaining such right until actual payment of such dividends.

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[18] ***Law No. 10303 of October 31, 2001 amended the Corporation Law with respect to the issue of preferred shares. According to the former provisions, a company was allowed to issue preferred shares without voting rights or with restricted voting rights up to two-thirds of its total issued shares. The companies already organized when this change came into force may keep such two-thirds ratio, provided that they observe the new rule in issues made after the effectiveness of Law 10303/01.***

Debentures

Joint-stock companies may also issue non-equity securities, such as participation certificates, subscription warrants and debentures. Debentures, which are the most important of these securities, grant their holders credit rights against the issuer. The conditions of this credit right held by the debenture holder against the company must be set out in the respective indenture. Debentures may be converted into shares, and will be necessarily secured by the issuing company. Unless otherwise permitted by law, the total amount of outstanding debentures cannot exceed the company's capital.

Participation Certificates

Participation certificates (*partes beneficiárias*) are nonpar securities issued by closely-held companies only, and confer on their holders the right to participate in up to 10% of annual profits. These securities carry none of the rights attributable to the shareholders, except for the right to oversee the acts of the company's senior managers. The bylaws may provide for redemption of these participation certificates by capitalization of a reserve specifically created for this purpose.

Subscription Warrants

A company with authorized capital may issue negotiable securities called subscription warrants (*bônus de subscrição*). These securities entitle their holders to subscribe for shares when the capital is increased, subject to the conditions stated on the corresponding certificates.

Shareholders' Rights

Shareholders have the following essential rights:

(i) to share the company's profits;

(ii) to share the company's assets upon liquidation;

(iii) to supervise the management of the company's business;

(iv) to be granted priority in subscribing for shares and convertible debentures, and receiving subscription bonuses; and

(v) to withdraw from the company in the situations determined by law.

Shareholders' Agreement

The company shareholders may sign shareholders' agreements to regulate share purchases and sales, first refusal rights, the exercise of their voting rights, or their controlling power over the company. A shareholders' agreement is binding on the company when registered at its head offices. A shareholder may also file a lawsuit for specific performance of the obligations

contained in the shareholders' agreement. These agreements cannot be invoked to release shareholders from their liability regarding voting rights or controlling power. The chairman of general meetings or decision-making committees of joint-stock companies cannot compute votes given in defiance of shareholders' agreements properly registered at the company's head offices.

Joint-stock Companies' Internal Structure

The decision-making and monitoring bodies of a company are: the Shareholders' General Meeting; the Board of Directors (*Conselho de Administração*); the Executive Office (*Diretoria*); and the Fiscal Board (*Conselho Fiscal*).

General Meetings

The shareholders' general meeting is the company's highest authority, deciding on all corporate matters and passing all such resolutions as the shareholders may deem appropriate to protect and develop the company. Such resolutions, however, are restricted to the company's corporate purposes and business, its bylaws and applicable laws.

The shareholders' general meeting has exclusive authority over the following matters:

(i) amendments to the bylaws;

(ii) the election and dismissal of senior managers and members of the fiscal board of the company;

(iii) the annual examination of management accounts and approval of the financial statements submitted by the company's management;

(iv) change of corporate type, consolidation, merger and spin-off of the company, its dissolution or liquidation, election and dismissal of liquidators, and verification of their accounts; and

(v) admission of bankruptcy and petition for debt rehabilitation (*concordata*) of the company.

As a rule, general meetings' resolutions of joint-stock companies are adopted by an absolute majority of votes, i.e., by stockholders representing 50% of the voting capital plus one vote.

General meetings are called by the Board of Directors, if any, or by the senior managers, as provided for in the company's bylaws. Meetings may also be called:

(i) by the Fiscal Board, in the events set out by law;

(ii) by any shareholder, when the senior managers fail to call the meeting in due course;

(iii) by shareholders representing at least 5% of the capital stock, when the senior managers fail to call a meeting at the shareholders' request; and

(iv) by shareholders representing at least 5% of the voting capital, or by those representing at least 5% of the nonvoting capital, when the senior managers fail to call a general meeting (on the shareholders' initiative) for instatement of the Fiscal Board.

Call notices for general meetings must state the place, date and time of the general meeting, as well as the agenda. In the event of amendment to the bylaws, the call notice must indicate this as an item of business. Irrespective of the formalities above, meetings attended by all shareholders are considered properly called.

Those attending a general meeting must prove their shareholder status. Shareholders may be represented by proxy.

Minutes of the general meetings must be drawn up in a proper book, then signed by, among others, the shareholders in attendance. These minutes must be filed with the Register of Companies.

Annual and Extraordinary General Meetings

Annual General Meetings are held within the four months following closing of the financial year to examine the senior management accounts; review, discuss and vote on the financial statements; elect the senior managers and the Fiscal Board members; resolve on the allocation of the net profits for every financial year and the payment of dividends; and approve the adjustment of the capital stock's currency denomination.

Extraordinary General Meetings are held at any time for any other purposes. Annual and Extraordinary General Meetings may be called concurrently, held at the same place, date and time, and recorded in the same minutes.

The company's senior managers must inform and make available to shareholders documents that will support the resolutions to be passed at Annual General Meetings, such as the management report and a copy of the financial statements. Availability of the documents, the place where they may be found, and the content of some of them must be published in both the official press and widely-circulated newspapers prior to the Annual General Meeting.

Certain matters voted by Extraordinary General Meetings may be subject to supermajority vote requirements. In principle, the following matters require approval of at least half of the company's voting capital:

(i) the creation of a class of preferred shares or any increase in the existing classes without regard to the existing ratios;

(ii) change in the conditions of one or more classes of preferred shares;

(iii) reduction in compulsory dividends;

(iv) consolidation or spin-off of the company, or its merger into another company;

(v) change in the company's corporate purpose; and

(vi) dissolution of the company.

Subject to legal provisions, dissenting shareholders are afforded the right to withdraw from the company upon reimbursement of the amount paid for their respective shares.

Management Bodies

Upon incorporation of the company and adoption of its bylaws, shareholders have the choice of dividing the corporate management body into two parts: the Board of Directors (*Conselho de Administração*) and the Executive Office (*Diretoria*). Should the company choose not to have a Board of Directors, the Executive Office will perform all administrative functions. If a Board of Directors is instated, the Executive Office must abide by its decisions. Establishment of a Board of Directors is mandatory for publicly-held companies, authorized capital companies, and financial institutions. Only individuals may be appointed for management bodies.

Board of Directors

The Board of Directors (*Conselho de Administração*) acts as an interface between the General Meeting and the Executive Office. It has full authority to establish the economic, corporate and financial policies to be followed by the company, and to supervise the Executive Office activities on a permanent basis.

If the Board members reside abroad, they must be represented by a person resident in Brazil with powers to receive service of process in any lawsuits filed on the basis of corporate legislation. Board members must be shareholders.

Board members are elected and removed by the General Meeting. The Board of Directors must be composed of at least three members, whose term of office cannot exceed three years, reelection being permissible.

The company's bylaws must also set out the rules for instatement and operation of the Board of Directors and calling of Board meetings. As a rule, the Board of Directors will pass resolutions by a majority vote; the bylaws, however, may stipulate a supermajority vote requirement for resolutions on specific matters. Minutes of Board of Directors meetings containing resolutions that produce effects on third parties must be filed at the Registry of Companies and then published.

A representative of employees may also sit on the Board, if this is stipulated in the bylaws. Such representative will be chosen by employees in a direct election organized by the company jointly with the employees' unions.

In publicly-held companies, subject to the conditions set out in the law, shareholders representing a certain portion of the voting capital stock or a certain number of preferred shares may elect and remove a member of the Board and his alternate by a separate vote in the General Meeting, excluding the controlling shareholder.

Executive Office

The Executive Office (*Diretoria*) is composed of at least two officers serving for no more than three years, reelection being permissible. As a rule, officers are elected and removed at any time by the Board of Directors. If no Board of Directors was instated, the General Meeting will be responsible for electing and removing the Executive Office members. Up to one-third of the Board members may be elected for Executive Office positions. The Executive Office represents the company in its dealings with third parties, among other duties. The bylaws may establish that certain managerial decisions should be taken in Executive Office meetings only.

Officers need not be shareholders, but must necessarily be resident and domiciled in Brazil.

Officers are not held liable for any of the obligations assumed on behalf of the company in the course of routine management procedures. Their powers must be set out in the bylaws, and may be limited by the shareholders.

In case of abuse of power, negligence or willful misconduct in violation of the law or bylaws, senior managers are held liable in the civil sphere for any losses to which they may have given cause. In this sense, senior managers are prohibited from:

(i) performing discretional acts at the company's expense;

(ii) performing acts without the prior authorization of the General Meeting or the Board of Directors, when required;

(iii) lending the company's funds or assets; or

(iv) receiving from third parties, without proper authorization, any direct or indirect personal advantage by virtue of the exercise of their position.

Senior managers are also prohibited from taking part in any corporate transaction in which their interest conflicts with that of the company.

If a senior manager is found liable for any losses caused to the company, the latter will be entitled by law, after a resolution to such effect is passed by the General Meeting, to file a derivative suit against him. Such suit does not preclude any other judicial measures available to shareholders or third parties directly affected by the senior management acts.

Fiscal Board

The Fiscal Board (*Conselho Fiscal*) must be mandatorily instated, but it is not required to

operate on a permanent basis. If the Fiscal Board will not officiate permanently it must be instated, at the shareholders' discretion, in a General Meeting. The Fiscal Board is composed of three through five members and an equal number of alternates, all of whom need not be shareholders. Only individuals resident in Brazil who hold a college degree or have previously and for a certain time held the position of company manager or fiscal board member may sit on the Fiscal Board. Persons prevented from holding management positions pursuant to law, members of the company's management bodies or their relatives, or company employees cannot sit on the Fiscal Board.

When the Fiscal Board officiates on a non-permanent basis, it is instated by the General Meeting upon request to such effect by shareholders representing at least 10% of the voting shares or 5% of the non-voting shares.

The Fiscal Board monitors the senior managers and informs the General Meeting accordingly. The Fiscal Board may also request that the senior managers appoint experts to look into certain facts that must be clarified for proper performance of its duties. The Fiscal Board may also request information from the company's independent auditors, if any.

The Fiscal Board duties may not be delegated or transferred to any other body of the company.

Transformation

Under the corporation law, a company may change its corporate type without interruption of its operations, dissolution or liquidation. This requires shareholders' unanimous approval, unless otherwise provided for in the bylaws. Dissident shareholders have the right to withdraw from the company.

Merger, Consolidation and Spin-off

Merger, consolidation or spin-off may be effected between companies of the same or of different types. On a merger, one or more companies are absorbed by another, which succeeds to all rights and obligations, with consequent termination of the company or companies absorbed. On a consolidation, two or more companies join to form a new company, which succeeds to all their rights and obligations, the former companies being extinguished. Finally, a spin-off is an operation by which a company transfers a portion of its assets to one or more companies, which already exist or are formed for this purpose. If all assets and liabilities of the company are transferred, it will be extinguished. The rights and obligations of the transferor are proportionately absorbed by the spun-off companies.

The reasons for performing these transactions must be explained and justified in a Protocol of Justification signed by the senior managers of the companies involved. This protocol will then be approved by the partners in a General Meeting of such companies. In these cases, dissident shareholders are also allowed to withdraw from the company.

Wholly-owned Subsidiary

A wholly-owned subsidiary is a company whose total capital stock is owned by another company. The owner of the wholly-owned subsidiary must be a Brazilian company. Incorporation by public deed is required. An existing company may be converted into a wholly-owned subsidiary upon acquisition of all its shares by a Brazilian company.

Payment of Dividends

Joint-stock companies may pay dividends to shareholders pursuant to law and under the bylaws, also considering the origin and nature of such funds. If the shareholder is an individual or legal entity resident or domiciled abroad, the dividends remitted abroad at the commercial exchange rate is subject to prior Central Bank registration of the foreign seed capital. The distribution of dividends in the same proportion as registered investments does not require prior Central Bank authorization, and is not subject to taxation.

