

**PINHEIRONETO**  
ADVOGADOS

**Overview of taxation and main  
tax concerns for Japanese  
companies in Brazil**

**April 15, 2015**

Jorge N. Lopes Jr.

**PINHEIRONETO**  
ADVOGADOS

# **1. Brazilian Main Taxes**

# (1) Direct Taxes on Brazilian Operations

Direct Taxes on Brazilian Operations		
Corporate Income Tax (" <u>IRPJ/CSL</u> ")	<p>Corporate Income Tax (federal)</p> <p>Two main tax regimes:</p> <p><u>Actual Profit</u> - the <b>taxable profit</b> will be <b>actual revenues less tax-deductible expenses</b> during the calendar year</p> <p><u>Presumed Profit</u> - the <b>taxable profit</b> will be a <b>percentage of the company's gross revenues</b>, with no deductions allowed. Only companies with no more than BRL 78 mm in annual gross revenues</p>	<p><b>34%</b></p> <p>(25% IRPJ + 9% CSL)</p>
Social Contributions on Invoicing (" <u>PIS/COFINS</u> ")	<p>Federal Taxes on Gross Revenues</p> <p><u>Cumulative regime</u> – no tax credits allowed - applicable for companies subject to Presumed Profit Regime</p> <p><u>Non-cumulative regime</u> – credits allowed on certain types of inputs as defined by law – applicable for companies under Actual Profit Regime</p>	<p><b>3.65%</b> (cumulative)</p> <p><b>9.25%</b> (non-cumulative)</p>

## (2) Indirect Taxes and Tax on Services

Indirect Taxes on Manufacturing/Distribution of Goods		
Tax on Manufacturing Products ("IPI")	Federal Value Added Tax ("VAT") sale of industrialized products	<b>Variable rates</b> (essentiality and classification of the product)
Tax on Distribution of Goods and Services ("ICMS")	State VAT sale of goods, or services of telecommunications and transportation	<b>7% to 25%</b> , (essentiality of the product)

Tax on Services		
Tax on Services ("ISS")	Municipal Tax on invoice price (Not a VAT)	<b>2% to 5%</b>

### (3) Import Taxes - Goods

Import Taxes – Goods		
Import Tax ("II")	Federal Tax on import of goods	Variable rate (essentiality and classification of the product)
PIS/COFINS - Import	Federal Tax on import of goods	<b>9.25%</b> , with certain variations for certain products
IPI - Import	Federal VAT on import of goods	Variable rate (essentiality and classification of the product)
ICMS - Import	State VAT on import of goods	<b>7% to 25%</b> (essentiality of the product)

## (4) Import Taxes - Services

<b>Import Taxes - Services</b>		
Withholding Income Tax ("WHT")	Federal Tax on income paid abroad	<b>15% to 25%</b>
Economic Domain Intervention Contribution ("CIDE")	Federal Tax on royalty payments and technical services	<b>10%</b>
PIS/COFINS - Import	Federal Tax on import of services	<b>9.25%</b>
ISS - Import	Municipal Tax on import of services	<b>2% to 5%</b>
IOF/Foreign Exchange	Federal Tax on inflow or outflow of funds from Brazil	<b>0.38%</b>

## (5) Certain Financial Transactions

Financial Transactions		
IOF/Credit	Federal Tax on Brazilian loans	<b>0.0041%</b> per day plus <b>0.38%</b>
IOF/Foreign Exchange	Federal Tax on inflow of funds into Brazil as a foreign loan	<b>6.0%</b> if maturity < 180 days
		<b>0%</b> maturity > 180 days
	Federal Tax on inflow/repatriation of funds as equity	<b>0.38%</b> or <b>0%</b> for equity in listed companies
	Federal Tax on outflow of dividends/ interest on net equity	<b>0%</b>
IOF/Insurance	Federal Tax on insurance	<b>7.38%</b> or <b>0%</b> for certain situations defined in law
IOF/Bonds	Federal Tax on bonds and securities	<b>0% to 1.5%</b>

## (6) Tax on Assets

Tax on Assets		
Tax on Real Estate Transfer ("ITBI")	Municipal Tax on the <u>transfer</u> of Real Estate properties	<b>2% to 6%</b>
Urban Building and Land Tax ("IPTU")	Municipal tax on the <u>ownership</u> of Real Estate property	Progressive rates
Tax on Automotive Vehicle Ownership ("IPVA")	State Tax on Automotive Vehicles	Variable rates
<i>Causa Mortis</i> and Gift Tax ("ITCMD")	State Tax on donation or inheritance	Up to <b>8%</b>



