GUIDELINES ON BRAZIL’S FOREIGN INVESTMENT LAW

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Guidelines on Brazil’s Foreign Investment Law
by Attila de Souza Leão Andrade Junior

January, 2004
São Paulo, Brazil
To my daughter, Elôra, with all my love
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<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>BACEN</td>
<td>Banco Central do Brasil (Central Bank of Brazil)</td>
</tr>
<tr>
<td>INPI</td>
<td>Instituto Nacional da Propriedade Industrial (National Institute of Industrial Property)</td>
</tr>
<tr>
<td>ITR</td>
<td>Income Tax Regulation (Brazil’s Regulamento do Imposto sobre a Renda - RIR)</td>
</tr>
<tr>
<td>NBH</td>
<td>National Bank of Housing (Brazil’s Banco Nacional da Habitação)</td>
</tr>
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CHAPTER I

The legal concept of “foreign capital” pursuant to Provision 1 of Law 4131 and problems related to this concept.

INTRODUCTION

This chapter shall be divided into sections each of which correspond to words and phrases underlined in Provision 1 of Law 4131. Brazil’s major Law regulating foreign investment. For instance, we start our analysis with the legal nature of the goods inherent in the concept of foreign capital; this analysis corresponds to the word “goods” underlined in the quote.

In the following section we shall endeavor to analyze the areas of investment of foreign capital which corresponds to the phrase “destined for the production of goods and services as well as financial or monetary resources introduced into the country to be invested in economic activities.

In the final section we shall examine the concepts of “residence”, “domicile” and “headquarters”, as well as the economic and legal consequences resulting from the adoption of such concepts, pursuant to Provision 1 of Law 4131.
1. ANALYSIS OF THE LEGAL CONCEPT OF "FOREIGN CAPITAL"

Law 4131, enacted on September 3, 1962 which regulates foreign capital investment and the remittances of profits and dividends abroad defines “foreign capital” as follows:

"For the purposes of this Law, foreign capital is the goods, machines and equipment introduced into Brazil without initial payment of currencies, destined for the production of goods or services, as well as the financial and monetary resources introduced into the country (Brazil) to be invested in economic activities, provided that in both cases (goods and resources) belong to individuals or companies resident or domiciled abroad”.

(The bracketed phrase was inserted by the author to clarify the meaning of the sentence in English)

1.1- Legal nature of the word "goods" in the above mentioned concept of foreign capital

What is the legal concept of "goods"? Are "goods" only machinery and equipment or do they also consist of industrial property such as patents, trademarks and copyrights? Brazilian Law allows for any remuneration from patent and license agreements to be considered foreign capital investment. In other words, royalties due under said agreements, rather than being remitted abroad, may be converted into foreign capital registrable with the Central Bank of Brazil, hereinafter referred to as BACEN. (We shall consider the issue of foreign capital registration with BACEN in a later chapter). However, this conversion would be contingent upon the registration of said agreements with Brazil’s National Institute of Industrial Property (Instituto Nacional da Propriedade Industrial, hereinafter referred to as the INPI).

1. Decree 35762 enacted on February 17, 1965, prov. 50. The condition that the agreement be previously registered with the INPI is provided for in the Central Bank form for the registration of the capitalization of royalties from said agreements.

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However, foreign investors may not pay in capital with the estimated value of the technology they are bringing into Brazil, such as a patent or any industrial property rights protected under the Laws of their own countries. BACEN officials do not permit this form of paying in because of the difficulties which might arise with such an estimate. Moreover, BACEN officials fear that if they allowed this form of paying in capital, foreign investors might make unreasonably high estimates of the value of their technology in order to obtain an equally high registration of foreign capital investment with BACEN.

BACEN regulates the registration of foreign capital paid in with royalties under patent and trademark agreements. Such regulation requires that investors interested in this form registration ought first to apply and obtain a certificate issued by INPI that the patent or trademark involved is still effective. In addition, investors must produce evidence that the agreement for the use and exploitation of the patent or trademark rights has been duly registered with the INPI and is still in effect. Finally investors must present to BACEN a copy of the minutes of the General Meeting of shareholders (in case of a corporation) or the amendment to the charter of a limited liability company regarding the capitalization, duly registered with the competent Trade Board. Likewise book entries regarding the capitalization process must be evidenced to BACEN. Obviously the amount of the capitalization shall be limited to the amount stated in the certificate of registration of the patent or trademark royalties agreements registered with and approved by INPI.

1.1.1 - Fiscal consequences arising from paying in capital with industrial property rights

A company sought a tax ruling from the Brazilian counterpart of the Internal Revenue Service (i.e., the Secretaria da Receita Federal) on the fiscal consequences arising from the investment of foreign capital to be paid in with industrial property rights. The company, which was domiciled abroad, was engaged in the computer program business and planned to pay in the capital of its Brazilian subsidiary with the estimated value of its computer programs (software technology).

The tax official ruled that programs acquired abroad are considered transfers of technology. Moreover, he stated that, from a tax Law point of view, expenses made in connection with the purchase of the technology could be deducted from the subsidiary’s taxable earnings up to five percent of the gross income derived from the final product or service.

In order to obtain this tax benefit the subsidiary should:

a) register the transfer of technology agreement with BACEN;

b) evidence that the sums paid to individuals or companies resident or domiciled abroad for technical, scientific or administrative services or assistance correspond to services rendered to the subsidiary through technicians or projects sent to Brazil; and

c) prove that such sums do not exceed the limits established under Normative Instruction 5 of the Secretaria da Receita Federal, hereinafter referred to as the SRF) enacted on January 8, 1 974. The tax official concluded that the SRF had no objection to the paying in of capital of the subsidiary in the form proposed; nevertheless, BACEN should have been consulted beforehand on this matter.\(^5\)

1.1.2 - Paying in capital with credits

Another interesting question is whether it is possible to pay in capital with credits. BACEN based on Provision 50 of Decree 55.762 does permit the paying in of capital with credits remittable abroad. Therefore, BACEN can authorize the registration of proceeds from loans duly registered with BACEN as foreign capital investment. In other words, Brazilian law enables the foreign borrower to convert the loan proceeds (including installments of principal, interest and other contractually stipulated charges) into foreign capital investment.

Provision 1 of Law 4131 establishes that “foreign capital is the goods, machines and equipment introduced into Brazil without initial payment of currencies...”. What did the legislator mean by the quoted phrase? Foreign investment can be made in the form of entry of machinery for which there is no payment abroad. In other words, import operations are not subject to registration with BACEN. However, there are two exceptions to this rule: one is the hypothesis provided for in Provision 1 of Law 4131, that is, the importation of goods related to foreign capital investment; the other is the importation of goods financed from abroad.

2. AREAS OF INVESTMENT OF FOREIGN CAPITAL

Can foreign capital be invested in any kind of economic activity in Brazil? No, only in those economic activities in which foreign capital investment has not been forbidden or restricted by Brazilian Law. We shall analyze below the restrictions that Brazilian law imposes on foreign capital investments. The reader should be advised that Brazil’s new federal constitution enacted on October 5, 1988 substantially altered these regulations and the subjects considered herein shall take such constitutional changes in due consideration. Likewise, the 1995 constitutional amendments as attached to the end of this hook brought about important changes to these restrictions reducing some and eliminating others entirely.