Joint-stock companies may also pay interest on net equity, pursuant to Law 9249/95 and Law 9430/96. Payment of interest on net equity is conditioned to the existence of profits at least twofold the interest amounts to be paid or credited. Interest on net equity is calculated by applying the Long-Term Interest Rate (TJLP) on the company's adjusted net equity. As CVM qualifies interest on net equity as dividends, it is viewed as a company's results rather than expenses. However, unlike the payment of dividends, the interest on net equity is subject to income tax at the rate of 15%.

Procedures for Organization of Companies

Regardless of the type of corporate entity, there are certain procedures in common for incorporation of companies in Brazil.

All organizational documents necessary to set up a company (i.e. the articles of association of limited liability companies, or the bylaws of joint-stock companies) must be established by a public deed or in a general meeting of incorporation, and then registered with the competent Register of Companies, which reports to the Commercial Registries of each Brazilian state and is monitored and regulated by the National Commercial Registration Department (DNRC). Moreover, the documents relating to certain types of corporate acts must be published in the state official press and in a newspaper widely circulating in the place where the company is headquartered.[19]

Enrollment in the Federal Revenue Office is mandatory for all partners, whether individuals or legal entities resident and domiciled in Brazil or abroad. Accordingly, foreign individuals must be enrolled in the Individual Taxpayers' Register (CPF), and foreign legal entities in the

[19] ***The House of Representatives is reviewing bills, which propose to require the publication of financial statements by limited liability companies and other companies, as in the case of joint-stock companies.***

National Register of Legal Entities (CNPJ).

A newly-formed company is also required to obtain its CNPJ enrollment in order to do business, open and transact current accounts in Brazilian banks, participate in government procurement and bidding procedures, and perform other acts before third parties.

In addition to obtaining the CNPJ enrollment, other procedures will be required before state and municipal governmental agencies and bodies after incorporation of the company. Such procedures will hinge on the type of activity to be performed by the company.

Finally, incorporation of companies whose partners are foreign individuals or legal entities implies the remittance of foreign capital to Brazil for payment of their respective ownership interests. Registration of this foreign capital with the Central Bank is mandatory, and takes the form of a self-registration (the investor itself and the Brazilian investee should provide for such registration).

Currently, this registration is made on-line via the Central Bank Information System (Sisbacen), specifically through the On-line Registration System for Foreign Direct Investments (RDE-IED). Accordingly, the foreign investment is automatically registered, regardless of prior Central Bank review or authorization. The foreign investment registered through the RDE-IED mode serves as basis for calculation of the amounts to be repatriated upon capital reduction, as well as for payment of dividends (at the commercial exchange rate) by the Brazilian company to its foreign partners.

Equity investments from conversion of foreign credits, as well as investments made via import of goods without foreign currency consideration and profit reinvestments are also subject to registration with the Central Bank.

ENVIRONMENTAL LAW

The 1988 Federal Constitution devotes a separate chapter to environmental stewardship. Everyone has the constitutional right to a balanced environment, which is viewed as a common asset that is essential to the healthful life of citizens. Stewardship of the environment was entrusted with the governmental authorities and the community as a whole.

The governmental authorities have the following constitutional duties, among others:

(i) to preserve and recover species and ecosystems;

(ii) to care for the variety and integrity of the country's genetic heritage, overseeing the entities acting in genetic research and manipulation;

(iii) to promote environmental education and awareness;

(iv) to define conservation areas; and

(v) to require environmental impact assessments before any potentially polluting activity is set up.

The federal, state and municipal governments have concurrent authority to legislate on environmental issues. As a result, environmental rules and requirements may vary depending on the place of business. However, some specific issues (water, energy, mining and nuclear activities) were reserved for the Federal Government; the states may also legislate on such issues only upon express federal authorization.

According to the Constitution, an individual or legal entity that is liable for any conduct or activity detrimental to the environment is penalized in the criminal and administrative spheres, and is also required to redress the existing damage.

Environmental laws are enforced by a set of federal government bodies. The National Environmental System (SISNAMA) comprises: **(a)** the National Council for the Environment (CONAMA), a regulatory, advisory and decision-making body; **(b)** the Ministry of the Environment, the central body in charge of coordination, supervision and control of the National Policy for the Environment; and **(c)** the Brazilian Institute for the Environment and Renewable Natural Resources (IBAMA), an executive environmental body.

SISNAMA is assisted by a number of other federal government entities, environmental stewardship foundations, and state and municipal government entities (including state and local environment offices, and other environment companies such as CETESB in the state of São Paulo).

A potentially polluting venture or activity is that whose nature, size or location may have a direct or indirect adverse impact on the physical, chemical or biological characteristics of the

environment. Environmental licensing for potentially polluting activities in national or regional level rests with IBAMA.

The state or Federal District environmental authorities are responsible for environmental licensing of ventures that extend beyond the territorial boundaries of one or more municipalities. And the municipal environmental authorities are entrusted with the licensing of local activities with an impact on the environment circumscribed within the territory of one same municipality. In practice, the state environmental entity plays a major role in environmental licensing for potentially polluting activities.

According to CONAMA, environmental licensing is compulsory for some specific activities, such as:

(i) ore extraction;

(ii) logging;

(iii) pulp and paper industry;

(iv) rubber industry;

(v) chemicals industry;

(vi) textiles industry;

(vii) hazardous cargo carrier, marina and port activities;

(viii) resorts and other entertainment complexes;

(ix) stock-raising and agriculture activities;

(x) tobacco industry.

Environmental licensing stands for an administrative act by which a competent environmental body lays down the conditions, limitations and control measures required from the applicant as a condition for the setup, expansion or operation of ventures or activities that use natural resources or are actually or potentially polluting, or otherwise prone to degrade the environment. The environmental licensing system embodies a set of administrative procedures intended to follow up on the development of a venture from its inception, controlling its setup and operations from time to time. The environmental authorities issue a number of different environmental licenses, depending on the type and stage of the venture for which they are applied.

Administrative Rules and Penalties

Federal Decree No. 3179 of September 21, 1999, which regulates Law No. 9605 of February 12, 1998 (the Environmental Crime Law), provides for the administrative sanctions applying to any conduct or activity that is damaging to the environment, such as the development of unlicensed operations or the release of pollutants beyond the limits prescribed by laws and regulations. Administrative offenses are punishable by:

(i) warning;

(ii) one-time or daily fine;

(iii) seizure, destruction, or rendering the irregular products unfit for further use or sale;

(iv) remediation order;

(v) suspension or cancellation of registration;

(vi) forfeiture, limitation or suspension of tax benefits or incentives, and ineligibility for credit facilities from official credit establishments; and

(vii) ineligibility for government procurement.

In addition to these sanctions under federal law, a number of Brazilian states have issued their own rules according a specific treatment to administrative penalties for environmental offenses.

Criminal Liability

The Environmental Crime Law sets out the criminal penalties for environmental offenses. Before the advent of such law, criminal sanctions were scattered over a number of legal texts, such as the Forest Code, the Hunting Code, and the like. Under the current laws, criminal liability applies to whoever has given cause to any conduct or activity that is damaging to the environment, to the extent of the degree of negligence or willful misconduct involved.

Under Brazilian law, criminal liability reaches not only the person directly responsible for the environmental damage, but also whoever was aware of the criminal offense but did nothing to avoid it, by omission or commission. These accessories to the crime include the officers, directors, other board and committee members, auditors, managers, agents or attorneys-in-fact of the offender. Criminal liability is also imputed to the legal entity directly, without prejudice to the penalties meted out to individuals held liable as accessories to the environmental crime. The disregard doctrine may likewise apply if necessary for redress of the environmental damage.

Penalties meted out to individuals are limited to those restricting freedom (detention or imprisonment) or rights (community services, temporary interdiction of rights, full or partial suspension of activities, fine, and home confinement). As for legal entities, the following penalties apply: fine; community services; and penalties restricting rights (such as full or partial suspension of activities, temporary shutdown of establishment, works or activities, and ineligibility for government procurement).

Environmental offenses qualify for plea bargaining with the Government Attorney Office, which has exclusive authority to initiate criminal prosecution, depending on the severity of the damage caused to the environment.

Civil Liability

In addition to administrative and criminal liability, the National Policy for the Environment in Brazil also draws on the polluter-pay principle adopted in other countries. This principle rests on strict liability, that is, irrespective of fault. The duty to redress is triggered by the existence of a causal relation between the activity performed by the venture and the damage caused to the environment.

The current National Policy for the Environment (established by Law No. 6938 of August 31, 1981) assumes that every environmental damage calls for remediation or redress. Accordingly, even polluting emissions below legal thresholds may translate into an environmental damage, making the offender liable for remediation or payment of damages.

Under prevailing laws, the Government Attorney Office may initiate a civil inquiry to detect potential irregularities or environmental damage, which may evolve into a lawsuit for protection of the environment and redress of damage (known as ‘civil public action’, similar to citizen suits). As these civil inquiries develop, the respondent may enter into a cease-and-desist commitment undertaking to exert efforts to remediate and/or redress the damage caused to the environment, thus avoiding the filing of a civil public action.

COMPETITION LAW

Law No. 8884 of June 13, 1994 (the "Competition Law") is primarily aimed at curbing and preventing unfair trade practices, and has its pillars in the principles of the 1988 Federal Constitution, i.e. free enterprise, open competition, the social role of property, consumer protection, and curbing of unfair trade practices. These constitutional principles equally provide the general guidelines for economic activities, as set forth in articles 170 et seq. of the Federal Constitution.

Prior to the 1988 Federal Constitution, other laws and regulations already contained some provisions on competition. The landmark in competition protection in Brazil was Law No. 4137 of September 10, 1962, which contained general rules on unfair trade practices, with very broad provisions aimed at controlling acts and contracts that could injure open competition on the Brazilian market. This law instituted the Administrative Council for Economic Defense (CADE), which is the Brazilian authority charged with enforcing the Competition Law in Brazil.

Other laws and decrees of lesser importance were subsequently issued. Law No. 8158 enacted on January 8, 1991, coupled with Law 4137/62, provided the basic framework for competition protection until enactment of the current Brazilian Competition Law.

The Competition Law transformed CADE into a federal independent agency (reporting to the Ministry of Justice), with greater clout to monitor and curb potential practices in restraint of trade.

The Competition Law applies to acts fully or partially performed within Brazil, as well as to acts undertaken abroad with effects on the Brazilian market. CADE's control authority is twofold: preventive (controlling acts that may lead to a dominant position in the market); and repressive (investigating and punishing unfair trade practices).

Preventive Control

Any acts that may limit or otherwise restrain free competition, or result in the dominance of relevant markets for certain products or services, must be submitted for CADE review. Based on the criteria set forth in the Competition Law, transactions such as the merger with or into or the purchase and sale of companies, or any other form of corporate grouping, require CADE's approval if **(a)** the resulting company or group of companies accounts for 20% of a relevant market, or **(b)** any of the parties has posted in its latest balance sheet an annual gross turnover equal to R$ 400 million. In relation to the gross turnover criterion, CADE takes into consideration not only the gross turnover of the companies directly involved in the transaction under review, but also the gross turnover of their economic groups worldwide.

The transactions falling within the criteria mentioned above must be submitted for CADE review within 15 business days from signing of the first binding document between the parties,

on pain of a fine ranging between 60,000 and 6,000,000 UFIR.[20]

The transaction documents must be submitted to the Economic Law Office (SDE), a body reporting to the Ministry of Justice, in charge of investigating unfair trade practices from an economic perspective and initiating administrative proceedings.

CADE's decision is final and conclusive in the administrative sphere. However, it can be appealed in court. The decision denying approval of a transaction will also state, on a case-by-case basis, the measures to be implemented by the parties to fully or partially return the acts already performed into their status quo ante.

A transaction entailing economic concentration may be approved if it is intended to increase the levels of productivity, improve quality or generate technology efficiencies, proof of which must always be provided. CADE is responsible for establishing the performance conditions under which a transaction will be approved, even if resulting in economic concentration.

Repressive Control

The Competition Law defines the criteria to be adopted to identify practices in restraint of trade, i.e. those that may actually or potentially limit, falsify or injure open competition or freedom of enterprise, control relevant markets for goods or services, arbitrarily increase profits, or entail the abuse of a dominant position. Law 8884/94 also lists examples of practices deemed to be potentially injurious to competition, among which: tie-in sales, refusal to deal, concerted price-fixing, market division, underselling, imposition of resale prices to distributors, retailers and representatives, overpricing, and profiteering.