**PINHEIRONETO**  
ADVOGADOS

## **2. Overview on Tax Litigation in Brazil**

## Tax Audit Phase

- Tax Authorities can inspect tax and accounting books of the company, and request information and documentation needed to clarify tax issues
  - Tax Authorities start by notifying the company of the audit and requesting books and other documentation for review (such as copies of bylaws, contracts, among others)
  - Tax Authorities can also require additional clarifications and documentation on certain tax or accounting issues
  - In general, short deadlines (5 to 10 days) to provide information and clarifications, but Tax Authorities can give additional time if the company explains why it needs it to gather the requested documents
- If Tax Authorities believe that are unpaid taxes, they issue a tax assessment (*Infraction Notice*)
  - No possibility of negotiating taxes or discounts with the tax authorities
  - Amnesty and Installment Programs can give certain discounts. They have been enacted from time to time (although there is no guarantee that there will be more of such programs in the future)

# Tax Assessment

- A tax assessment generally charges:
  - (i) the tax amounts claimed by the authorities
  - (ii) Fines - 75% or 150% for federal taxes (different in state and municipal)
  - (iii) Interest in arrears (SELIC, which is currently at 12.65% a year)
    - Interest is calculated both on principal and fines (disputable on fines)
    - Interest accrue since triggering event until the debt is paid
    - The fine can be avoided if, before the tax assessment, Taxpayer files a judicial lawsuit and deposits in court the amounts under dispute
      - If Taxpayer wins, the amounts deposited returns to the company as adjusted by the SELIC rate since the deposit date
      - If it loses, the amounts deposited are simply transferred to the Government on a definitive basis
- Tax Debts can eventually grow high by virtue of high fines and interest in Brazil

## Once a Tax Assessment is issued

- There are two main types of procedures to fight tax assessments in Brazil (generally applicable for federal, state or municipal taxes):
  - Administrative tax litigation (no deposit or guarantee required)
  - Judicial tax litigation (deposit or guarantee required)
- Under certain rules, taxpayers can choose how to litigate a tax case:
  - **A:** First Administrative and, if Taxpayer loses, Judicial Litigation
  - **B:** First Judicial Litigation, waiving the right to Administrative Litigation
  - Usually, Taxpayers choose to first use Administrative litigation:
    - Faster (3 to 5 years)
    - No deposits/guarantees required
    - Despite the fact that interest continue to accrue (SELIC)
    - If Taxpayer wins, it is over, Tax Authorities cannot seek judicial litigation
    - But if Taxpayer loses, Taxpayer can still seek judicial tax litigation
    - If Taxpayer adopts judicial tax litigation first, it cannot use administrative litigation anymore