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4. RIR, arts 233 and 234

5. Normative Ruling CST 79/75 of July 31, 1975
2.1 - Exploration of mines, mineral resources and hydraulic energy

After the second edition of the book, Congress has enacted the Constitutional Amendment n°6 in 1995 which is reproduced in its entire in Exhibit 1 to this edition. This Amendment was a great step to ward the liberalization of the Brazilian economy in that it lifted the ban on foreign-owned private companies concerning the exploitation of mines, mineral resources and hydraulic energy. In the past, pursuant to paragraph 1 of art. 176 of the Brazilian Constitution, the right to engage in the exploration or drilling of mines in general was limited to “Brazilians or Brazilian company of national capital pursuant to the Law”. The above mentioned Constitutional Amendment eliminated the specific reference to a Brazilian company of national capital. Accordingly, Brazilian companies are defined as companies organized in Brazil no matter who owns its shares. In this case, a foreign domiciled company which owns 100% of the shares of a Brazilian Company may now explore mines and produce hydraulic energy.

2.1.1 - Oil exploration, research and drilling

Likewise this prior constitutional restriction as indicated in the earlier editions of this book is no longer in effect. Pursuant to Constitutional Amendment no. 9 enacted on November 9, 1995 (Exhibit 2 hereto), Congress finally ended the long established monopoly of oil exploration, research and drilling granted to Petrobras, Brazil’s state owned oil company. Constitutional Amendment n°9 enabled private companies to explore, research and drill oil in Brazilian national territory. Such private companies can be either foreign or nationally controlled; in other words, foreign domiciled companies may own 100% of the shares of a Brazilian company, that is, a company organized in Brazil, the purpose of which is the exploration, research and extraction of oil. However, the constitutional amendments still give authority to the federal government in terms of coordinating those activities. Accordingly, the federal government is still in charge of hiring the services of the private companies, whether foreign or nationally controlled, to explore, research and drill oil in the national territory of Brazil.

The author believes that this constitutional changes will tremendously improve the status of the matter in Brazil. It is expected that Brazil will double or triple its oil production now that the government monopoly in these activities is gone. Private companies, both foreign and national are likely to increase oil production since they are now allowed to invest in these productive areas. The major reason for this change resides in the fact that Petrobrás, due to budgetary constraints was having problems in funding new drilling and research projects to the extent desirable for production to catch up with the ever increasing consumption of oil in Brazil. This move is an excellent sign for the direction that Brazil is now following in line with the international trend demonstrating that the best government is the least government.

2.1.2 - Exploration of minerals necessary for the production of atomic energy

Likewise the Constitution provided the State a monopoly for the research, drilling, enrichment, re-process, industrialization and trade of minerals necessary for the production of atomic energy. (Constitution art. 177-V). These minerals include uranium, thorium, cadmium, lithium, boron, beryllium, zirconium and graphite. In addition, the Federal government is constitutionally prevented from granting authorizations or powers to others to conduct any of the above mentioned activities in relation to the said minerals. (Constitution, art. 177 paragraph 1). Moreover no speculative contracts of any sort are allowed to the aforementioned undertaking.

The Constitutional amendments did not change this particular constitutional restriction. Therefore, the exploration of minerals necessary for the production of atomic energy continues to be a monopoly of the federal government and private enterprise is still not allowed to participate in the process. It is apparent. The reasons for this constitutional prohibition are obvious. Atomic energy is still a matter of national security in Brazil and elsewhere. Accordingly the minerals necessary for the production of atomic energy remains in the realm of “national security” are unlikely to be changed in near future.

2.2 - The law governing scientific research undertaken by foreigners in the Brazilian territory

On August 26, 1969, the Brazilian government promulgated Decree 65,057 which established the conditions for granting permission for scientific expeditions to operate in Brazil. These expeditions would consist of the “allocation of human and material resources for a limited period of time, aiming at the implementation of a specific plan to obtain data and scientific
knowledge, to prove or to establish theories..." (Decree 65,057, prov. 2). However, the following activities are excluded from the provisions of the decree:

a) activities provided for under Decree 63,164 of August 26, 1968 when they are executed on the continental shelf or in Brazilian rivers and territorial waters (up to 200 miles from the coast); and

b) scientific research which is the monopoly of the Brazilian government or any of its agencies or subdivisions.

Decree 65,057 establishes that scientific research undertaken by individuals, companies or entities resident or domiciled abroad must first obtain authorization from Brazil's National Research Council (Dec.65,057, prov.4).

2.3 - Coastal maritime transport of goods

For many years, the coastal maritime transport of goods was reserved for Brazilian flag vessels. Brazil's federal constitution in its article 178 maintained this reservation. However, Constitutional Amendment no. 7 enacted on August 15,1995 (exhibit 4 hereto) altered the policy in that it allowed foreign vessels to undertake the coastal and inland transportation of goods.

2.4 - Ownership and management of newspaper, television and radio companies

Recently constitutional amendment no. 36 enacted in May, 28, 2002, made possible foreign investment in newspaper, television and radio companies in Brazil provided that the investment would not exceed thirty percent of the shares in the said companies.

2.5 - Acquisition of land or real estate and the establishment of industrial and trade facilities by foreigners in national security areas

Current Brazilian Law provides that foreigners who purchase land or interests in real estate or who undertake the building of factories or facilities destined for commerce or bridges and roads in areas which are considered "national security areas" need the authorization of the National Defense Council. For the purpose of this Law, "national security areas" consist of territories which are located within 150 kilometers from Brazil's frontiers with other countries.

For the purpose of this Law, the following activities are deemed to be in the interest of national security:

a) the weapons and ammunitions industries;

b) the research into and exploration for mineral resources;

c) the production of electrical energy, except for energy production oil exceeding 150 kilowatts;

d) the plants and laboratories engaged in the production of explosives of any kind for use in warfare; and

c) communications media, such as radio, television, telephone and telegraph.

Furthermore, with reference to the factories or the activities outlined above:

a) a minimum of 51% of the capital of said companies must be owned by Brazilians;

b) a minimum of two thirds of the companies' employees must be Brazilian; and

c) the administration or management of said companies must be assigned to Brazilians, with foreigners only permitted to participate as a minority group. If Brazilian labor is unavailable to execute the necessary tasks, the National Defense Council may, in exceptional cases, allow foreign workers to be hired up to 49% of the company's personnel, provided that they are hired only for a specific time.9

Foreign individuals or companies cannot, in any manner, transfer their land or real estate interests located in the above specified areas without the prior authorization of the National Defense Council. If foreign individuals or companies acquire more than one third of the respective municipal area
in any city, the National Defense Council shall refuse their request for authorization and shall arrange with the Real Estate Registry Office that no more of additional land or real estate interests be filed with said office in said individuals’ or companies’ name.

2.5.1 - Acquisition of rural land by foreign individuals or companies

A foreign resident of Brazil, a company domiciled abroad which is authorized to operate in Brazil and a Brazilian company in which more than 50% of the voting shares are held by individuals or corporations resident or domiciled abroad who wish to invest capital in the acquisition of rural real estate in Brazil can only do so if said acquisition has as its purpose the execution of agricultural, livestock or industrial projects which are related to the purpose of the company pursuant to its charter. Agricultural and livestock projects must be previously approved by the Ministry of Agriculture.