SDE will inquire into these illegal practices and irregularities, commencing administrative proceedings, if appropriate, whereas CADE will render its final decision accordingly.

Administrative proceedings can be filed *ex officio* by SDE, or through a duly substantiated complaint in writing filed by the Senate, House of Representatives, a congressional committee, or any interested party. Both SDE and CADE may request information from any persons, agencies, authorities or entities, whether public or private. SDE and CADE may also impose on the offender preventive measures seeking to suppress such illegal practices and irregularities, as well as levy daily fines for contempt of their decisions.

CADE may impose the following penalties:

(a) on the company: a fine ranging from 1% to 30% of its gross turnover for the last fiscal year. The fine cannot be less than the profits obtained by the company by means of the illegal practice concerned, when capable of being quantified;

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[20] ***UFIR is a benchmark rate used for monetary adjustment purposes. It was extinguished in October 2000, with its value frozen at R$ 1.0641.***

(b) on the company's senior manager: a fine varying from 10% to 50% of that imposed on the company, if he is eventually held liable for such illegal practice.

The penalties stated above may be doubled in case of recidivism. In addition, the following supplementary penalties may be applied: cancellation of tax incentives or public subsidies; prohibition from contracting with official financial institutions and participating in public bids; company spin-off, transfer of control and/or divestiture; or other measures held to be appropriate to eliminate the effects of the illegal practice.

Under Law No. 8137 of December 27, 1990, there is a possibility of preventive detention of the senior managers for the sake of public and economic order, when there is proof of the crimes and sufficient indicia of the respective offender.

Regulatory Agencies

The Federal Government created several regulatory agencies in charge of specific economic sectors, the most important of which are the following:

- ANATEL – National Telecommunications Agency;
- ANEEL – National Electric Power Agency;
- ANP – National Oil Agency;
- ANTT – National Land Transportation Agency;
- ANTAQ – National Water Transportation Agency.

The primary function of these agencies is to monitor and regulate activities of relevant public interest, which gradually moved from public to private entities. Such agencies are responsible for regulating the structure of the markets under their respective scope of authority. Despite the creation of such agencies, the prevailing stand is that CADE still has the right and duty to exercise preventive and repressive control from a competition perspective, even in regulated sectors. In some cases, cooperation agreements between CADE and the regulatory agencies regulate and establish their respective spheres of authority in reviewing acts and contracts.

LABOR LAW

The guiding principles of labor law are defined in the Brazilian Constitution. The basic rights and duties of employers and employees are set out in the 1943 Consolidated Labor Laws (CLT), in collective bargaining agreements and collective labor conventions, as well as in some specific laws on certain matters affecting labor relations.

Brazilian labor law defines an *employee* as the person who renders services on a regular basis and subordinated to, and under the direction of, an employer in return for compensation. A self-employed worker, in turn, renders services on an independent basis, acting for himself, determining his own tasks, developing his own business, and assuming the risks of his activities, with no subordination relationship.

For its part, *employer* is defined as a company or sole proprietorship that takes the risk of its economic activity, hires, pays salaries, and sets out the guidelines for the services provided by the employee. Companies belonging to the same economic group, under the same control or direction, are jointly and severally responsible for compliance with labor-related obligations.

Employment Contract

A formal agreement is not required for individual employment under Brazilian law. Oral employment is fully valid. In any event, however, it is essential that the employment contract be recorded in the Work and Social Security Card (CTPS) of the employee within 48 hours from hiring. The company, in turn, must keep specific hiring records in a proper book.

As a general rule, an employee is hired for an undetermined period of time, and contracts for a determined period of time constitute an exception to this rule. The latter contract will only be valid when **(i)** the nature of the services justifies establishment of a preset period of time; **(ii)** the nature of the company's activity is temporary; or **(iii)** it is a probation contract.

Employees' Rights

An employment relation immediately gives rise to a series of rights warranted by the Brazilian legislation, irrespective of whether such rights are mentioned in the employment contract. In addition to such rights, specific legislation and collective labor conventions may ensure certain categories of employees other or broader rights. Employees' main rights are the following:

(i) **Compensation**: may be paid monthly, fortnightly, weekly or even per task, depending on the conditions established for the employment. The compensation paid to an employee may never be less than the minimum wage established by the Government and valid throughout the Brazilian territory, or less than the lowest wage floor established in the collective labor convention for each professional category, whichever is higher. Compensation includes food, lodging or any other benefits the company provides

habitually to the employee by express or tacit agreement. Once these benefits are granted, they become part of the employment contract, and cannot be reduced or abolished.

(ii) **Weekly Remunerated Rest Period (DSR)**: all employees have a right to one day's remunerated rest period, which should preferably fall on a Sunday. For employees who receive their compensation monthly, payment of the weekly remunerated rest period will already be included in the monthly compensation.

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(iii) **Vacations**: every employee, upon completing one year's service with the same company (the "entitlement period"), is entitled to 30 days' vacation unless he has been absent from work more than five unjustified times during the period. Vacation should be granted in the year following the entitlement period, which is called vesting period, under penalty of the employer's being required to pay double vacation.

(iv) **One-Third Vacation Bonus**: employees are entitled to receive a one-third bonus in addition to the normal monthly compensation, at the time of annual vacations.

(v) **13th Salary**: in December of each year, the employer will pay the employee an extra compensation, known as 13th salary, corresponding to the salary for said month plus the annual average of other monies habitually paid to the employee during the year.

(vi) **Prior Notice**: An employment contract for an undetermined period may be terminated at any time without good cause, upon prior notice given by one party to the other. If it is the employer that decides to terminate the employment contract without good cause, it must give the employee at least 30 days' prior notice, and during such period the employee is entitled to reduce the workday by two hours or to be released from work for seven consecutive days, without prejudice to payment of his compensation. The employer may release the employee from work during the prior notice period by paying the respective sum in lieu.

(vii) **Workday**: As a rule for all employees, the maximum workday is eight hours and the maximum workweek is 44 hours, with one-hour break for meal and rest. Some professional categories are eligible for a special workday system. Work performed beyond the time limits provided under the law is treated as overtime. The minimum compensation for overtime is 50% higher than the normal hourly rate. No overtime payments will apply to employees engaging in external activities that cannot be subject to fixed work hours, or to managers (i.e., the employees in management positions, including officers and heads of a department or branch). Night work is performed between 10:00 p.m. and 5:00 a.m. Work performed between these hours entitles the employee to an additional compensation at least 20% above the overtime rates.

(viii) **Unemployment Compensation Fund - FGTS**: According to the Federal Constitution, the FGTS system became automatic and compulsory for all employees hired after October 5, 1988. Under the FGTS system, every month the employer must deposit the equivalent of 8.5% of each employee's compensation for the previous month in a blocked bank account in the name of the employee. An FGTS-opting employee

unfairly dismissed is entitled to withdraw the total FGTS deposits made by the employer in his FGTS account, plus interest, monetary adjustment and a 50% fine figured on the total amount deposited by said employer. Collective employment contracts may provide for an additional indemnity.

(ix) **Social Security**: every employee must be officially enrolled in the Social Security System. Social security in Brazil is sponsored by monthly contributions from employees, employers and the State. After a certain period of enrollment and contribution, the employee is entitled to receive social security benefits under the pertinent law.

Interruption and Suspension of an Employment Contract

When an employment contract is interrupted, the employee temporarily ceases to provide services, without prejudice to his compensation or benefits or computation of length of service. Typical examples are sick leave, maternity leave and annual vacations.

An employment contract is suspended when services, compensation, computation of length of service and other benefits cease without termination of the employment relation. Typical examples include leaves of absence without pay and participation in strikes or industrial actions.

Termination of an Employment Contract

According to Brazilian law, an employment relationship may be terminated on the initiative of the employer, of the employee or by lapse of time. Irrespective of the cause, the instrument of termination of an employment contract must specify the reason why the employment relationship is being terminated and list the sums paid to the worker. Such instrument will serve as a receipt for the company. Employers that fail to pay the sums owed employees will be subject to a fine and to payment of an indemnity equal to the employee's salary. Finally, if the employee has been with the company for more than one year, the instrument of termination will only be valid if prepared with the assistance of the respective labor union or executed before a Ministry of Labor representative.

An employment relation may be terminated by the employer with or without good cause.

(i) **Dismissal with Good Cause**: may only occur in the event of gross misconduct, as defined by law. The main reasons for dismissal with good cause are:

(a) dishonesty;

(b) regularly doing business on his own account or for the account of a third party without the employer's permission, when such activity (i) competes with the employer's business or (ii) adversely affects the quality of the employee's work;

(c) criminal sentencing of the employee under a final and conclusive judgment, provided that execution of the penalty has not been suspended;

(d) habitual intoxication during working hours;

(e) breach of trade secrets;

(f) any act of indiscipline or insubordination;

(g) abandonment of employment.

If the employee is dismissed for good cause, he will be entitled only to the compensation corresponding to the days already worked during the month, accrued vacation and the additional one-third bonus in respect of the accrued vacation.

(ii) Dismissal without Good Cause (Unfair Dismissal): If the employer terminates the employment contract without good cause, the employee will have the following rights:

(a) outstanding salary for the days worked during the month;

(b) 30 days' prior notice;

(c) ratable 13th salary (calculated on the salary earned during the last month of employment);

(d) vacation or double vacation pay, if any;

(e) one-third vacation bonus; and

(f) release of the FGTS deposits, with a fine of 50% on the total amounts deposited in the employee's FGTS account during the employment contract.

The individual employment contract and the collective labor convention may provide for other benefits, which must also be considered upon termination.

(iii) Resignation: A resigning employee is entitled to all the monies listed above, except for prior notice and release of the FGTS deposits plus a 50% fine. Employees that resign prior to completing one year's length of service will not be entitled to ratable vacation pay.

(iv) Constructive Dismissal: the employee may deem his employment contract terminated, claiming the respective indemnity, in the following events:

(a) the employer demands services beyond the employee’s capabilities, contrary to the law and good morals, or outside the scope of the employment contract;

(b) the employee is treated too strictly by his superiors;

(c) the employee is in evident danger of being considerably harmed;

(d) the employer fails to comply with its contractual obligations;

(e) the employer performs acts prejudicial to the employee or his family's honor or repute;

(f) the employer physically harms the employee;

(g) the employer reduces the work to be performed in a manner that considerably affects the salary received by the employee.

The severance pay must be fully settled by the employer within 10 days of the letter of constructive resignation or prior notice (in the latter case, if payment is made in lieu). If the employee works during the prior notice period, the severance pay must be settled on the first business day after the end of the notice period. Failure by the employer to respect these deadlines will entail a fine equivalent to the employee's one-month compensation.

Employment Contracts for a Determined Period

As a rule, employment contracts for a determined period terminate upon lapse of such period. In this case, the employer does not owe any indemnity to the employee, but the latter will be entitled to the following:

(i) 13^{th} salary, paid ratably (on the basis of the last salary);

(ii) unused vacation pay, if any;

(iii) 1/3 vacation bonus; and

(iv) release of the FGTS deposits.

If the employer opts for early termination of the determined-period employment contract, it must pay the employee an indemnity equal to half the salaries to which the employee would be entitled until the end of the originally agreed period. On the other hand, if the contract is terminated by the employee, he will be liable for any damage incurred by the employer as a result of discontinuance of the employee services. Nevertheless, the indemnity payable by the employee to the employer will not be higher than that which would be owed the employee if the situations were the opposite.

Foreign Workers

Brazilian labor law adopts the two-thirds rule, by which all companies (with some exceptions) must ensure that at least two-thirds of their employees be Brazilian citizens. This ratio applies both to the number of employees and to the payroll, which means that two-thirds of the salaries paid by any company in Brazil must go to Brazilian employees. Likewise, under the two-thirds rule a Brazilian worker cannot receive a salary lower than that paid to a foreign worker

performing the same job. Furthermore, in case of redundancy, the foreign employee is to be dismissed before the Brazilian employee who performs the same work.

Immigration Control

A visa is required for the entry of aliens in Brazil. Law No. 6815 of August 19, 1980 (the "Foreigners' Statute") regulates the entry and stay of aliens in Brazil, their identification, job placement, the development of professional and other activities, acquisition of Brazilian nationality, extradition, expulsion and deportation, and further sets out the reciprocal rights and duties of the alien and the Brazilian Government.