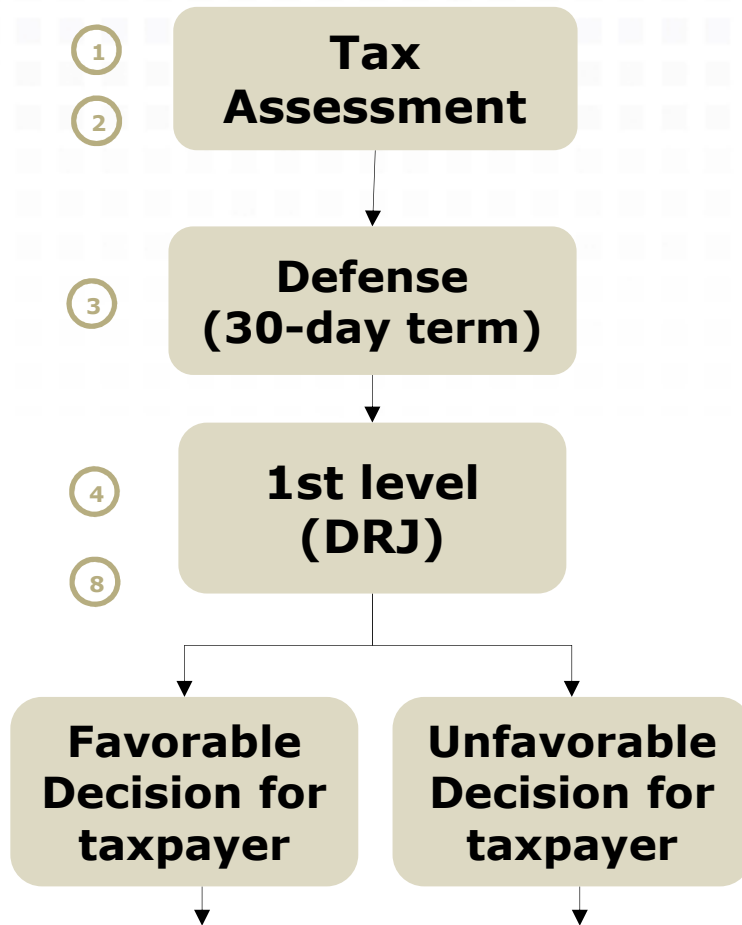
## Deadline for Defense

- In Administrative tax litigation, the defense must be submitted within **30 days** from the tax assessment (*Auto de Infração*)
  - It is a tight deadline to be met
    - Sometimes, the defense is heavily based on documents of prior years, which take time to be collected by the company
    - In general, all the arguments and supporting documents must be presented within this deadline (with few exceptions)
  - If this deadline is not met, Taxpayer cannot utilize the administrative tax litigation
    - Once elapsed the 30 days without a defense, Tax authorities will remit the tax debt for foreclosure, and Taxpayer will have to provide a guarantee for the debt and litigate it in judicial courts
    - In this case, an additional amount of up to 20% of the debt will be charged from Taxpayer as legal fees for the Federal Tax Attorney

**PINHEIRONETO**  
ADVOGADOS

## **2.1. Administrative Tax Litigation**

## 1st level



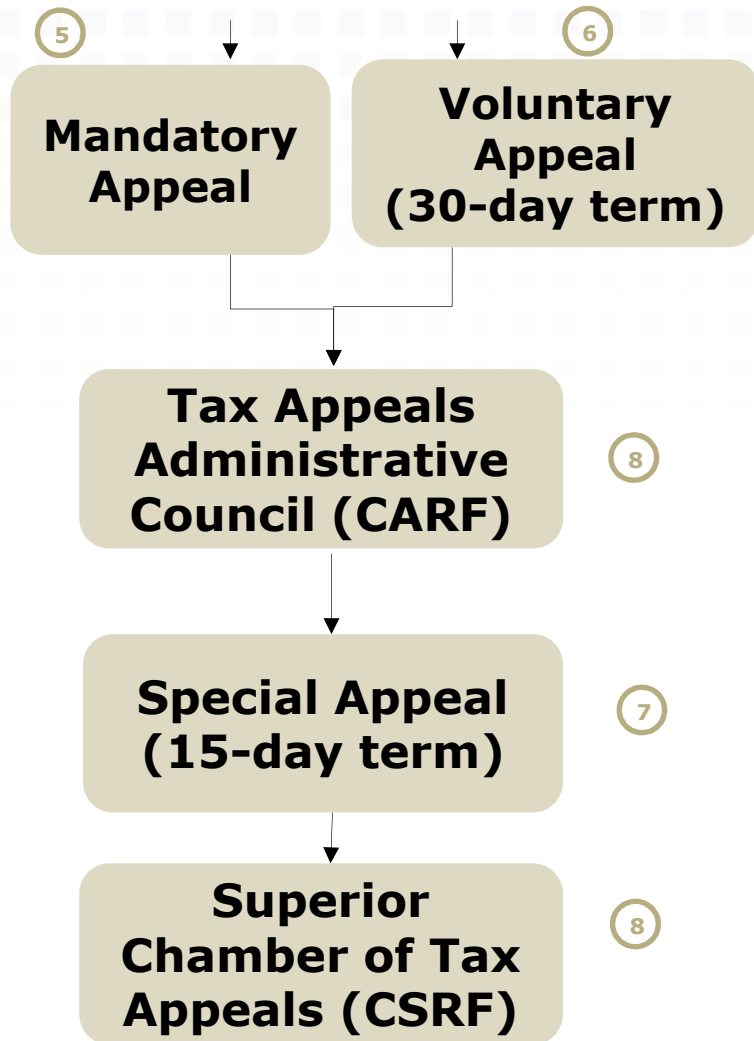
1. Taxpayer receives the tax assessment from the tax authorities

2. Taxpayer can waive litigation and pay the tax assessment within 30 days. In this case, a 50% discount on the fine is granted

3. Taxpayer must present a defense within 30 days from the tax assessment. This defense will start the litigation procedure

4. Taxpayer can also pay the updated assessment within 30 days from first level decision. In this case, a 30% discount on the updated fine is granted