The acquisition of rural real estate by foreign individuals or companies must be executed by means of a public deed. This deed should specify:

a) the identifying document of the purchaser; (charter, articles of incorporation, etc.)

b) evidence of the purchaser’s residence in Brazil; and

c) when the real estate is located in an area defined as national security area, evidence that National Defense Council’s authorization was obtained.

In the case of acquisition of rural real estate by foreign company authorized to operate in Brazil, or by a Brazilian company whose shares are held in whole or in part by individuals or companies resident or domiciled abroad, the public deed should indicate:

a) the National Defense Council’s authorization for the purchase;

b) the company charter and amendments, thereto; and

c) Presidential authorization for the foreign company to operate in Brazil.

Capital investments in the purchase of rural real estate related to agricultural, livestock and industrial projects should be made in the form of subscription of shares. For corporations (sociedades por ações) governed by law 6404 of December 15, 1976, as amended, which are engaged in such projects, the shares should be issued as nominal shares.

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7. Law 2597, prov. 6
8. Law 2597, prov. 7

9 Law 2597, prevs. 9 and 10
2.5.2 - Foreign capital investments in urban real estate located in Brazil

Foreigners may purchase urban real estate under the same legal conditions as those which Brazilians are subject. However, foreign capital investment in real estate located in Brazil must be made in the form of subscription of shares in the capital of a company organized under Brazilian Law. Moreover, its corporate charter must specifically provide for the acquisition of real estate in the clause establishing the corporate purposes. Finally, the investment must be registered with BACEN to enable the investor to repatriate his capital and to remit profits thereon.

2.6 - Foreign capital investment in the Brazilian capital market

Since the first edition of this book was published in 1980, there have been substantial changes in the legislation on foreign capital investment in the Brazilian capital market and all such changes have worked for the best. In fact, enormous amounts of foreign capital have been invested in the Brazilian stock exchange, namely in São Paulo and Rio de Janeiro. Partly due to such foreign investment and partly due to the good performance of many Brazilian companies, the stock exchange in Rio de Janeiro and São Paulo have reached positive indices of unprecedented levels. For instance, the São Paulo stock exchange transactions have generated quite handsome profit for investors therein; the average shares quoted in the São Paulo stock exchange have generated profit of about 350% in one year, in dollar figures, discounting the cruzeiro devaluation in the period and after taxes. No other stock exchange in the world has produced such high yields. Although legislation has not had magic effects in the economy as a whole, the legislation on Brazil’s capital market has greatly contributed to its prosperity in the last ten years.

This segment of the book shall summarize and update the reader on the major changes in Brazilian legislation in connection with foreign investment capital in stocks and securities in general.

2.6.1 - D.L. 1401 investment companies

This is the oldest form of foreign capital investment in the Brazilian capital market. In the first edition of this book, one entire chapter (Chapter IV) was dedicated to its analysis and study. In revising this book, author thinks that perhaps such examination would not justify an entire chapter. In the first place, D.L. 1401 has not been able to attract great sums of foreign currency into the Brazilian stock market; D.L. 1401 has provided too many restrictions on this type of investment and investors in this market reacted very badly to these restrictions. In order to be successful, the Law should have been drafted to conform to investors’ needs that is, to provide freedom and flexibility for their investments. Otherwise it would simply not work. D.L. 1401 is the best example of this. And yet, below there is a brief description of D.L. 1401 which is basically a restatement of the Law as it has not been changed.

On May 7, 1975, the Brazilian government promulgated Decree Law (D.L.) 1401 which regulates the creation of investment companies whose shares may be subscribed to by individuals or corporations resident or domiciled abroad. Such companies in which shares are subscribed to must be corporations organized under Law 6404 of December 15, 1976 and the incorporation must be previously approved by Brazil’s Securities Commission (“Comissão de Valores Mobiliários CVM”) which is the counterpart of the US Securities and Exchange Commission(SEC).

As per this D.L. 1401, the following rules must be complied with:

a) the initial capital of the company in which shares are subscribed to by foreign investors must be paid to a Brazilian investment bank, or a brokerage or securities firm;

b) the company’s shares must be delivered to foreign investors within 180 days of the date in which shares are subscribed to;

c) only foreign investors are entitled to subscribe to and to pay the company’s capital increases;

d) the company’s portfolio must be managed by a Brazilian financial institution within the scope and pursuant to the terms and conditions of Law 4728;
c) investments in the companies must be previously approved by Brazil's Securities Commission.

The investment companies created by D.L. 1401 are tax-exempt provided that the foreign capital invested in the payment of their shares is duly registered with and approved by BACEN and Brazil's Securities Commission (CVM) and that such investments remain in Brazil for at least three years as of date of their registration.

Taxation rules on D.L. 1401 companies are herein summarized. Dividends paid by the investment companies to shareholders resident or domiciled abroad are subject to a 15% withholding tax at the source. This tax rate can be reduced, however, according to the length of time of the foreign investment in Brazil. Thus, the dividends are taxed at different rates, provided that no repatriation of capital has occurred other than pursuant to the table below:

<table>
<thead>
<tr>
<th>Length of time of the investment (as of the date of registration)</th>
<th>Tax Rates</th>
</tr>
</thead>
<tbody>
<tr>
<td>From 6 to 7 years</td>
<td>12%</td>
</tr>
<tr>
<td>From 7 to 8 years</td>
<td>10%</td>
</tr>
<tr>
<td>Over 8 years</td>
<td>8%</td>
</tr>
</tbody>
</table>

Reader should note that the supplementary income tax which was assessed in the past in connection with credit, payment, distribution and remittance of dividends abroad (including dividends on shares of investment companies) no longer exists. Please note that Law 8383 enacted on December 30, 1991 explicitly abolished this supplement income tax. This is a great inducement to further foreign capital investment in Brazil as it has eliminated a tremendous tax burden on foreign investors. Therefore, the country has become quite competitive with other modern economies as a magnet for foreign capital investment. Please note that the 15% withholding tax on dividends mentioned above may be reduced if the country in which the investor was incorporated or is domiciled or resident has a tax treaty with Brazil (e.g., Japan, whereby dividends are taxed at 12.5%). Please note that as of January 1, 1996, this 15% withholding tax on dividends was abolished.

26.2 - Foreign Investments in mutual funds

The Brazilian government enacted Decree-Law no. 2285 on July 23, 1986 in order to create mutual funds in which individuals and companies resident or domiciled abroad could invest their monies. This D.L. 2285 was later regulated in depth by BACEN Resolution no. 1289 of March 20, 1987. Pursuant to these regulations, foreign capital companies the shares of which are held by individuals or companies resident or domiciled abroad were created. The main feature of such companies is that they must be organized as an authorized capital joint stock corporation and its corporate purpose shall be to invest in Brazil's diversified bonds and securities portfolios. The incorporation of these investment companies under D.L. 2285 and BACEN Resolution 1289 is contingent upon prior CVM authorization; in addition the following legal requirements must be met:

a) increase in the authorized capital;

b) capital increase by means of capitalization of profit and reserves;

c) collateral requirements of managers of the companies in order to secure performances of duties;

d) provision enabling amendments to the corporate charter;

e) provision on reduction of subscribed capital;

f) provision on dissolution and liquidation of the Company;

g) existence of agreements to be executed with underwriters in order to raise funds abroad aiming at the subscription of and paying in of the company shares; and

h) placement and management agreements between the company and the financial institution in connection with the bonds and securities portfolio to be held by the investment company.