Under Brazilian legislation (including labor laws), aliens legally residing in Brazil are granted the same rights as Brazilian citizens. However, the granting of work visas in Brazil depends on certain requirements, as explained below.

Brazil's immigration policy is coordinated by the Brazilian Immigration Council, a body of the Ministry of Labor and Employment. The granting of any kind of visa is conditional upon national interests, and possession or ownership of assets in Brazil does not necessarily entitle the alien to obtain any type of visa or authorization to remain in Brazil. In practice, visas are issued to aliens by diplomatic missions or other consular bodies. Brazilian law contemplates the following types of visa:

(i) transit;

(ii) tourist;

(iii) temporary;

(iv) permanent;

(v) courtesy;

(vi) official; and

(vii) diplomatic.

Transit Visa

An alien in transit in Brazil heading towards another country must obtain a transit visa, unless he does not stop in Brazil. If such stop is for the purpose of taking a connection of any means of transportation, no transit visa is required. The alien holding a transit visa will be allowed to stay in Brazil for a maximum non-extendible period of 10 days.

Tourist Visa

This visa is issued to an alien entering Brazil for entertainment and family reunion, and does not

serve for immigration or engagement in remunerated activities in Brazil. A tourist visa is valid for up to five years, allowing the alien to enter the country during this period. Each stay cannot exceed 90 days, which is extendable only once for an equal period not exceeding 180 days a year. The Brazilian government signed several international treaties granting tourists reciprocal treatment. Therefore, tourists from countries releasing the requirement of entry visas for Brazilians are equally released from presenting a visa to enter Brazil.

Temporary Visa

Temporary visas may be issued to an alien in one of the events prescribed by law. Temporary visa holders may stay in Brazil for a determinate period of time. They may also leave and return to the country within the original period of stay. Finally, the granting and validity of a visa does not prevent the alien from applying for and obtaining a new visa of the same or different type.

Pursuant to Brazilian law, a temporary visa is issued to persons coming to Brazil in the following circumstances:

(i) on a cultural trip or study mission;

(ii) on a business trip;

(iii) as an entertainer or sportsman;

(iv) as a student;

(v) as a scientist, teacher, technician or other professional contracted to work for a local organization or to render services for the Brazilian government;

(vi) as a foreign correspondent for newspapers, magazines, radio, television or foreign news agencies; and

(vii) as a missionary.

Aliens on business trips, entertainers and sports figures may remain in Brazil for up to 90 days. Such period may be extended up to 90 days, at the discretion of the Brazilian immigration authorities.

Aliens on a cultural mission, scientists, teachers, technicians, and foreign correspondents may remain for the duration of the mission or work contract, or for the time it takes for their respective services to be rendered, subject, however, to the maximum period of stay stipulated by law. Temporary visas may be renewed for another equal period.

An alien who intends to engage in any remunerated activity in the Brazilian territory must apply for a temporary or permanent visa. Temporary visas will only be granted to foreign entertainers, sports figures, scientists, technicians, teachers and professionals who meet the requirements of the Brazilian Immigration Council and have a work contract approved by the Ministry of Labor and Employment, unless they are visiting Brazil to render services to the Brazilian government.

The alien must also produce evidence of the means to support himself and his family while in Brazil.

Temporary visa holders are entitled to bring their effects, excluding automotive vehicles, and their professional equipment into Brazil. These goods enter Brazil under a special customs system for temporary admission, for which no import license is required, although certain formalities must be complied with.

Holders of temporary visas are subject to certain restrictions, such as not being permitted to establish themselves as sole proprietorships, nor to become managers, officers or senior managers of companies. Dependents of temporary visa holders and foreign students may not engage in remunerated activities. Also, aliens who have entered Brazil on temporary visas but with work contracts may only engage in remunerated activity with the companies that contracted them.

Remunerated Activities

An alien who intends to engage in any remunerated activity in a Brazilian-based company must apply for a temporary or permanent visa, as the case may be. If such activity is carried out in disagreement with the visa rules, the company will be subject to the fines imposed by the Brazilian authorities and the alien may be deported.

Technical Services

The alien may obtain a work permit and a temporary visa in the cases of technology transfer or technical assistance services under an agreement entered into between Brazilian and foreign companies. In such events, however, there are some requisites for granting of the visa: the Brazilian company's demand for the services must be sporadic, and the services must be specific and unrelated to the company's routine activities; and the activities to be carried out by the alien must be so specialized that they cannot be performed by Brazilian labor. The respective technical assistance or technology transfer agreement must be registered with the National Industrial Property Institute. The temporary visa will be valid for up to two years, extendable for an equal period, and cannot be transformed into a permanent visa.

Employment Contract with Aliens

An alien may apply for a temporary visa to engage in remunerated activities in Brazil under an employment contract entered into with a Brazilian company. The respective application must be submitted to the Ministry of Labor and Employment for review, accompanied by documents supporting the professional skills and expertise of the alien, in addition to his suitability for the activities to be performed within the Brazilian territory. The visa requisites include: **(a)** two years' experience in the practice of a high level profession; or **(b)** three years' experience in the practice of an average level profession, with a minimum education of nine years. The Brazilian company must provide the Ministry of Labor and Employment with the reasons for hiring the aliens to the positions concerned.

Permanent Visa

A permanent visa will be issued to an alien who comes to Brazil with the intention of immigrating into and staying in the country for an indefinite period. Under applicable law, the granting of a permanent visa is conditional upon certain qualifications; the skills offered must be specialized, thereby facilitating an increase in productivity, technology absorption and attraction of resources to specific sectors of the Brazilian economy, and, of course, must satisfy the Brazilian Immigration Council's selection criteria. An alien holding a permanent visa may leave the country and return without an entry visa, provided that no more than two years have elapsed since his departure from Brazil.

Management Positions

The granting of permanent visas to aliens who are officers or executives, or who hold other management positions in Brazilian companies, is conditional, for a period of up to five years, to actual performance of the duties to which they were assigned under a corporate act duly registered with the competent government bodies.

In these cases, there are other requisites for granting of the visa, as follows:

(i) the Brazilian company must evidence that it received investments, for each alien contracted, in an amount equal to or higher than US$ 200,000.00[21] or its equivalent in other currencies, in the form of cash, technology transfer or capital goods. Proof of such investments must be provided by means of the foreign capital registrations maintained with the Central Bank of Brazil or by submission of the respective foreign exchange contract for remittance of funds to Brazil (in the latter case, accompanied by the corporate documents evidencing the contribution of such capital to the Brazilian company); and

(ii) the Brazilian company must have generated, in the year preceding that in which the alien was contracted, an increase in the payroll equal to or greater than 20% or 240 minimum wages,[22] as a result of the creation of new job opportunities.

Concurrent Activities

Under Brazilian law, aliens holding management positions in Brazilian companies on the conditions mentioned above cannot have their duties changed by being assigned new activities in the company, or perform the same or new duties in other companies of the same economic group or conglomerate, without the prior authorization from the Ministry of Labor and Employment. Economic group or conglomerate is defined by Brazilian law as a group of

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[21] ***The issuance of a permanent visa to Argentineans depends on a minimum investment of US$ 100,000.00, pursuant to the Agreement for Trade Facilitation entered into between Brazil and Argentina on February 15, 1996.***

[22] ***The minimum wage in Brazil is R$ 260.00.***

companies directly or indirectly controlling, controlled by, or under common control with an entity.

When applying for this prior authorization from the Ministry of Labor and Employment, in addition to the procedures adopted to obtain his permanent visa the alien must:

(i) submit the respective application, making express reference to the original visa application;

(ii) provide proof of the relationship existing between the companies of the same economic group or conglomerate;

(iii) submit the act relating to appointment for the positions that he will hold in all of the companies; and

(iv) deliver a letter of consent to this interlocking directorate status, signed by the company that had originally obtained the authorization to hire this alien.

In this case, there is no need for **each company** of the economic group or conglomerate involved in this interlocking directorate event to provide proof, for each alien, of the minimum investment of US$ 200,000.00 mentioned above. It will suffice that proof of such investment be provided upon obtaining his original permanent visa.

Mercosur Visa

Pursuant to Decision No. 16 of December 15, 2003, the Mercosur Common Market Council instituted the Agreement for Creation of the "Mercosur Visa", which is still pending ratification by the Member Countries, including Brazil.

This Agreement is slated to make it easier for citizens of the Mercosur Member Countries to circulate temporarily when rendering services in other Members Countries. Management activities are among those contemplated by the Agreement. In this case, the alien may stay up to two years, extendable only once for an equal period.

Differently from the general rules applying to obtainment of a permanent visa as mentioned above, granting of the "Mercosur Visa" is not conditional on applicant's submission of evidence of economic reasons or on any prior authorization for work purposes. The two-thirds rule does not apply either. Therefore, when the Agreement comes into force, granting of the "Mercosur Visa" will depend only on proof with respect to appointment of the alien for the respective position.

Labor Reform

The Brazilian Government is committed to implementing a labor reform to facilitate employer/employee relationships. Some of the issues addressed by this labor reform are:

(i) Hour Bank: this will allow the company to adapt its employees' work hours to variations in its needs;

(ii) Suspension of the employment contract: the company may suspend the employment contract for two to five months, offering the worker a retraining course;

(iii) Adoption of summary proceedings in labor-related cases: this step would expedite labor claims involving sums up to 40 minimum wages, which currently account for 45% of all labor disputes. With this new procedure, disputes may be settled in only one hearing; and

(iv) Preliminary conciliation committees: formed of representatives of employees' unions and employers' associations, these committees would resolve in a preventive and expeditious manner labor disputes that would otherwise drag on for years in court.

TAXATION

The 1988 Federal Constitution has conferred taxing authority on the Federal Government, the States, the Federal District, and Municipalities. The 1966 National Tax Code, accommodated by the 1988 Federal Constitution, provides for the governmental instances that may create and collect taxes.

Taxes in whatever instance must always abide by certain tax law principles warranted by the Federal Constitution, including:

(i) Strict lawfulness principle (*princípio da legalidade*): any and all taxes must be created by a law detailing all triggering events, the taxpayer, the tax base and rate, when and how it will be owed and payable.

(ii) *Ex post facto* taxation principle (*princípio da não retroatividade*): events predating the effectiveness of the law creating a tax or increasing its rate are not reached by such law.

(iii) No same-tax-period taxation principle (*princípio da anterioridade*): except in a few cases generally relating to quasi-taxes created for the implementation of economic policies, no tax may be levied in the same tax year in which the law creating or increasing it is published.

Major Brazilian Taxes

Tax	Tax Base and/or Triggering Event	Rate
Corporate Income Tax (IRPJ)	Actual or estimated profits; profits determined by tax authorities	15%
IRPJ Surcharge	Actual or estimated profits; profits determined by tax authorities	10% on the income in excess of R$ 240 thousand per annum
Withholding Income Tax (IRF) on overseas remittances	Income and capital gains earned by non-residents from paying sources in Brazil	15% or 25%, depending on the type of income
Tax on Manufactured Products (IPI)	Sales price when a product leaves the industrial establishment or upon import	Variable per product classification
Tax on Financial Transactions (IOF)	Credit, foreign exchange, insurance and securities transactions	Variable per type of transaction
Social Contribution on Profits (CSL)	Adjusted net profit	9%
Profit Participation Program Contribution (PIS)	Gross revenues	1.65% under the non-cumulative regime, and 0.65% under the cumulative regime
Social Security Financing Contribution (COFINS)	Gross revenues	7.6% under the non-cumulative regime, and 3% under the cumulative regime
Provisional Contribution on Financial Transactions (CPMF)	Financial transactions, especially current account debits	0.38%
Contribution on Economic Activities (CIDE) –Overseas Remittances	Payment of royalties and fees on technology transfers and technical services by foreign persons	10%
CIDE – Fuels	Marketing and import of fuels	Variable per type of fuel
Tax on Distribution of Goods and Services (ICMS)	Transaction value	7% through 25%
Tax on Services (ISS)	Service price	2% through 5%
Import Duty (II)	CIF product value	0% through 35%
Estate and Gift Tax (ITCMD)	Value of assets or rights transferred by donation or legal succession	2% and 6% according to state law
Inter-Vivos Transfer Tax (ITBI)	Transfer of title to real properties and related rights	Up to 8% according to municipal law
Urban Land and Building Tax (IPTU)	Direct or beneficial ownership and possession of urban properties	According to municipal laws
Export Duty (IE)	When a product made in Brazil or with domestic content leaves the country, as per CAMEX act	Usually 30%; other rates may be established up to 150%. Currently, most products are taxed at a zero rate.