## 2nd & 3rd level



5. Favorable 1st level decisions for taxpayers are automatically subject to tax authorities' "mandatory appeal"

6. Unfavorable 1<sup>st</sup> level decisions can be appealed by Taxpayer to CARF

7. Special Appeals can only be filed to CSRF in case of divergent rulings on the same facts (by different chambers of CARF or another chamber of CSRF). On the other hand, DRJ and CARF review every factual and legal issues

8. In case of an unfavorable final decision to Taxpayer, the National Treasury will record the debt in the Federal Debt Roster within 30 days from the publication of such decision, and will then start a judicial tax enforcement proceeding on the debt. A 20% amount on the updated remaining tax debt will then be added as legal fees of the Federal Tax Attorney



## Timeline

- 1st level
  - From tax assessment to the 1st level decision
    - 6 months to 1 year (estimated term)
- 2nd level
  - From the appeal to CARF to its decision
    - 1 to 2 years (estimated term)
- 3rd level
  - From special appeal to the CSRF decision
    - 1 to 2 years (estimated term)

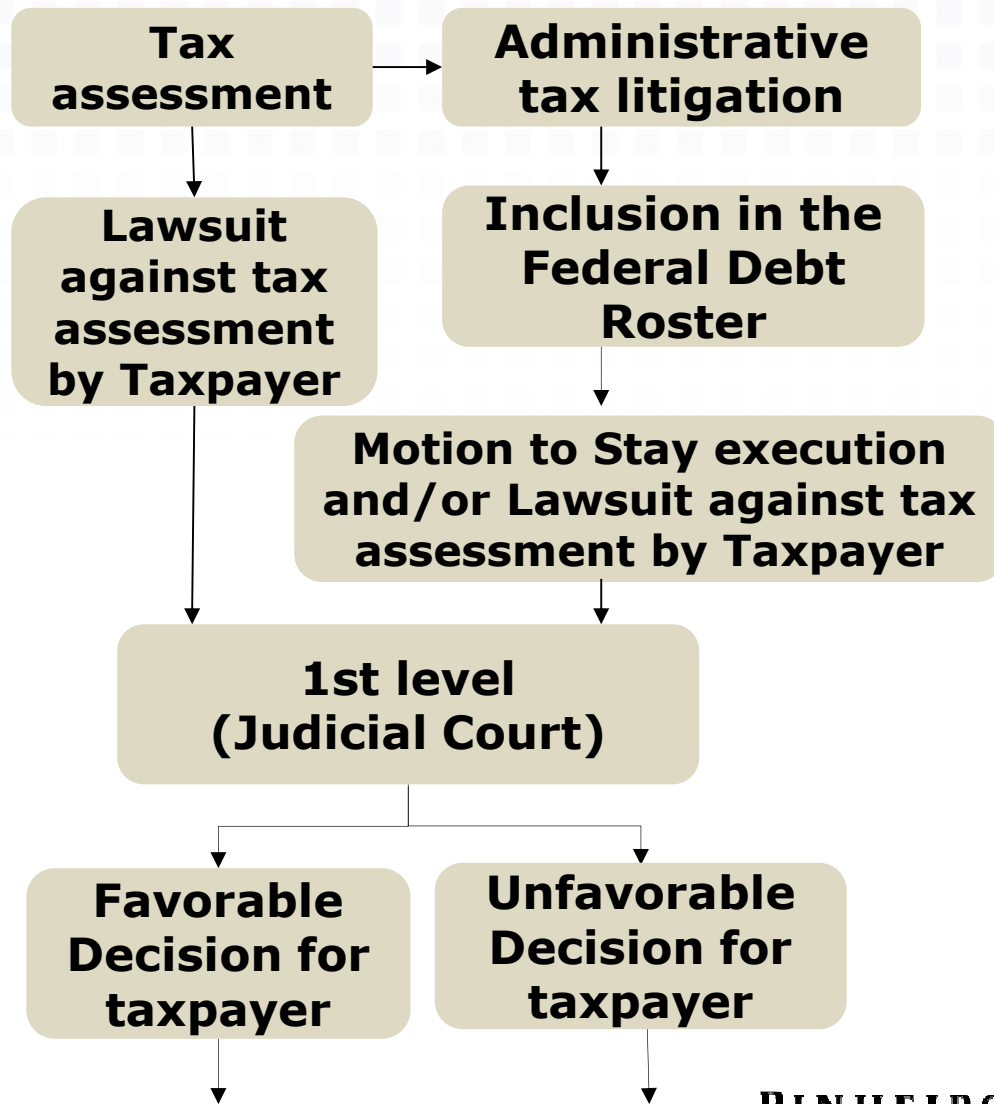
## During Administrative Litigation

- While pending a final tax administrative decision:
  - Tax debts cannot be enforced by the Tax Authorities
  - But the SELIC interest continues to accrue
    - Taxpayer can waive its right to administrative litigation and file a lawsuit while depositing the amounts. After that, even if interest still accrue, Taxpayer will not have to disburse them anymore if it loses the case
  - Taxpayer is still entitled to obtain a tax clearance certificate
    - Important since the taxpayer cannot participate in public biddings without a tax clearance certificate