The capital structure of D.L. 2285 mutual fund investment companies must be represented by common registered shares and 90% of their issuing price established for subscription of the companies' initial capital shall be destined for the constitution of a capital reserve. Only foreign investors,
that is, individuals or companies resident and domiciled abroad can hold shares in such mutual funds and the minimum investment per investor is currently US$ 5,000. Shares of the fund to be sold to foreign investors must be paid in within 120 days as of the date of their subscription. As indicated, both individuals and companies can hold shares in these mutual fund companies; it has become a practice to place holding companies chartered in one of the tax haven islands to be the ultimate holder and beneficiary of such shares. In this way, such holding companies reap the best of all possible legal words as they benefit both from the tax advantages in Brazil and in the country of their incorporation.

Such mutual fund companies are managed by investment banks, brokerage houses and securities dealership firms as duly authorized by CVM (Brazil’s Securities Commission) pursuant to management agreements to be entered between the companies and managers. The managing institution must maintain a technical department specialized in the analysis of bonds and securities under the direct supervision and responsibility of one of its directors. The management agreements must provide for the following:

a) dates of the term of the agreement including extensions thereof;

b) the services which the managing institution shall render to the investment companies in strict conformity with the by-laws of such managing institutions;

c) the remuneration for the services of the managing institution and the form of payment thereof;

d) the conditions for replacement of the managing institution;

e) the minutes of the general shareholders meeting and the minutes of incorporation of the investment company approving the management agreement; and

f) name(s) of the director(s) of the managing institution directly responsible for the management of the bond and securities portfolio.

If managing institution fails to perform any of its duties or defaults in complying with any of its obligations under the management agreement, it shall be subject to CVM’s cancellation of its authorization to operate as manager of the fund.

Funds entering Brazil under the D.L. 2285 mutual funds investments shall be subject to registration with BACEN for purposes of exchange control of foreign capital investments and remittances abroad of dividends and capital gains obtained from the sale of shares issued by the investment companies and repatriation of the capital. Registration shall be applied for by the managing institution up to the last business day of the month following the month in which the investments were made. To obtain registration, the managing institution shall submit a full list of the investors, accompanied by individual cards specifying the investment of each one. The certificate of registration of foreign capital to be issued by BACEN shall be the proper title to remittances of dividends, capital gains and capital repatriation thereon.

The most important existing restriction under current rules on mutual funds investments under D.L. 2285 as regulated by BACEN Resolutions 1289 and 1658 is the fact that investors must hold their investments in the fund for a minimum of 90 days.

Taxation rules on this type of foreign investment can be summarized as follows:

a) there is no capital gains tax on the sales of the foreign investor’s participation in the fund;

b) there is a 15% withholding tax on profit paid, credited or remitted to the foreign investor-holder of shares in the fund; this tax can be reduced by a more favorable tax percentage provided for in any tax treaty between Brazil and the country in which the foreign investor is either resident or domiciled;

c) there is no supplementary income tax on the payment, credit or remittance of dividends, capital gains or capital repatriation;

d) there is no tax on capital increase or capital reserves; the distribution of shares resulting from such capital increase does not trigger the levying of any tax thereon.
2.6.3 - Securitises Portfolios

The very same legislation which created the mutual funds provisions provided for the securities portfolio. This basically does not differ from the legislation mutual funds. The only difference resides in the fact that under the securities portfolio type of investment, the shares are held by a single legal entity (an investment company or a trust) incorporated outside Brazil. In order to take advantage of the institutional investors abroad (trusts, pension funds, insurance companies, etc.), BACEN and CVM enabled such investors to invest in Brazil through securities portfolios. The basic rules on exchange control and taxation concerning mutual funds are applicable to such securities portfolios.

2.6.4 - Debt/Equity Conversion Funds

The huge unpaid external debt which Brazil owes to the international financial community, over US$ 100 billion, has triggered a great many ingenious expedients to alleviate or mitigate the problems derived therefrom. One of such expedients first alluded to in the author's first book, "O Capital Estrangeiro no Sistema Jurídico Brasileiro" (Cia. Editora Forense, Rio, 1979) was the conversion of debt into equity. The first major legal regulation on the debt-equity conversion was BACEN Resolution no. 1460 of February 1, 1988. According to this Resolution, the credits, based upon art. 50 of Decree no 55,762 may be converted into investments in Brazil, provided that such credits are related to Brazil's external debt restructuring agreements involving:

a) medium and long term external liabilities (loans and financing) duly registered with the Central Bank of Brazil (BACEN) and their respective charges (interest, etc.);

b) foreign currency deposits in the Central Bank of Brazil referring to matured shares of principal and their respective charges (e.g. interest, contractual fees, etc.); and

c) foreign currency deposits in the Central Bank of Brazil under the terms of item 1 of Resolution no 1263 dated February 20, 1987 and their respective charges (e.g. interest, etc.).

The credits convertible into equity under Resolution no 1460 of BACEN may be made irrespective of whether the credit rights abroad and the corresponding debt in Brazil have or have not been subject to assignment.

There are basically two types of debt-equity conversions; one of which has been labeled "formal conversion" and the other "informal conversion". The formal conversion is represented by debt-equity conversion transactions in stock exchange bids. These bids include portions or tranches of Brazil's external debt bonds as provided for in article 1, item 1 of Decree no 96,673 dated September 12, 1988, as well as the debts related to deposits in BACEN referred to above under items "b" and "c". As part of this formal conversion plan, it is envisaged that debt so converted shall be allocated to developmental projects in the north (SUDAM projects) and in the northeast (SUDENE) of Brazil and such allocations must account for at least 50% of the total formal conversion proceeds.

Still in connection with the formal type of conversions, the BACEN resolution provides that debt registered with BACEN as public debt, that is, debt owed by the federal, state and municipal governments, including their corporations, may only be converted into investments in the public sector. Otherwise, debts registered with the Central Bank of Brazil in the name of private companies may be converted into investments in either the public or the private sectors.

As for registration of investments derived from formal conversions, such registrations with BACEN shall be equal to the amount of the winning bids. The foreign currency registration for the purpose of debt-equity conversion shall be the face value of the debt as registered with BACEN less the actual price paid in the bid. The difference shall be treated as national capital. For example, let us assume that the debt as registered is worth US$ 100.00. However in the auction, the interested party in the conversion only obtains US$ 80.00. Accordingly he will register the US$ 80.00 into shares of a company (the shares of which were bought in the stock exchange bid) with BACEN and the remaining US$ 20.00 will be canceled by BACEN and will be treated as shares worth US$ 20.00 in national currency (reais), the ultimate consequence, is that investor will only be able to remit profit and eventually repatriate capital on the basis of the US$ 80.00 shares as registered.
BACEN Resolution nº 1460 also provides that the shares bought under a debt-equity conversion plan are to remain in the ownership of the investor for a minimum period of 12 years as of the date of the capitalization of the conversion proceeds. Nevertheless, investor may remit dividends on such shares during the period pursuant to the provisions of Law 4131. In this case, the beneficiary of such dividends will be subject to a 15% withholding tax except for lower tax rates provided for in tax treaties to avoid double taxation of earnings which Brazil has signed with various countries (this withholding tax is no longer in existence as of January, 1996).