Federal Taxes

Income Tax

Income tax (IR) is assessed on the income and capital gains earned by Brazilian-based individuals at a progressive rate of 15% or 27.5%, depending on the taxpayer's ability to pay.

Corporate IR is levied at 15% on the taxable profits determined at the end of each fiscal quarter or year. A 10% surcharge is levied on the actual profits, estimated profits, or profits determined by the tax authorities, in excess of R$ 240 thousand per year. Taxable profits are ascertained by deducting the operating costs and expenses from the gross income originating from the company's core activity and incidental businesses. Some of these costs and expenses are not allowed as deductible because of their nature or amount involved. In some cases, a company's taxable profits are tax-free.

In some cases, a legal entity may opt for taxation on estimated profits, instead of actual profits. Under the estimated profit tax regime, a company's operating income is first applied a certain rate vis-à-vis its field of activity, and then the tax base is calculated. A legal entity qualifies for the estimated profit tax election if its total gross revenues was equal to or below R$ 48 million in the preceding calendar year (or R$ 4 million times the number of calendar months, if it operated for less than 12 months).

Brazilian residents are taxed on their reported income and capital gains, whether earned in Brazil or abroad.

There are certain ceilings on setoff of tax losses. Past reported losses can only be carried over up to 30% of the taxable income ascertained in each year, there being no deadline for this carryover procedure.

Profits and dividends from Brazilian sources generated as from January 1, 1996 are tax-exempt.

Brazilian and foreign companies are accorded the same tax treatment. Therefore, the profits of branches of foreign companies in Brazil are automatically treated as constructive income, i.e. deemed at the disposal of the parent company, irrespective of whether or when these funds are remitted abroad.

A holding company is subject to the taxation system applicable to the corporations mentioned above. Income tax is payable only on direct income earned by the holding company, i.e. income from its business activities, since indirect income (i.e. profits earned by subsidiaries) has already been subject to corporate income tax.

Withholding Income Tax

The income, capital gains and other compensation paid, credited, delivered or remitted by paying sources in Brazil to foreign-based individuals or legal entities are subject to withholding

income tax (IRF) at a general rate of 15%. This rate is increased to 25% when such remittances refer to services or employment, or when the beneficiary is resident or domiciled in a country where income is not taxed or levied a maximum income tax below 20%.[23]

IRF is levied at a zero rate on corporate profits and dividends generated by Brazilian companies effective January 1996. Special rates also apply under double taxation treaties signed by Brazil.[24]

Transfer of Investments Abroad

Effective February 1, 2004, "a Brazilian-based individual or corporate buyer, or the attorney-in-fact of a foreign-based buyer, shall be responsible and liable for withholding and payment of income tax on the capital gains referred to in article 18 of Law No. 9249 of December 26, 1995, earned by a foreign-based individual or legal entity selling assets located in Brazil" (Law No. 10833 of December 29, 2003). Until then, the sale or disposal of assets or rights located in Brazil by foreign-based individuals or legal entities was not subject to income tax. The Federal Revenue Office issued Normative Ruling (IN) No. 407 on March 17, 2004, regulating said law. However, this taxation is still a debatable issue.

A foreign buyer may register its capital at the same amount attributable to the seller until then, irrespective of the price paid abroad for such investment. In this case, the registration number entered at the Central Bank RDE – IED mode should be changed to reflect the new foreign investor, so that the latter may remit/reinvest profits and repatriate its capital.

Social Contribution on Net Profits

The Social Contribution on Net Profits (CSL) applies to Brazilian companies (including financial institutions), and is calculated on the net profits before the allowance for income tax, adjusted by the additions, exclusions and offsettings prescribed by tax law. This tax base may be lowered by carrying over a negative tax base in past periods, capped at 30%.

CSL is levied on all profits, income and capital gains earned by Brazilian entities in Brazil and abroad (worldwide income taxation principle).

Constitutional Amendment No. 33 of December 11, 2001 introduced some changes in the tax system. According to such amendment, the export income should be exempt from quasi-tax social contributions as from December 12, 2001.

Despite the efforts of the federal tax authorities to defend a different stance, it stands to reason

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[23] ***According to Federal Revenue Office Normative Ruling (IN) No. 188 of 2002, the following countries are viewed as tax havens: Andorra, Anguilla, Antigua and Barbuda, Netherlands Antilles, Aruba, Commonwealth of the Bahamas, Bahrein, Barbados, Belize, Bermuda, Campione D`Italia, Channel Islands (Alderney, Guernsey, Jersey and Sark), Cayman Islands, Cyprus, Singapore, Cook Islands, Costa Rica, Djibouti, Dominica, United Arab Emirates, Gibraltar, Granada, Hong Kong, Lebuan, Lebanon, Liberia, Liechtenstein, Luxembourg (as regards holding companies governed, under Luxembourg laws, by the Law of July 31, 1929), Macaw, Madeira Island, Maldives, Malta, Isle of Man, Marshall Islands, Mauritius Islands, Monaco, Montserrat Islands, Nauru, Niue Island, Oman, Panama, St Christopher-Nevis, American Samoa, Western Samoa, San Marino, Saint Vincent and the Grenadines, Santa Lucia, Seychelles, Tonga, Turks and Caicos, Vanuatu, US Virgin Islands, and British Virgin Islands***

[24] For a list of countries, see the chapter on corporate law.

that the tax immunity established by such constitutional amendment also extends to CSL, as income is also part of the CSL tax base (as in the case of legal entities subject to the estimated profit taxation regime) and, besides, the profits earned by exporter companies paying CSL on taxable profits can only exist and be ascertained if there is any export income, which is in turn exempt from social security contributions under said constitutional amendment.

CSL is levied at 9% for all legal entities, including financial institutions. Since 1997 CSL is no longer deductible when computing the income tax base (actual profits).

Profit Participation Program Contribution and Social Security Financing Contribution

Effective February 1999, the Profit Participation Program Contribution (PIS) and the Social Security Financing Contribution (COFINS) are levied on the company's revenues, meaning all income earned under whatever accounting classification.

Law No. 10637 of December 30, 2002 introduced the PIS **non-cumulative** system, by which this quasi-tax contribution is levied at 1.65% only on the value added by the taxpayer at each stage of the production and commercial chain. Not all companies qualify for this non-cumulative system; some are still fully or partially subject to the PIS cumulative system, depending on the activity and type of income, as prescribed by law. The **cumulative** system follows the taxation rules set out in Law No. 9718 of November 27, 1998, adopting a flat PIS rate of 0.65%.

Law 10833/03 established the **non-cumulative** system for COFINS, applying at a rate of 7.6% on taxable events as from February 1, 2004. As a trade-off for this non-cumulative system, however, the lawmaker allowed the use of credits (most of them relating to acquisition of goods and services necessary for the company's core activity).

The new COFINS system does not apply to all legal entities or any type of income. As in the PIS contribution, a company's activities may call for full or partial adoption of the erstwhile cumulative system for COFINS as prescribed by law. The **cumulative** system follows the taxation rules set out in Law 9718/98, and is levied at a flat rate of 3%.

Effective May 1, 2004, the levy of PIS and COFINS extended to imports of foreign products and services, known as "PIS – Imports" and "COFINS – Imports" (Provisional Measure No. 164, subsequently passed into Law No. 10865 of April 30, 2004). These quasi-tax contributions are triggered by: **(a)** entry of foreign goods in the Brazilian territory; or **(b)** payment, credit, delivery, use or remittance of funds to foreign-based persons in consideration for services rendered.

The services triggering the levy of PIS – Imports and COFINS – Imports are those originating abroad and provided by a foreign-based individual or legal entity, encompassing those **(a)** rendered in Brazil or **(b)** whose results are felt in Brazil, even if performed abroad.

In these cases, PIS and COFINS are paid by **(a)** the importer, meaning the individual or legal entity that brings the goods into the Brazilian territory; **(b)** an individual or legal entity retaining services from a foreign-based resident; and **(c)** the service beneficiary, if the principal is also resident or domiciled abroad.

The tax base for these quasi-tax contributions is as follows: **(a)** *upon import of goods*: the customs value on which Import Duty (II) is or would be assessed, plus the II and ICMS values, in addition to the value of the contributions themselves; or **(b)** *upon hiring of services abroad*: the amount paid, credited, delivered or remitted abroad, before income tax but including the ISS value and the contributions themselves.

As a rule, PIS – Imports and COFINS – Imports adopt the same rates as those charged under the non-cumulative taxation system.

These contributions are due: **(a)** on the date of registration of the Declaration of Import (DI), in case of imports of goods; **(b)** on the date of payment, credit, delivery, use or remittance, for service imports or under specific circumstances; and **(c)** on the date of expiration of the period of stay at a bonded warehouse.

As for legal entities qualifying for the non-cumulative taxation regime, these quasi-tax contributions on imports may translate into credits for future setoff against these contributions levied on the income from sale of the respective products and services in Brazil. This credit is calculated – at the same rates adopted for the other assessment events – on the tax base for PIS – Imports and COFINS – Imports, in addition to the value of these same contributions, plus the IPI on imports (when the last-named is a part of the acquisition cost). Unused credits may be carried forward to subsequent months.

This credit only applies to contributions on imports of goods intended for further resale or goods and services serving as inputs on the manufacture of goods or provision of services intended for sale. Tax-exempt imports also qualify for these credits, unless the goods imported are used as inputs for products or services not subject to these contributions, or else taxed at a zero rate or exempt.

These tax credits cannot be offset against quasi-tax contributions payable on **(a)** income earned from resale of goods, when such contribution is payable by the selling company as a tax substitute; **(b)** the proceeds of product sales subject to one-time taxation; and **(c)** income not subject to the non-cumulative tax system.

The Executive Branch may lower these rates to zero and reestablish the rates of PIS – Imports and COFINS – Imports on certain chemicals and pharmaceuticals. In addition, these contributions are assessed at a zero rate on some products, such as printing paper or machinery and devices for the movie industry.

Provisional Contribution on Financial Transactions

The Provisional Contribution on Financial Transactions (CPMF) is levied at 0.38% on financial

transactions between individuals and legal entities.

These financial transactions encompass the transfer or circulation of cash, credits and financial rights, as well as any amount settled or charged by financial institutions, even those entailing a book-entry circulation of currency only, and irrespective of transfer of title to such cash, credits or rights.

Some activities are exempt from CPMF or taxed at a zero rate, such as the amounts transacted through deposit accounts held by financial institutions in relation to some core activities.

Effective August 1, 2004, an investment deposit account will be available in financial institutions and other entities accredited with the Central Bank, through which investments may be transacted without the levy of CPMF.

Tax on Manufactured Products

The Tax on Manufactured Products (IPI) is assessed on the manufacture of domestic products as well as on the imports of foreign products. IPI is paid by the respective manufacturer and/or importer.

The IPI tax paid on raw materials, work in process and packaging material, among other items, may serve as a tax credit. IPI is non-cumulative, and the taxpayer may reduce this tax charged on its transactions by the tax already paid in past stages of the production chain.

Decisions handed down by regional federal courts in several circuits, and later upheld by the Federal Supreme Court, have consolidated the stand that IPI credits arise from the acquisition of inputs that are **(a)** tax-exempt, **(b)** subject to a zero rate, or even **(c)** not subject to IPI taxation. However, entitlement to these credits is not acknowledged by law, which has prompted a slew of court disputes over this issue.

The IPI rate varies per type of product. The Federal Executive establishes the IPI rates by decree. Currently, the higher IPI rates are reserved for non-essential items, such as cigarettes, liquor, cosmetics, and the like.

The no same-tax-period taxation principle does not apply to IPI tax, which can thus be created or increased in the financial year already in course.