**PINHEIRONETO**  
ADVOGADOS

## **2.2. Judicial Tax Litigation**

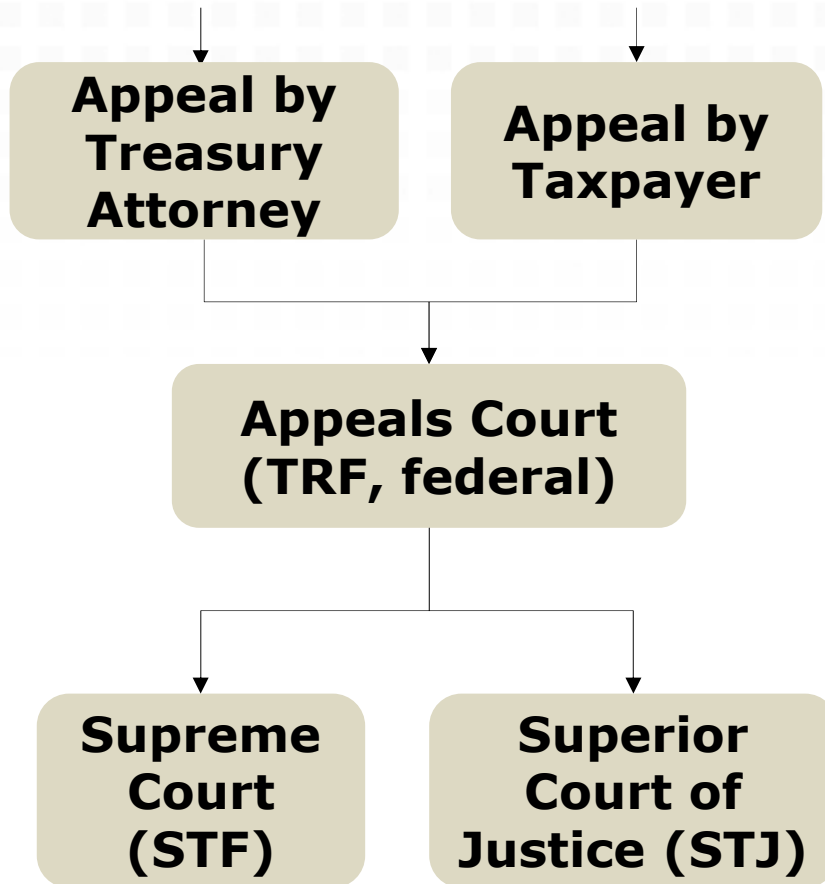
## 1st level



### Judicial Litigation

- In case of a potential tax assessment, Taxpayer can:
  - before the tax assessment is issued: file a lawsuit, deposit the amounts and avoid fines;
  - after the tax assessment is judged in administrative courts and before it is included in the Federal Debt Roaster: file a lawsuit against the tax assessment; or
  - upon the foreclosure (following inclusion of the debt in the Federal Debt Roaster): present guarantees and submit a motion to stay tax execution as its defense.

## 2nd and 3rd level



### Highlights

- Favorable 1st level decisions for taxpayers are subject to automatic “mandatory appeal”
- 1st level judicial courts and TRF review both factual issues and legal issues
- STJ reviews legal issues except for constitutional matters, but does not review factual issues
- STF reviews only constitutional matters

## Guarantees

- Taxpayer is required to present a guarantee on the full updated amount of the tax debt (including interest and fine), in order to be able to litigate the debt in judicial courts
- Example of Guarantees:
  - Judicial deposit, bank letter, guarantee-insurance, pledge of assets (e.g. pledge on real estate)
- Judges at the request of the Federal Tax Attorney may refuse the pledge of illiquid assets (preference for full deposits)
- Guarantees needed to suspend the immediate enforceability of the tax debt