BACEN Resolution nº 1460 also prohibits the debt-equity conversion plan to cause the entire de-nationalization of companies, that is, that the total control of companies currently held by individuals domiciled in Brazil be transferred to individuals or companies resident or domiciled abroad.

The informal debt-equity conversion plan differs substantially from the formal in that under the informal plan, the creditor assigns to a third party (generally abroad), at a discount its credit as registered with BACEN. Whoever purchases such debt will receive the equivalent amounts of the debt in reais. For illustration, let us assume that someone has a credit duly registered with BACEN for US$ 1,000. The creditor sells his credit for, for instance, US$ 700,00. The purchaser will be entitled to receive in reais in Brazil the amount equivalent to US$ 1,000 which he may use to subscribe and pay in shares in the capital of a Brazilian company. After the transaction takes place, BACEN will write off the entire debt in US$ dollars which was registered. In this way, everyone gets a piece of the action: Brazil profits in the sense that it will reduce the amount of its hard currency debt; the creditor will receive an amount of his credit which he otherwise would not have received and the purchaser will profit by receiving the entire amount in reais from the original debtor in Brazil for something acquired at a substantial discount. (he had an actual profit in the example of 30%). In essence, that is how the informal conversion works.

The rules of taxation on debt-equity conversion plans can be summarized as follows:

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a) the mere purchase of shares in Brazil will not trigger income tax;
b) creditor should not be concerned with Brazilian taxes because he sold his credit at loss;
c) dividends to be paid on the shares resulting from the debt conversion shall normally be subject to the 15% withholding tax save lower rates provided for in the previously mentioned tax treaties which Brazil has signed with some countries (reminder: this withholding tax was eliminated on dividend payments after January, 1996);
d) there is no longer any supplementary income tax to be assessed on the payment, credit or remittance of dividends to the beneficiary resident or domiciled abroad.

Reader should take note that the debt-equity conversion plan has had enormous success in Brazil. However, there has been great criticism of this program. Criticism is aimed at the inflationary outcomes of this program in the sense that for each dollar written off from Brazil’s unpaid external debt, too many new reais were issued fueling the inflationary process in the Brazilian economy. However, this criticism is no longer valid as the debt-equity conversion plan has been brought to a virtual halt and after the Real Plan, inflation was successfully controlled.

2.7 - Foreign capital investment in Brazilian insurance companies

Foreign insurance companies may invest their reserves in Brazilian insurance operations, provided that:

1. the foreign insurance company is duly authorized by Presidential decree to operate in Brazil pursuant to provisions 59 to 73 of Decree-Law 2627 of September 26, 1940. In the event that a foreign insurance company subscribes shares in the capital of a company organized under the Laws of Brazil, the corresponding investment must be registered with BACEN in accordance with Law 4131;
2. the foreign insurance company (or Brazilian insurance company in which a foreign insurance company holds shares) is authorized by the Ministry of Finance after having received a favorable decision from the Superintendence of Private Insurance ("Superintendência de Seguros Privados") and the National Council on Private Insurance ("Conselho Nacional de Seguros Privados"), pursuant to Provision 1 of Decree 60,459 of March 13, 1967 and articles 21.V and 33 of Decree Law 73 of November 21, 1966.

2.8 - Foreign Capital Investment in the Brazilian Fishing Industry

The fishing industry is defined by Law as the “activities in connection with the capture, conservation, processing or industrialization of animals or plants which have the water as their habitat”. According to provision 19 of Decree Law 221, Brazilian or foreign fishing industries cannot do business in Brazil without prior authorization from the Ministry of Agriculture. Decree Law 221, as amended by Decree 65055 of August 18, 1969 and Law 65276 of December 1, 1975, regulates the fishing activities of foreign boats and requires an authorization from the Ministry of Agriculture in order to fish in Brazilian waters. Violation of this rule shall result in the seizure of the fishing vessel and penalties for the owner of the vessel, payment of fines.

2.9 - Foreign Investments in Telecommunications

Article 21 of the Brazilian Constitution assigned to the federal government the powers to control the telecommunications services in Brazil. The government created a wholly-owned holding company called Embratel which in turn placed under its umbrella a gamut of state telephone companies (such as Telesp for the state of São Paulo, TELERJ for the state of Rio de Janeiro and TELEMIG for the state of Minas Gerais, etc) which lag behind the expectations of Brazilian consumers. The Brazilian public telephone system has greatly deteriorated because of the governmental budget constraints in new investments in the segment. Therefore, Congress was sensitive to the issue and enacted on August 15, 1995, Constitutional Amendment no. 8 (exhibit 5 as attached hereto) which restated the federal government’s powers to explore telecommunication services but it enabled to do so by means of subcontracting to private companies. Accordingly, the federal government has started the process of welcoming private companies, both foreign and Brazilian, to participate in providing the telecommunication services. For instance, in the first half of 1997, the federal government put up for bid for the servicing of mobile phones throughout the country. For this purpose, it divided the nation into several regions and foreign companies were encouraged to participate in the bidding in the form of consortia with Brazilian-controlled companies. Several US and European companies participated successfully in this bid and were awarded (indirectly through the consortium in which they participated) several contracts for these regional services. The B Band cellular telephone system is an extremely profitable segment of the Brazilian market.

3. Concepts of Foreign Investors' "Residence", "Domicile", and "Headquarters" and the Implications of Adopting These Concepts

The concept of foreign capital investment pursuant to Provision 1 of Law 4131 depends, in turn, upon the concepts of "residence," "domicile" and "headquarters". According to the definition, foreign capital investment consists of the monetary resources, equipment, and machinery (which belong to individuals or companies resident, domiciled or whose headquarters are abroad) which enter Brazil to be allocated to a specific economic activity. Note that Brazilian Law does not consider the concept of nationality in defining the foreign investor; it resorts to the concepts of "residence", "domicile" and "headquarters".

Before we analyze the implications arising from the adoption of these concepts, we will inform the reader of the notions of "residence", "domicile" and "headquarters" in Brazilian Law. "Residence" is the place where a person lives or resides. "Domicile" is the place where an individual has the center of his or her economic and legal activities. "Headquarters" is the place where a company's administration or main office is located. Note that we have only used the words "residence" and "domicile" in the text of this book (and will continue to do so) because in U.S. Law, unlike Brazilian Law, "domicile" can be used for both individuals and companies centers of economic and legal activities. Consequently, we shall replace the word "headquarters" with the term "domicile" to indicate the main place of economic and legal affairs for both individuals and companies alike.
The following situations may occur as result of adopting these legal concepts:

1. if a foreigner who is a resident of Brazil makes an investment in the country, such investment shall not be considered foreign investment;

2. If a Brazilian who is a resident abroad makes an investment in Brazil, such investment shall be considered foreign investment.

Now what would happen to a foreign investor who transfers his residence or domicile to Brazil? According to the concept of foreign investment centered on residence or domicile abroad, the registration certificate for the investment with BACEN would be canceled and, as a result, he would no longer be entitled to repatriate capital or remit profits thereon.

**Chapter II**

General principles of the registration of foreign capital investment.

Provision 3 of Law 4131 provides that the following shall be registered with BACEN:

a) foreign investment made in Brazil, whether in cash, goods or loans;
b) remittances made abroad as repatriation of capital or remittances of profits, dividends, interest, royalties and other remuneration under technical assistance agreements or any other remittances

c) reinvestment of profits from foreign investments,

d) alterations in the capital of companies whose shares are held by either individuals or companies resident or domiciled abroad.