Tax on Financial Transactions

The Tax on Financial Transactions (IOF) is a federal tax levied on:

(i) credit transactions made by financial institutions;

(ii) intercompany loans between non-financial companies;

(iii) loans between individuals and legal entities (the latter acting as borrowers);

(iv) exchange transactions made by institutions authorized to deal in exchange;

(v) insurance transactions made by insurance companies; and

(vi) securities transactions, when performed by institutions authorized to operate on the securities market.

The IOF rate varies per type of transaction, and is currently capped at 1.5% per day on the credit transaction value. A lower IOF rate is prescribed by tax law for a number of transactions. IOF is assessed at a zero rate on certain events, including export credit, support and improvement transactions, or rural credit, investment and support transactions.

The IOF on foreign exchange transactions is levied at different rates per type of deal, at a maximum rate of 25%. Lower rates apply in the following events, among others:

(i) 2% for forex transactions carried out by credit card companies and other institutions with regard to acquisition of products and services abroad by the respective members; and

(ii) 5% for the sums brought into Brazil deriving from or intended for loans with an average repayment period of up to 90 days.

Presently, most currency inflows and outflows are subject to IOF tax at a zero rate. These transactions comprise, among others: **(a)** payments of forex contracts relating to service imports; **(b)** payments remitted abroad under technology transfer agreements registered with the National Industrial Property Institute (INPI); or **(c)** payments of imported products.

The no same-tax-period taxation principle does not apply to IOF tax, which can thus be created or increased in the financial year already in course.

Contribution on Economic Activities

Currently, there are two types of Contribution on Economic Activities (CIDE):

(A) CIDE on Overseas Remittances

This CIDE is assessed on remittances overseas relating to payment of copyrights, trademark and patent royalties, technical services and assistance, administrative support, and related activities. As a rule, the Brazilian company figures as taxpayer of this CIDE tax, which is levied at up to 10% on the amounts remitted overseas. This contribution usually escapes the provisions set forth in the international double taxation treaties to which Brazil is a signatory.

(B) CIDE on Fuels

The CIDE is assessed on imports and sales of oil and byproducts, natural gas and derivatives, and fuel alcohol, as follows:

(i) gasoline: R$ 860.00 per cubic meter;

(ii) diesel oil: R$ 390.00 per cubic meter;

(iii) aviation kerosene: R$ 92.10 per cubic meter;

(iv) other kerosene: R$ 92.10 per cubic meter;

(v) fuel oils with high sulfur content: R$ 40.90 per ton;

(vi) fuel oils with low sulfur content: R$ 40.90 per ton;

(vii) liquefied petroleum gas, including natural gas and naphtha derivatives: R$ 250.00 per ton; and

(viii) fuel alcohol: R$ 37.20 per cubic meter.

The CIDE levied on liquid hydrocarbons not intended for use in gasoline or diesel oil may be offset against both the CIDE tax payable on imports or sales in the domestic market and the PIS and COFINS assessed on domestic sale of these products.

Transfer Pricing

As already mentioned, IR and CSL are assessed on the net profits duly adjusted by additions, exclusions and offsetting under tax laws. Transfer pricing rules stand as one of these adjustments, and are intended to avoid the transfer of results overseas by way of price manipulation in product or service imports or exports between related or affiliated companies.

Transfer pricing rules seek to ensure that the prices adopted in cross-border transactions between related parties will be determined on an arm's length basis and on market conditions, thus avoiding the manipulation of prices for the transfer of revenues abroad.

By the same token, in the imports carried out by Brazilian legal entities, it must be checked whether prices were determined on usual market conditions. The Brazilian tax authorities set certain limitations on allowable expenses, the reason why any excess price must be added to the Brazilian company's taxable profits.

As for exports, transfer pricing rules are adopted to check whether the prices paid to Brazilian

companies are not substantially lower than those adopted on usual market conditions. In these cases, the Brazilian tax authorities set minimum values to be posted by the Brazilian company as taxable income from transactions involving the sale of products or the provision of services to foreign related parties.

State Taxes

Tax on Distribution of Goods and Services

The Tax on Distribution of Goods and Services (ICMS) is figured on the circulation of goods (thus covering the entire chain of trades from the manufacturer to the end consumer) and on the provision of intrastate and interstate transportation and communications services. As a rule, the transaction value serves as the ICMS tax base. ICMS is paid by the trader or provider of carrier/communications services. ICMS is a non-cumulative tax and, as such, generates a tax credit to be offset by the product or service recipient against the tax payable on future transactions. Each Brazilian state is free to establish its own ICMS rates. Generally, intrastate transactions are taxed at a 17-18% rate. Interstate transactions are taxed at fixed rates determined by the Federal Senate. As a result, ICMS applies at a rate of 12% on the transactions directing products and services to the Brazilian states in the South/Southeast regions (except the Brazilian state of Espírito Santo); and 7% on the transactions directing products and services to the Brazilian states in the North, Northeast and Center-West regions (including the Brazilian state of Espírito Santo).

ICMS tax exemptions, breaks and incentives are granted or cancelled via agreements (known as *convênios*) entered into between the Brazilian states. However, these states usually grant ICMS tax breaks and incentives to attract investments, without the consent of other states.

Exports are not subject to ICMS.

Estate and Gift Tax

The Estate and Gift Tax (ITCMD) is a non-progressive tax figured on the value of goods and rights conveyed by donation or estate succession, at a rate to be determined by each Brazilian state (capped at 8%, as determined by the Federal Senate). In the state of São Paulo, for example, the ITCMD is levied at a rate of 4%.

According to the Federal Constitution (which entrusted the Brazilian states with authority to assess ITCMD), this tax is payable to the state of the donor's domicile in case of donation or conveyance of title to movable properties, instruments or credits. If these assets originate from inheritance, ITCMD is payable to the state where the probate proceedings are processed. The tax figured on the transfer of real properties and attaching rights is payable to the state where these assets are located.

Municipal Taxes

Tax on Services

The Tax on Services (ISS) is assessed on the services provided by a company or independent contractor or professional, in accordance with a list of services attached to a federal supplementary law. This tax is figured at a rate of 2-5% on the service value.

The list of eligible services is attached to Supplementary Law No. 116 of July 31, 2003. This law updated the erstwhile list of services prepared in 1987, which lagged behind a slew of services that followed the technology improvements over the last two decades. Besides increasing this list, Supplementary Law 116/03 innovated by levying ISS on service imports. In these cases, if ISS cannot be charged directly to the foreign service provider, the service recipient will be responsible for payment of such tax.

Inter-Vivos Property Transfer Tax

The Inter-Vivos Property Transfer Tax (ITBI) is a municipal tax assessed on the conveyance of title to real properties and related rights, at a rate ranging between 2% and 6% as determined by each municipality (in the City of São Paulo, ITBI is figured at 2%). The taxpayer is the buyer of real property or related rights. According to the Federal Constitution, no ITBI is payable on the conveyance of real properties or rights contributed to a company's capital stock or resulting from merger, consolidation, spin-off or winding-up of a legal entity, unless the buyer's core activity is the purchase and sale, lease or rental of real properties and related rights.

Urban Land and Building Tax

The Urban Land and Building Tax (IPTU) is assessed on direct or beneficial ownership and possession of urban properties. In fact, IPTU corresponds to two different taxes: **(a)** a building tax levied on direct or beneficial ownership and possession of real properties located in urban areas; and **(b)** an urban land tax levied on direct or beneficial ownership and possession of land in urban areas.

IPTU is figured annually on the assessed value of the real property, at a progressive rate to be determined by the value, use and location of said property.

In the City of São Paulo, IPTU is levied at 1% on the assessed value of real properties solely or primarily intended for residential use, after applying a discount or premium vis-à-vis the actual value assessed for the real property. For other uses, the IPTU rate is 1.5%. As for the urban land tax, the City of São Paulo has set it at 1.5% on the assessed value of the property.

Foreign Trade

Brazilian foreign trade policies are established by the Federal Government. The entry of foreign products for domestic consumption is subject to the MERCOSUR rules and to the Common

External Tariffs (TEC), under the codes prescribed by the Common Mercosur Nomenclature (NCM).

Import Duty (II) rates for most products range between 0% and 35% (the import policy implemented by the Federal Government is prone to lower these rates to 14% on average).

II is usually figured on the customs value plus insurance and freight (CIF). II is not subject to the no same-tax-period taxation principle; hence, the Federal Government may change the II rates at any time in the course of the same financial year. This flexibility over II rates operates as an effective tool for foreign trade control in Brazil.

Save for a few exceptions, the import of products with domestic comparable items may not enjoy certain tax or foreign exchange incentives; the Foreign Trade Office (SECEX) is to determine whether these local comparable products exist (usually based on consultations with Brazilian manufacturers). A product made in Brazil is deemed comparable to a foreign counterpart if they are substitutable in terms of quality, price and delivery terms.

Imports are also subject to IPI and ICMS. Under special conditions, some products qualify for tax exemptions, breaks and incentives with regard to IPI and/or ICMS.

A federal Export Duty (IE) applies when products made in Brazil or with a domestic content exit the Brazilian territory. IE is figured on the export value (or, in the absence of such value, on the ordinary price that the product or comparable item would reach at the time of exports on ordinary international market conditions).

When determining the IE tax base, the selling price for exported goods cannot be lower than their acquisition or production cost plus taxes and quasi-tax contributions and a 15% markup on the overall cost and taxes.

IE is assessed at 30%, but the Federal Government may lower or increase it up to 150%. The Executive Branch – through the Foreign Trade Chamber (CAMEX) – defines the products that are subject to IE and the respective rates (when these rates differ from the general rule set out above).

According to the current Federal Government's policy of encouraging Brazilian exports, IE is levied at a zero rate on most products.

Drawback

Drawback – an export incentive governed by Decree No. 4543 of December 26, 2002, as amended (Customs Rules) – consists of a non-assessment, exemption or refund of taxes assessed on the imports of goods employed in the processing of products for further export. The following taxes and duties qualify for the drawback system:

(i) II;

(ii) IPI;

(iii) ICMS; and

(iv) Freight Surcharge for Renewal of the Brazilian Merchant Marine (AFRMM).

This drawback system applies in three distinct manners, namely:

(i) **non-assessment** of taxes figured on the import of products to be later exported after value is added to them in Brazil, or else intended for the manufacture, supplementation or packaging of other products for export;

(ii) **exemption** of taxes assessed on the import of goods in a volume and quality equivalent to those employed in the improvement, manufacture, supplementation or packaging of products for export; and

(iii) **refund** of all or a portion of the taxes paid on the import of goods to be later exported after value is added to them, or else intended for the manufacture, supplementation or packaging of other products for export.

This benefit applies, among others, to:

(i) goods to which value is added in Brazil for further export;

(ii) raw materials, work in process or finished products used in the manufacture of goods for export;

(iii) parts, assemblies, devices, machines, vehicles or equipment for export;

(iv) goods intended for packaging, packing or presentation of products for export; and

(v) animals for slaughtering and further export.

The following do not qualify for the drawback system:

(i) import of goods utilized in the manufacture of products for consumption within the Manaus Free Trade Zone (ZFM) and free trade areas;

(ii) import or export of suspended or prohibited goods;

(iii) exports payable in Brazilian currency;

(iv) export carried out in non-convertible currencies and the like against imports carried out in freely convertible currencies; and

(v) import of oil and byproducts.

Drawback is available to companies authorized to deal in foreign trade. As for companies that only engage in the trading of said products, the last-named must have been manufactured to order at an industrial establishment for the account of a drawback beneficiary for further export.

(A) Drawback – Non-assessment

To obtain drawback for non-assessment of duties, a company must file a claim at the Foreign Trade Office. The drawback system will be valid for one year, extendable only once for an equal period, except where goods are imported for production of capital goods involving a long-cycle manufacturing process, when it will be valid for up to five years.

The goods eligible to this drawback system must be fully utilized in the production process or in the packaging, packing or presentation of goods to be exported. When these goods are not fully or partially used in the manufacturing process, or else, are used in a manner inconsistent with the drawback rules, they must be repatriated, re-exported, destroyed or even used for consumption upon payment of the duties that had been suspended, plus statutory charges.