## Timeline

- 1st level
  - From lawsuit or inclusion in the Federal Debt Roster to the decision of the 1st level court
    - 3 years (estimated term)
- 2nd level
  - From the appeal to Appeals Court (TRF) to its decision
    - 2 to 3 years (estimated term)
- 3rd level
  - Decision by STF and/or STJ
    - 3 to 5 years (estimated term)

## Judicial Courts

- At each level, Federal Courts will decide case about federal taxes, and State Courts will decide the case about state and municipal taxes
- There are no specialized judicial tax courts in Brazil
  - Tax Administrative courts are generally more technical
  - Judicial Judges are not specialists in technical tax issues, although some tax matters involving unconstitutionality of laws are more deeply analyzed in judicial courts



**PINHEIRONETO**  
ADVOGADOS

## **3. Other Relevant Tax Issues**

## (1) Overview

- In 1995, Law No. 9,249 adopted the worldwide income taxation principal for Brazilian legal entities
- Income, capital gains, and profits earned abroad are subject to taxation in Brazil
- Brazil adopted rules of Controlled Foreign Company – CFC in order to tax the profits earned by controlled and associated companies abroad, in the end of each year

## (2) Dividends

- Profits generated by a Brazilian company are subject to Corporate Income Tax (“IRPJ/CSL”) at the combined rate of 34%
- The dividends distributed by a Brazilian company to its shareholders (Brazilian or foreigners) are not subject to taxation by the Brazilian Withholding Income Tax (“WHT”)
- Dividends are not tax deductible
- The Tax on Exchange Transaction (“IOF”) is currently assessed at a 0% rate on the remittance of dividends

### (3) Interest on Net Equity

- Interest on Net Equity – alternative method of remunerating shareholders
- The payments of interest on net equity are treated as **tax deductible expenses (34%)** and taxed by the **WHT at a 12.5% rate** in the case of Japanese companies, due to the Brazil-Japan Tax Treaty (as a general rule, Interest on Net Equity is taxed by the WHT at a 15% rate)
- The IOF is also assessed at a 0% rate on the remittance of Interest on Net Equity

## (4) Capital Gain taxation

- Law No. 9,249/95 reduced the general WHT from 25% to 15% on capital gains earned by non-residents in Brazil
- In the case of Japanese companies, **there is no taxation on capital gains derived from the sale** as set forth the Brazil-Japan Treaty
  - **It is the only Brazilian Treaty with such provision**

## (5) Transfer Pricing Rules

- Brazilian transfer pricing rules are basically foreseen on Law No. 9,430/96, as amended. However, due to the constant changes to which Law No. 9,430/96 was subject through the years, transfer pricing rules in Brazil are also constantly changed
- In respect to Japanese companies, the most relevant issue on this matter concerns:
  - Calculation of profits on “PRL” (Resale Price Less Profit) method
  - Application of the PCI/PCEx (Independent Comparable Prices/Prices of Commodities subject to Quote on Exports) methods
  - Possibility of the APA (Advanced Pricing Agreement) in the absence of a transfer pricing method

## (6) Thin Capitalization Rules

- Brazil introduced thin capitalization rules limiting the deductibility of interest relating to loans with related companies abroad or companies headquartered in tax havens/privileged tax regimes
- The Brazilian company will be allowed to deduct interest paid to Japanese related companies if the total debts with related parties is lower than 2 times the net equity of the company
- Interest paid to companies headquartered in Japan is subject to WHT at a 12.5% rate due to the Brazil-Japan tax treaty (as a general rule, interest is taxed by the WHT at a 15% rate)
- The inflow of cash into Brazil under cross-border loan agreements trigger the assessment of IOF at the general rate of 6%. However, the referred rate is currently reduced to 0% if the term of the loan is longer than 180 days

## Contact Information

### **Speaker:**

Jorge N. Lopes Jr.

Tax Partner

Phone number: (+55 11) 3247 8791

Email: [jlopes@pn.com.br](mailto:jlopes@pn.com.br)

### **Japan Desk:**

Bruno Balduccini ([bbalduccini@pn.com.br](mailto:bbalduccini@pn.com.br))

Jorge N. Lopes Jr. ([jlopes@pn.com.br](mailto:jlopes@pn.com.br))

Yuka Ono ([yono@pn.com.br](mailto:yono@pn.com.br))

Jun Ishii ([jishii@pn.com.br](mailto:jishii@pn.com.br))

Mary Fukugakiuchi Hamasaki ([mhamasaki@pn.com.br](mailto:mhamasaki@pn.com.br))