Provision 4 of Law 4131 establishes that:

"Registration of foreign investment shall be made in the currency of the country of origin and registration of reinvestment of profits shall be made simultaneously in the national currency (Reais) and the currency of the country to which said profits could have been remitted, and the conversion shall be made at the average rate prevailing for the period during which the reinvestment was made.

Sole paragraph - If the investment is made in capital goods, registration shall be made for the price of the goods in the country of their origin (pro forma invoice) or, if documentary proof is unavailable, for the price of said goods as entered in the books of the company which receives the investment.

Before we even comment on provision 4 of Law 4131, we must invite reader's attention to the fact that this provision has been partially amended. In fact, Decree 365 of December 16, 1991 provided that as of January 1, 1992 the registration of reinvestment of profits derived from foreign capital shall be made on the basis of the average exchange rate on the date of the capital increase (and no longer the average exchange rate prevailing in the period from the date of approval of capitalization of profits by shareholders to the date on which profit capitalization is sought with BACEN). Unquestionably, this change has greatly benefited foreign investors since, by altering the timing for the assessment of the rate, foreign investors would be allowed to use a more favorable exchange rate and therefore would have more hard currency to register with BACEN as profit reinvestment. Except for this particular change, the rules under Provision 4 of Law 4131 remain unaltered. Let us examine these rules in the next paragraphs.

Why is the registration of the foreign investment made in the currency of the country of origin? Why the registration of the investment made in Reais? There is only one explanation: because of the possible inflationary devaluation of Brazilian currency (although after the creation of Real Plan, the Brazilian currency became quite stable). Note that if the registration were to be only made in Brazilian currency by the time the foreign investor repatriates his capital or remit profits thereon, he may be sending a devalued currency vis a vis his own currency (This possibility currently is deemed to be unlikely to occur). To avoid this and to encourage foreign investment, Brazilian law enables the foreign investor to seek registration of his investment in the same currency in which the investment was made in Brazil. Incidentally, Decree 365 above confirmed the same applicable principle on this. Accordingly, if the foreign investor brings US dollars, he will be able to register the investment in US dollars.

In connection with the registration of capitalized profits, the Law provides for a double registration in the national currency and in the currency of the country to which the profits could have been remitted (both Law 4131 and decree 365 provide for the same rule on this). What is the reason for this double registration? Registration of capitalized profits is made in Reais because the profits have been entered into the company's books, whereas registration of capitalized profits is made in the foreign currency because said profits have accrued to the foreign capital originally registered with BACEN for the purpose of remitting profits abroad.

Provision 4 of Law 4131 quoted above seems to have created a distinction in connection with the registration of investment in foreign currency. Note that in the beginning of this provision, it was established that "the registration of foreign investment shall be made in the currency of the country of origin and registration of reinvestment of profits shall be made simultaneously in the national currency (reais) and in the currency of the country to which said profits could have been remitted" (please note that Decree 365 did not alter provision 4 of Law 4131 in this respect). Theoretically, the currency of the country to which said profits could have been remitted is the currency of the foreign investor's country. However, the phrasing of this provision raises a question: would BACEN allow the foreign investor to remit profits in a currency other than his own? We do not think so, except if the currency which he should remit abroad is unavailable in the market. For example, instead of authorizing a remittance in US dollars (the currency of the country to which the profits could have
been remitted), BACEN would authorize a remittance in German marks due to the unavailability of US dollars at the date of the remittance.

As previously mentioned, according to the sole paragraph of Provision 4 of Law 4131, when the foreign investment is made in capital goods, the respective registration with BACEN is made pursuant to the FOB price as stated in the pro forma invoice. However, BACEN may eventually authorize registration for the CIF price if the insurance and freight costs are actually defrayed by the foreign investor.

Provision 4 of Decree 55762 establishes that the registration of foreign investment can be made on the basis of foreign currency which is actually brought into Brazil. Thus, Provision 4 of Decree 55762 seems to revoke Provision 4 of Law 4131 in that the registration of the foreign investment may be made in the currency which is actually invested in Brazil rather than the currency of the foreign investor’s country of origin. This means that a US investor may bring Euros rather than US dollars if he wishes to do so.

Provision 5 of Law 4131 establishes that the registration of the foreign investment must be made within thirty days of the date of its entry in Brazil and that said registration shall be made free of charge. Within the same time limit, foreign investors must seek the registration of capitalized profits, that is, thirty days as of the date of publication of financial statement or dividend notice.

What happens if the registration is not sought within the time period set forth by Law? Would the investor lose his right to obtain the registration? The Law does not provide the answer to this question, except that Provision 58 of Law 4131 does establish penalties which vary from 20 to 50 times Brazil’s minimum wage in the case of violation of the Law. Thus, theoretically, the foreign investor who does not comply with the deadline to request the registration of his investment with BACEN would be subject to a fine. However, in practice, not even this penalty has been applied to those who do not meet said deadline.

If BACEN officials deny the request for registration of foreign investment, would remedies be available to the foreign investor to review the decision? Yes, he may avail himself of both administrative and judicial remedies to review the decision which denied him the requested registration. In the administrative area, he may appeal the decision to the director in charge of granting registration of foreign investments. Still on the administrative level, he is entitled to appeal the decision to the National Monetary Council, pursuant to Provision 4, item XXVI of Law 4595 of December 12, 1964.

If the foreign investor is not successful in his administrative appeals, he has the right to resort to the Brazilian courts where he may obtain an injunction from the courts in order to have BACEN register the foreign investment. This injunction, called “mandado de segurança” (“writ of mandamus”), is provided for by Provision 5 of Law 1533, promulgated on December 31, 1951.

2. PURPOSES OF REGISTRATION OF FOREIGN INVESTMENT WITH BACEN

The purposes of the registration of foreign investment with BACEN are basically the following:

a) Registration enables Brazilian government authorities to effectively control the inflow and outflow of foreign currencies in Brazil. In a country such as Brazil, which faces a serious balance of payments problem, this control is extremely necessary and important. We mentioned above that the remittance of profits is contingent upon the certificate of foreign investment issued by BACEN;

b) Registration provides the Brazilian government with reliable statistics concerning foreign investments in Brazil. On the basis of this statistical data, the Brazilian government may formulate more realistic policies on foreign investments and assess their contribution to the country’s social and economic development.
3. REGISTRATION OF FOREIGN INVESTMENT IN CASH OR GOODS

Either a representative of the foreign investor or a representative of the company which receives the investment may request the registration with BACEN. If the request is made by the former, he must furnish BACEN with the following information:

a) the nature of the investment: whether it shall be made in cash or in goods;

b) the value of the investment in foreign currency, the exchange rate and the corresponding value in reais;

c) the name and complete address of the company which shall receive the foreign investment;

d) the shareholders’ participation in the company’s capital including the number and types of shares subscribed to.

If the request is made by a representative of the company which shall receive the investment, he must provide BACEN with the following:

a) data on the foreign investor, including its name, complete address and capital;

b) data on the company receiving the foreign investment, including its name and complete address and capital structure.