(B) Drawback – Exemption

The Foreign Trade Office is also in charge of approving drawbacks for exemption of duties. Any interested party must prove that processing, manufacture, supplementation or packaging of the exported products have utilized imported goods of the same quality and quantity as those for which exemption is being claimed. The approval must state the price and specification of the exported goods, as well as the specification, tax code and unit price of the merchandise to be imported.

(C) Drawback – Refund

Drawback for refund of duties falls within the authority of the Federal Revenue Office, and may cover all or a portion of the duties paid upon import of the goods exported after their processing or used in the manufacture, supplementation or packaging of other items for export. To qualify for this type of drawback, any interested party must evidence that the exported products were processed, manufactured, supplemented or packaged with the use of the imported merchandise.

Export Processing Zone

The Export Processing Zone (ZPE) is a free-trade area delimited and regulated by Decree-law No. 2452 of July 29, 1988 (as amended). It is slated for the setup of companies engaging in the manufacture of goods to be later exported for sale abroad only.

ZPE is created by means of a Decree. The states and municipalities forward a joint or separate proposal indicating, among others, a proper ZPE location that gives access to international airports and ports, in addition to evidencing the minimum infrastructure and services available in the region. This proposal is reviewed by the National Council for Export Processing Zones (CZPE).

In order to set up in ZPE, a company must submit a project for CZPE approval, and its corporate purpose must contemplate only the business of manufacturing for further export.

Under applicable legislation, the ZPE companies are not allowed to organize branches or participate in other companies located outside ZPE. Companies submitting projects for mere transfer of industrial plants already established elsewhere in Brazil are not allowed to set up in ZPE. A company established in ZPE is not authorized to manufacture, import or export:

(i) weapons or explosives;

(ii) radioactive materials; and

(iii) oil and its by-products.

Once the applicable legal requirements have been observed, the import and export activities carried out by ZPE companies will be exempt from the following taxes:

(i) IPI;

(ii) II;

(iii) AFRMM; and

(iv) IOF.

The benefits granted to companies authorized to set up in ZPE will be valid for up to 20 years, renewable for equal successive periods, provided that the company evidence that the objective and requisites described in its original project have been fulfilled.

The services performed in ZPE are afforded a specific treatment under the law:

(i) the services performed by a ZPE company will be deemed to have been provided abroad;

(ii) the services performed to a ZPE company by a foreign-based person will be deemed to have been provided abroad;

(iii) the services performed to a ZPE company by a Brazilian-based person will qualify as an export of services, except for those performed under a concession granted by the public authorities or under an employment contract.

The ZPE companies will pay income tax in accordance with the legislation applicable to other Brazilian-based companies, as in effect on the date of signing of the respective commitment for setup in ZPE. However, a more favored legal treatment may be subsequently adopted. The ZPE companies are exempt from income tax on remittances and payments made in any way to foreign-based persons.

The ZPE companies failing to comply with applicable legislation may be imposed penalties in the form of warnings, fines and even cancellation of the authorization to operate in ZPE.

Investment Incentives

There are some situations in which a company or its shareholders can obtain tax incentives from government agencies. Brazilian economic policy adopts the constitutional principle by which small businesses and small-sized companies incorporated under the laws of Brazil, and headquartered and managed in Brazil, are to be offered favored tax and legal treatment and simplified tax procedures under the law.

An example of this favored treatment was the creation of the Integrated System for Payment of Taxes and Contributions of Small Businesses and Small-sized Companies (*Sistema Integrado de Pagamento de Impostos e Contribuições das Microempresas e das Empresas de Pequeno Porte* – SIMPLES). SIMPLES consists of a differentiated, simplified and favored tax system available to companies qualified as small businesses (ME) and small-sized companies (EPP) under Law No. 9317 of December 5, 1996, as subsequently amended and regulated, in line with article 179 of the Federal Constitution. It offers a simplified and unified method for payment of taxes at favored and progressive rates to be levied exclusively on the company's gross income.

For the purpose of taxation by SIMPLES, ME stands for any legal entity reporting an annual gross income equal to or lower than R$ 120 thousand, whereas EPP stands for any legal entity reporting an annual gross income between R$ 120 thousand and R$ 1.2 million.[25]

Gross income comprises the proceeds from the provision of services or the sale of goods and services in transactions carried out on one's own account or on behalf of third parties, excluding, however, cancelled sales and unconditional discounts. For the purpose of SIMPLES, gross income does not include the net gains derived from fixed- and variable-income investments or the non-operating results from capital gains in the sale of assets.

As a rule, the executive branches of the Federal Government, the States, the Federal District and the Municipalities have authority to grant incentives in Brazil. These incentives consist of a continually-changing package of subsidized financing, tax credits and tariff exemptions, created to promote the economic development of certain areas of the country, or to channel private capital into specific economic activities.

For incentive purposes, investment projects are approved on a case-by-case basis by the relevant government agency. Incentives include an exemption from taxes for a specific period of time, subsidized credit from governmental development banks, and the privilege of importing capital goods duty-free, or at sharply reduced tariff rates.

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[25] ***These limits and amounts refer exclusively to the taxation of ME and EPP by SIMPLES. For all other purposes, ME and EPP are governed by Law No. 9841 of October 5, 1999, article 2 of which provides for limits and amounts other than those indicated above. As per the amounts updated by Decree No. 5028 of March 31, 2004: (i) ME is defined as a company or entrepreneur reporting an annual gross income equal to or lower than R$ 433,755.14; and (ii) EPP stands for a company or entrepreneur that falls outside the definition of an ME and has an annual gross income between R$ 433,755.14 and R$ 2,133,222.00.***

Manaus Free Trade Zone

The Manaus Free Trade Zone (ZFM) was created and regulated by Law No. 3173 of June 6, 1957 and Decree-law No. 288 of February 28, 1967, respectively. ZFM is administered by the Manaus Free Trade Zone Authority (SUFRAMA).

ZFM is an import free-trade area, and offers special tax incentives. It was conceived to maintain an industrial, trade and farming center in the Amazon region, with economic conditions that will foster the Amazon development, thereby overcoming certain local difficulties as well as the great distance between the production sites and consumers.

Special ZFM tax incentives are warranted under the Constitution until 2013, which may be extended by the Federal Government.

The ZFM production capacity has contributed to foster the Gross Domestic Product (GDP) in Brazil. In 2003, the trade balance in the Manaus industrial hub totaled US$ 4.45 billion, whereas in February 2004 the trade balance already reached US$ 739 million.

With a few exceptions, the export of domestic products for consumption or manufacture in ZFM and re-export of these products are afforded the same tax treatment as any other exports to other countries. Export of the ZFM products to other countries, in turn, is exempt from IE.

Under Law No. 10865 of April 30, 2004, the IPI and II tax benefits granted to companies set up in ZFM also cover contributions levied on imports such as PIS –Imports and COFINS – Imports.

ZFM is of paramount importance for the growth of the Western Amazon, while offering attractive incentives and interesting conditions for joint ventures.

Setup of Companies

In order to set up in ZFM, a company must submit an industrial project schedule to SUFRAMA. If approved by the SUFRAMA Board of Directors, the company must send to SUFRAMA the definitive industrial project and the architectural plan.

SUFRAMA has adopted a basic production process (PPB), consisting of a detailed description of the several phases of the manufacturing process, to be followed by all companies applying for tax benefits in ZFM. This is to avoid having ZFM become a simple warehouse for the assembly of imported products, taking undue advantage of tax exemptions, as well as to augment the domestic content of goods produced in ZFM.

A company is authorized to set up in ZFM and enjoy tax incentives after being approved by the SUFRAMA Board of Directors.

Tax Incentives

The companies set up in ZFM are eligible for exemption from or reduction in the following taxes:

(i) Import Duty (II) on products intended for ZFM consumption or on inputs used for products manufactured in ZFM when they are shipped to other points in Brazil;

(ii) Tax on Manufactured Products (IPI) on foreign products intended for consumption or manufacture in ZFM, and on goods produced in ZFM intended for consumption in ZFM or elsewhere in Brazil;

(iii) Income Tax (IR) for undertakings approved by the Amazon Development Authority, in the amounts and for the periods prescribed by tax laws;

(iv) Tax on Distribution of Goods and Services (ICMS) for products from other states that are slated for consumption or manufacture in ZFM. Additionally, the companies may have an ICMS credit with regard to products from other Brazilian states, and refund of the variable ICMS portion for industrial undertakings approved by the Amazonas State Finance Office; and

(v) Tax on Services (ISS) for companies providing services under projects approved by the Manaus City Hall.

INTELLECTUAL PROPERTY©

Brazilian protection to intellectual property rights is established in the Federal Constitution and in various federal laws and international treaties signed and confirmed by Brazil. Intellectual property encompasses copyrights and related rights, protecting literary, artistic and scientific works, as well as industrial property rights intended for industrial and commercial use of inventions, trademarks, patents and industrial designs.

The Brazilian legislation on intellectual property is relatively recent, and already conforms to the minimum standards established by the Trade Related Aspects of Intellectual Property Rights (TRIPS), an international treaty entered into by the members of the World Trade Organization (WTO) and incorporated into Brazilian regulations by Decree 1355/94.

Besides TRIPS, Brazil signed and confirmed the major international treaties relating to intellectual property rights, including:

(i) Paris Convention of 1883, revised in Stockholm in 1967, which features industrial property protections;

(ii) Berne Convention of 1886, revised in 1971, which features copyrights protection;

(iii) Rome Convention of 1961, which features protection to singers and other artists, producers of phonograms and broadcasting organizations; and

(iv) Patent Cooperation Treaty (PCT).

INDUSTRIAL PROPERTY

The protection accorded to industrial property rights under Law 9279/96 (Industrial Property Law) comes effective through the granting of trademarks, patents, utility models, industrial designs, and prohibition against false geographical indications and unfair competition. Such law introduces certain innovative concepts, such as the granting of patents for prescription drugs, chemicals, pharmaceuticals and food products, and the acknowledgment of rights inherent to well-known trademarks (Article 6*bis* of the Paris Convention).

Company names are also protected as industrial property, but are regulated in specific rules.

The Brazilian Industrial Property Institute (INPI) is the government agency in charge of issuing and enforcing the rules on industrial property rights, as well as of carrying out a formal review of the applications for trademark registration, geographical indications and patent grants.

Trademarks

Protection of trademarks in Brazil follows an attributive system, which means that all rights

stem from registration of the respective trademark in Brazil. However, trademarks well known in their respective sphere of activities are warranted protection under Brazilian law, irrespective of registration in Brazil, pursuant to the Paris International Convention and the Industrial Property Law.

In Brazil, registration may be applied for as a Brazilian or foreign trademark. Foreign trademarks are recorded under the terms of the Paris Convention, which grants a priority period of six months counting from the date of application in the country of origin for their owners to apply for registration of the same trademarks in other member countries (as in the case of Brazil).

A Brazilian trademark is a trademark applied for by a Brazilian or foreign company to distinguish products or services germane to its activities. We will discuss this concept further below.

The major point in registering a trademark within the priority period set out by the Convention is that the date of filing in the country of origin will also be valid in Brazil. If a trademark is applied for in Brazil by a foreign person without a priority claim under the Paris Convention, the trademark will be treated as Brazilian, and the Convention benefits will not apply.

The following documentation must be submitted when applying for registration of foreign trademarks in Brazil:

(i) power of attorney, including express powers for the attorney-in-fact to receive service of process relating to any suits filed against the owner of such trademark in Brazil;

(ii) certified copy of the application for registration or certificate of trademark registration in the country of origin, if a priority claim is filed;

(iii) affidavit stating that the applicant is a company legally organized in its own country, and specifying the activities performed by it, which must be directly related to the products/services for which it intends to obtain registration in Brazil; and

(iv) samples of the trademarks to be registered, if they are composed of symbols, drawings, colors, or stylized letters.

Registration of a Brazilian trademark may be applied for by a Brazilian or foreign interested party; the trademark application and registration will follow the procedures set forth in the Industrial Property Law.

Use of a trademark is essential for its protection in Brazil; if a trademark is not used for five years after its registration, or if such use is interrupted for more than five consecutive years, forfeiture of the trademark will occur. If the trademark is used by its owner or a licensee in Brazil, registration will be valid for ten years; this protection may be renewed for like successive periods.