In addition to the above-mentioned information, the following documents must be presented to BACEN:

1. a statement by the owner (foreign shareholder) that he is still the holder of the shares derived from the investment that he subscribed to, including the total number of shares, their serial numbers, par value and total value;

2. proof of the foreign investor’s domicile: in the case of individuals, a statement issued by the proper authority from the foreign investors’ country will be accepted as evidence. In the case of corporations, a statement signed by two directors of the Brazilian company which shall receive the investment declaring the foreign investor’s name and complete address shall be considered evidence;

3. when the investment is made in cash, the exchange agreement (“contrato de câmbio”) and the credit notice from the bank which handled the exchange operation must be furnished. When the investment is made in capital goods, the following documents must be presented: the import license, the proper customs document (“4a via do despacho alfandegário”) and the pro forma invoice;

4. copies of the publication in the Official Gazette of the following documents: the charter and by-laws of the foreign company which makes the investment and the minutes of the shareholders’ meeting in which the company constitution or charter or the increase in the capital of the company was approved;

5. copies of all entries in the company’s books concerning the foreign investment. Said copies must be signed by the company’s chief accountant or president.

Whereas this and the other lists of documents and information required by BACEN and mentioned in this chapter are subject to change, we strongly recommend that interested individuals or corporations check with BACEN on these matters at the time they apply for registration.

3.1 - Specific questions concerning the registration of foreign investment in Brazil either in cash or in capital goods

3.1.1 - Is there a legal requirement for a minimum capital contribution from the foreign investor?

No, Brazilian Law does not require the foreign investor to allocate a minimum amount of capital. Such allocation of capital should be made in accordance with the company’s financial needs and the foreign investor’s ability and willingness to allocate such funds.

3.1.2 - Is there a legal deadline to pay in the share subscribed to by the foreign investor?

No, Brazilian Law does not establish a deadline for (either national or foreign) shareholders to pay in the shares subscribed to. However, a few boards of trade in Brazil have required companies to insert a provision in their charters establishing a deadline agreed upon by shareholders. We think that this requirement is not based on the Law.
3.1.3 - The price of goods imported into the country in the case of foreign investment with capital goods.

We already know that the foreign investor may contribute with goods in exchange for shares in the capital of a Brazilian company. There have been cases where the foreign investor has falsely inflated the value of the goods imported into Brazil in order to obtain registration of the highest possible amount of foreign capital investment with BACEN. This fictitious price fixing of the imported goods is a violation of Brazil’s exchange Laws, and the violator is subjected to penalties in accordance with Provision 60 of Law 3244/57 as amended by Provision 169 of Decree Law 37/66 which reads as follows:

“The violations of the exchange control Law in the importation of goods shall subject the violators to the following penalties:

I ..............................................................

II- 100% (one hundred percent) of the value of the fraud in the case of fictitious over or under-pricing of the imported goods”.

Accordingly, assuming that the real price of the imported goods is US$1,000 but a value of US$1,200 is fixed, the importer would be liable for a US$200 fine, which is 100% of the difference between the fictitious price (US$1,200) and the real import price (US$1,000).

There was an interesting case whereby this penalty was questioned by an importer: a company whose capital was subscribed to by another company domiciled abroad had imported goods, such goods constituting the foreign holding company’s contribution to capital. The tax authority imposed the fine established in Provision 60 of Law 3144/59 (as amended) on the grounds that the prices of the imported goods were falsely fixed in order to give the foreign investor an advantage.

The company sought an injunction in court against the tax authority’s decision on the imposition of the penalty. The court ruled that there had been no violation of Brazil’s exchange control Law because the import was made without payment of foreign currencies. The authority appealed this decision and the higher court overturned the previous decision on the grounds that:

“The over or under-pricing of imported goods is per se a violation of the exchange control Law. When the import license was issued, the foreign investor, rather than receiving foreign currency payments, received shares in the company’s capital. These shares have as economic value and one may state that, for purposes of determining the overpricing of the imported goods, the value of these shares subscribed to with the goods would be considered as if payments had been made abroad. Therefore, we think that the penalty as imposed is lawful and the sentence must be reversed”.

Paragraph 2 of Provision 60 of Law 3244/57, enacted on August 14, 1957 establishes that “a difference either above or below the price, which does not exceed 10% (ten percent) of the price and 5% (five percent) of quantity or weight shall not be considered a violation of the foreign exchange law”.

In light of the rule quoted above, could the company have received a more favorable judgment from the higher court? Maybe it could have, if it could have proven that the difference in price was less than 10% of the real price and that such difference was not due to deceit, fraud or simulation. An administrative court decision sets forth this rule.

10. Writ of Mandamus 63, 239 of the Court of Justice of the former state of Guanabara ( today, the state of Rio de Janeiro). This decision was reached by Justice Jorge Lafayette Guimarães in Revista Aduaneira, nº 7/74, pp 144 - 154.

3.2 - Registration of the conversion of proceeds from foreign loans into foreign capital investment

Provision 50 of Decree 55762 authorizes the Central Bank to register the conversion of proceeds from foreign loans into foreign capital investment. The borrower, rather than being entitled to receive installments of principal and interest on the loan, is entitled to receive dividends on the investment after the conversion is made. The conversion is made by means of a symbolic exchange operation.

The following documents must be presented to the Central Bank so it can make the above mentioned conversion:

1. a statement from the investor that he is still the holder of the shares derived from the investment that he subscribed to, including the total number of shares, their serial numbers, par value and total value. In the case of nominal shares, this statement can be signed by the accountant, president or director of the Brazilian company which shall receive the investment;

2. in the case of symbolic exchange operations, the exchange agreement duly executed pursuant to the Law;

3. copies of the minutes of the shareholders’ meeting in which the capital increase resulting from the conversion was authorized;

4. copies of all entries in the company’s books concerning the conversion; and

5. the original of the registration certificate of the foreign loan which is to be converted into capital investment.

3.2.1 - Specific problems in the conversion of proceeds from foreign loans into capital investment

The conversion of the loan into investment can create a problem for which the Law did not provide a solution. As a general rule, with a few exceptions, the minimum amortization period for foreign loans is eight years. In other words, proceeds from foreign loans must remain in Brazil for at least eight years. Let us assume that the borrower wants to convert the loan into capital before the loan has been paid off. Can he do it? Yes, he can because

Brazilian Law does not require a minimum term for capital investment to remain in Brazil except if the investment is made in the form of a loan. Thus, the foreign equity investor can repatriate his capital any time he wishes.

Would the capital increase derived from conversion be taxable? No, pursuant to Brazilian Law, increase in capital is not taxed. Likewise, Brazilian Law does not tax capital increases arising from the capitalization of reserves and undistributed profits, except for the cases examined at the end of the chapter. Please note however that if interest on loans is also converted, then, there will be taxation on the interest prior to its conversion.

Should proceeds from foreign loans be converted into shares in the capital of the company which owes money to the borrower or can they be converted into shares in another company? Theoretically, they can be converted into shares in a company other than the one which is the debtor in case the debt is transferred from the original debtor to a third party and provided that the creditor agrees to this credit assignment. However, in practice, it is more common for the foreign loan proceeds to be converted into shares in the company which is the debtor.

3.3 - Registration of the conversion of foreign capital earnings into loans

Provision 50 of Decree 55762 establishes the conversion into loans of (1) interest on registered foreign loans, and (2) remittable profits on registered foreign capital and other remittable amounts abroad. In any such cases, BACEN must approve the interest rates and the maturity and grace periods of the loans. These rules change quite often due to Brazil’s economic and financial situation. Therefore, the reader is highly advised to update information with BACEN directly or through his or her Lawyers.