Under the Industrial Property Law, several conducts are viewed as a crime against trademarks, punishable by imprisonment from one through three months, and from three months through

one year, or fine, as applicable.

Company Name

In addition to marks, the Brazilian legal system also provides protection to company names. As a rule, protection elicits from the filing of the company's acts of incorporation with the competent body. Furthermore, the Paris Convention establishes that company names will be protected in all countries of the Union, irrespective of registration.

Patents and Utility Models

Under the Industrial Property Law, the essential conditions for granting of patents in Brazil are: novelty, inventive activity, and industrial use. Moreover, an item of practical use, or any part thereof, is patentable as a utility model, provided that it is susceptible of industrial use, presents a new shape or layout, and involves an inventive act that results in functional improvement in terms of use or manufacture.

A patent is deemed new whenever its subject matter is not included in the prior art, meaning that it was not previously accessible to the public either by written or oral description, or by use or other means, including the contents of patents in Brazil and abroad, before filing of the patent application. This will not apply to those cases in which a priority claim was applied for beforehand or otherwise evidenced under the Paris Convention.

The protection afforded by a patent is valid for 20 years (for inventions) or 15 years (for utility models), counting from the date of filing of the application at INPI.

Patent applications to INPI must contain: the inventor's claims; a complete description of the invention and a drawing (if appropriate); and evidence of compliance with all legal requirements. After the application is filed, a preliminary formal review will be carried out, and a filing certificate will then be issued. This application will be kept in secrecy for 18 months, and will then be officially published. The inventor will have 36 months to request a formal review of the application. If no such request is made, the application will be dismissed. The letter patent will be issued after granting of the patent application, and may be canceled by court order at any time.

Commercial use of a patent must begin within three years of issuance of the respective letter patent, on pain of compulsory licensing or forfeiture of the corresponding patent. Forfeiture of a patent may also occur if its use is interrupted for a period of at least two consecutive years; if the inventor fails to pay the respective annuity fees to INPI; if the inventor expressly waives his privilege; or if the patent is canceled through judicial or administrative channels.

Under the Industrial Property Law, several conducts are held as a crime against patents, punishable by imprisonment from one through three months, and from three months through one year, or fine, as applicable.

Unfair Competition

In addition to protection specifically granted to trademarks, patents, utility models and industrial designs, the Industrial Property Law criminalizes unfair competition acts, punishable by imprisonment from three months through one year, or fine. Such offense must be grounded on unquestionable proof of one's intention to discredit another's business or reputation; to create confusion with other commercial and industrial establishments or service providers; or to create confusion with third-party goods and businesses available on the market. Unfair competition entitles the aggrieved party to seek redress in the civil sphere and impose criminal liability on the offender.

Among other events, unfair competition is asserted against whoever:

(i) publishes, gives or discloses a false statement on a competitor, to one's own advantage;

(ii) uses fraudulent means to divert, for one's own or someone else's benefit, clientele of another;

(iii) uses or imitates an advertising slogan or sign of another, so as to cause confusion with its products or establishments;

(iv) misuses another's business name, company name or insignia, or sells, displays, offers for sale or maintains in stock a product with such references;

(v) sells, displays or offers for sale, in another's container or wrapper, an adulterated or counterfeited product, or trades it for another product of the same type, even if not adulterated or counterfeited;

(vi) gives or promises money or other assets to employees of a competitor, encouraging such employees to neglect their duties to the detriment of the competitor;

(vii) receives cash or other assets, or accepts a promise of payment or reward to neglect one's duties as an employee to the benefit of a competitor of one's employer; and

(viii) makes unauthorized disclosure**,** exploitation or use of any confidential matter, information or data used in industry, trade or service activities, to which he had access as a result of a contractual or employment relationship, even after termination of the corresponding contract, except for any matter, information or data that is available to the public or is clearly available to an expert on the matter;

If unfair competition is held to occur, the Industrial Property Law authorizes the aggrieved party not only to pursue the applicable civil measures for cessation of this offense and redress of damages, but also to seek reparation for other unfair competition practices that may taint the reputation of third-party business or create confusion between competitors and/or their products.

TECHNOLOGY TRANSFER & PATENT, TRADEMARK AND FRANCHISE LICENSE AGREEMENTS

Technology transfer and patent, trademark and franchise license agreements must be filed with INPI. The INPI review of agreements dealing with the licensing of industrial property rights, trademarks, patents, technology transfers, and technical assistance and related services is currently limited to (i) the aspects inherent to the documents submitted for review; (ii) compliance with tax; (iii) observance of currency control policies; and (iv) the breach of unfair competition or antitrust rules.

INPI approval for such agreements is essential not only for Central Bank registration (making overseas remittance of payments feasible), but also for the technology recipient or licensee to post the amounts so disbursed as allowable expenses. Moreover, only after the respective approval will such contracts be binding on third parties.

As a rule, technology transfer agreements must specify their object and clearly describe the method to be adopted for actual transfer of technology. Patent or trademark license agreements must set out the conditions for actual use of the patents regularly filed or granted in Brazil or for the licensing of the respective trademark or application in Brazil.

Patent and trademark license agreements must also specify whether the license is granted with exclusivity on a remunerated or royalty-free basis, and if sublicensing is allowed. The term of effectiveness of such agreements cannot exceed the validity of the patent or trademark registration.

Technical and scientific assistance service agreements must specify the period for the rendering of specialized services; the number of technicians involved; the degree of expertise and training programs; and the agreed compensation.

Franchise agreements must also be filed with INPI, and their validity is primarily dependent on two aspects, namely: (i) temporary granting of the rights that involve, together with use of the respective trademarks, the rendering of technical assistance services or other technology transfer mechanisms necessary to achieve the respective goals; and (ii) the flat or floating fee payable by the franchisee to the franchisor, calculated at a percentage of sales or of the price for each unit sold or purchased by the franchisee from its suppliers, on the profits earned, or on a flat amount.

COPYRIGHTS

Copyrights in Brazil are regulated by Law No. 9610 of February 19, 1998, pursuant to which all creative works of inspiration however outwardly expressed are protected as intellectual property.

Copyrights are divided into moral and pecuniary rights. Moral rights ensure that the work is bound to the identity of its author, and are not transferable. Moral rights of the author include, among others: (i) the right to claim authorship of the work at any time; (ii) the right to have his name stated on the work in connection with any use thereof, (iii) the right to object to any

modification of the work that would be prejudicial to the author's reputation or honor.

Pecuniary rights are those related to use, enjoyment and disposal of an intellectual work. These rights are transferable to third parties, including to legal entities.

The author of the work or, in the absence of proof to the contrary, the person who purports to be the author, or the person whose name is included on the work, is deemed to be the copyright owner under Brazilian law.

Any person who adapts, translates, compiles or edits a work in the public domain may claim copyright to such work, but this same person cannot prevent publication of another adaptation, translation, compilation or edition of the same work.

Either a person or an entity may own copyrights, subject to the authorization or assignment by the respective author.

Registration of copyrights in Brazil is optional, and not essential for its protection. However, in order to secure his rights and to evidence ownership, an author may register his works at specific agencies.

Civil and criminal actions may be brought against anyone infringing another's copyrights. The civil courts prohibit the publication of any work that infringes copyrights, and may also award damages to the copyright owner. Copyright infringement is also punishable as a criminal offense.

SOFTWARE

In Brazil, software is regulated by Laws Nos. 9609 (Software Law) and 9610 (Copyright Law), both dated February 19, 1998, which provide for, among other issues: (a) the protection of software as an intellectual property right; (b) the software marketing rules and the creation of mechanisms to keep governmental control over such marketing activities, with a view to protecting software rights in Brazil; and (c) the criminal penalties that are to apply in the event of copyright infringement along with certain marketing rules related to software protection.

Software rights are protected for a period of 50 years as from January 1st of the year following publication of the software or, in the absence of such publication, as from creation of the software in each country. As in the case of copyrights, foreign-based owners of software are also entitled to protection in Brazil, provided that the country of origin of such owners offers reciprocal treatment (in terms of extent and duration) to Brazilians and foreigners domiciled in Brazil.

Software protection is not conditional on registration in Brazil; accordingly, the author need not

register such software to claim ownership rights. Nevertheless, the software may be registered with INPI.

Infringement of software copyrights is punishable by confinement from six months to two years, or a fine.

According to the Software Law, the following events (among others) do **not** characterize an offense against software copyrights:

- reproduction of a copy that was legally acquired, whenever indispensable for proper use of the software; and

- integration of software and its basic characteristics into an application or operating system, if technically indispensable for the user needs, and provided that it is used exclusively by the person that actually effected such integration.

Final Comments

As shown above, the Brazilian legal system offers an array of rules aimed at protecting intellectual property rights.

In addition to the events set out above, the Industrial Property Law protects industrial designs and curbs false geographical indications.

Moreover, the Brazilian legal system protects the so-called personality rights, as in the case of the right to one's image, which is inviolable under the 1988 Constitution.

It is also worth noting that, even though the Brazilian legal system contains no rules exclusively focusing on Internet relations and acts, some legal provisions protect intellectual property rights against their unauthorized dissemination or use through new technologies, including the Internet.

Finally, advertising is also regulated in Brazil by the National Self-Regulatory Advertising Council (Conar). This entity lays down the ethical standards to be followed in advertising, and may even be called to action when unfair competition practices are conducted by way of advertisements.

COMMERCIAL REPRESENTATION AND DISTRIBUTORSHIP

The Brazilian legal system offers investors a number of mechanisms to trade their products, with special emphasis on commercial representation and distributorship. In principle, these mechanisms have a distinct nature, but may be adopted by investors as an effective distribution channel to place their products in the Brazilian market without establishing a company in Brazil.

Commercial Representation

In a commercial representation arrangement, the representative stands for an individual or legal entity that intermediates business for the principal on a non-occasional basis within a preset territory, in consideration for a fee (or 'commission'), which is usually set at a percentage of the transaction value.

The legal framework for commercial representation activities[26] confers several rights and protections on commercial representatives, which somewhat impair the parties' freedom to contract. These safeguards include a prior notice requirement to be met by the principal if the commercial representation agreement is terminated without cause; or a minimum indemnification payable to the commercial representative in some events of principal's unilateral termination of the agreement or the representative's termination with cause.

In its section on "commercial agency and distribution", however, the Civil Code contains certain provisions that would somewhat conflict with traditional views on commercial representation under Law 4886/65, even though some legal scholars equate an agency arrangement to commercial representation. But this is still a controversial issue among legal scholars, and past court rulings are still incipient to clarify how the Civil Code provisions should apply to commercial representation relations.

Distributorship

Distributorship usually stands for an agreement by which the distributor acquires certain products from the principal for further resale within a preset area for the account and at the risk of the distributor itself. Unlike the commercial representation or service arrangement, the distributor receives no compensation from the principal; the distributor's earnings originate from its profit margin (that is, the difference between the purchase and resale prices).

However, articles 710 *et seq.* of the Civil Code (dealing with "commercial agency and distribution") define *distributorship* as a commercial relationship in which the thing to be traded is placed at the representative's disposal. Accordingly, the distributor would be a commercial representative that carries the products offered to clients, which is far different from the

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[26] ***Law No. 4886 of December 9, 1965, as amended by Law No. 8240 of May 11, 1992 (Commercial Agency Law) and by Law No. 10406 of January 10, 2002 (Civil Code).***

definition consolidated by legal scholars for *distributorship* as mentioned in the preceding sentence. As a consequence, it is still unknown whether articles 710 *et seq.* of the Civil Code do apply to traditional distributorship relations.

As in the commercial representation, legal scholars have not reached a consensus on this issue, and there is still no court ruling on how the Civil Code provisions should apply to distributorship relations.

If the courts eventually confirm that the Civil Code rules do not apply to traditional distributorship relations as mentioned above, there would be no specific law regulating them. As a result, distributorship would become an atypical relation governed by general principles of law. In this case, distributorship could be viewed as more flexible than commercial representation, as the parties would be free to establish the commercial conditions for their arrangement as they deemed suitable.

Conversely, if the courts hold that articles 710 *et seq.* of the Civil Code also apply to distributorship agreements involving the purchase and resale of products, then the distributorship arrangement will be treated as a kind of commercial representation. In this case, the protections accorded by law to commercial representatives could also extend to distributors.