In the event of the registration of the conversion interest into a loan, the following documents should be presented to BACEN:

1. the registration certificate of the loan with BACEN;

2. copies of all entries in the company’s books concerning the amortization of the loan, evidencing all the interest already paid, the inflation adjustment of the balance and variations in the exchange rate;
3. in the case of a symbolic exchange operation, the proper exchange agreement ("contrato de câmbio");
4. the creditor's statement whereby the conditions of the loan are specified;
5. the original of the borrower's previous request for BACEN authorization of the loan; and
6. the new request form for BACEN's authorization for the conversion, duly completed.

Notice: the list of documents changes very often; please check with BACEN on the matter before application.

The following documents should be presented in the case of the registration of conversion of dividends into a loan:

1. the registration certificate of the foreign investment with BACEN;
2. a copy of the Official Gazette in which the company's balance sheet and profit and loss statement were published; and
3. a copy of the Official Gazette in which the minutes of the shareholders' meeting at which the balance sheet and the distribution of dividends was approved were published.

3.4 - Registration of the conversion of royalties and payments due under technical and scientific services, and other royalty related agreements into foreign capital investment

In the case of a request for registration of the conversion of royalties due under technical service, transfer of technology or patent and trademark license agreements into foreign capital investment, the following documents should be presented to BACEN:

1. the application for registration of investment form duly completed;
2. indication of the owner of the privilege (whether technology, patent or trademark) or the render of the service, that the privilege is still valid or the service is to be rendered;

3. certificate of the existence and effectiveness in Brazil of the respective privileges granted by INPI as well as evidentiary documentation as to validity thereof in the respective country of origin;
4. Certificate of INPI's approval of the respective agreement;
5. copy of the minutes of the general meeting of shareholders or the amendment to the charter of the company with their respective registration with the proper Trade Board; and
6. a copy of the book entries made by the company which owes royalties under any of the above mentioned agreements.

We wish to invite reader's attention to the fact that BACEN on June 2, 1992 promulgated Circular Letter 2282 which established conditions for registration of foreign capital by means of use of royalties under patent and trademark license agreements, conditions which are set forth above.

3.5 - Registration of Transfer of Technology and Technical, Patent and Trademark License Agreements

Since the publication of the first edition of this book, the entire legislation on transfer of technology agreements and technical assistance agreements has been changed. In first place, the basic body of legislation in this area, the INPI Normative Act n°15 (which was extensively examined in the first edition) was abolished. The effect meaning of these changes was to facilitate the registration of these agreements and refreshing liberal winds have swept through the corridors of INPI in connection with this matter. All to please foreign investors and to encourage foreign technology to come to Brazil and to effectively participate in Brazil's new age of prosperity and economic development. The federal government finally understood that foreign capital is quite sensitive to rigid and unfair regulations. The government finally realized that if abundant capital and technology were to be invested in Brazil, the vast array of strict legal regulation of the past had to go away. Basically, that was what happened.
3.5.1 - Patent license agreements

The Code of Industrial Property which was examined in the 2nd edition of this book was revoked. Brazil’s new patent law is law no 9.279 enacted on May 14,1996. We shall hereby summarize the basic legal principles which apply to patents in conformity with the new legislation. First, for a patent to be eligible for registration with INPI it must disclose a novelty or priority in the state of the art (art. 8). Accordingly, foreign patents which may have been inserted in the category of “public domain” are not eligible in Brazil under current legislation. In this respect, one should remind the reader that Brazil is a signatory of the Paris Convention on the protection of industrial property and the new Law confirmed the provisions and obligations arising from all international treaties which Brazil had signed (art.4). Likewise, the owner of a foreign patent may seek its registration in Brazil provided that he is able to demonstrate that the priority rule was observed. As per article 4(c) of the Paris Convention, priority periods are twelve months for patents of invention and utility models, from the date of application in the country of origin.

If the basic requirement is met as per the preceding paragraph, the foreign licensor may seek registration of his patent in Brazil. Under the new patent Law, a patent of invention is valid for twenty years as per article 40 of Law no 9.279 (and not 15 years as per the previous Law); patents on utility models are valid for fifteen years from the date of application for their registration with INPI (and not 10 years as per previous legislation).

Under current Brazilian law, causes for forfeiture of the patent are the following:

a) if the annual fee is unpaid;

b) if the patent is not exploited in Brazilian territory within two years of the date of the issuing of the patent certificate;

c) if the validity of the patent license is expired in the country of origin;

d) if the patent owner expressly renounces the rights under the patent certificate; and

e) if the patent owner is not duly represented by an attorney in fact in Brazil.

(Law no. 9.279, art 78)
Questions arise as to how patent rights under a license agreement can be evidenced in order to avoid forfeiture. In practice, for instance, periodical importation of the items covered by the patent rights may also evidence its use in Brazil even though a formal agreement to license the patent has not been signed. Otherwise, in the case of an agreement being performed, there seems to be no problem; the performance of the agreement itself is the evidence.

Under Brazilian Law, patents can be classified as follows:

a) patents of invention; and

b) utility models.

The following cannot be patented as either inventions or utility models under the new Brazilian patent Law:

a) new scientific findings and theories, and mathematical models;
b) purely theoretical concepts;
c) plans, principles and methods of a commercial, accounting, financial, educational, marketing or monitoring nature;
d) literary, architectural, artistic, scientific works and aesthetic creations;
e) software programs;
f) simple data presentation;
g) game rules;
h) surgical, therapeutical and medical techniques and processes; and

i) scientific concepts involving biological materials to be found in nature "in living status".

(Law 9.279, art. 10).

However, the great advancement in the new Law which much pleased the US industrial segment was that pharmaceutical or drug inventions and formulae can now be patented in Brazil. This has prompted many new investments as announced by US and European companies in this segment of the Brazilian economy.

Provision 3 of Law 4131 provides for special registration of license and technical assistance agreements as well as patent and trademark license agreements with BACEN. The company or individual interested in the registration of the above mentioned agreements with BACEN must present the specific registration form to BACEN duly completed. We refer the reader back to section 3.4 of this chapter on this issue.

As to remuneration under a patent license agreement, the following must be said. The price for the patent license is, pursuant to the Law, established on a percentage basis or as a fixed value per product unit, in either case imposed on or related to the net sales price or, when applicable, linked to the profits earned by the product which is being licensed. The percentage as negotiated by the parties should be calculated on the "net sales price". Note that for purpose of calculating the remuneration, the concept of "net sales price" above is the value of the invoice, based on actual sales, less taxes, charges, raw materials and components imported either from the licensor or from any other supplier directly or indirectly linked with him, commissions, return credit, freight, insurance and packing expenses, in addition to other deductions agreed to by the parties.

The term of the patent license agreement can not exceed the term of validity of the corresponding patent as registered with INPI.

Other contractual stipulations stated in a patent license agreement are left to the parties' freedom to contract and much of the nonsensical regulation imposed by INPI Normative Act no. 15 are gone. This has stimulated patent owners to license in greater numbers to Brazilian companies interested in obtaining the state of the art. And yet, some basic public order interests should be taken into consideration when such agreements are drafted. Accordingly restrictions on a licensee's ability to export should definitely be avoided as it would most certainly trigger government opposition. These provisions badly hurt Brazilian interests and affect the country's basic drive and need to generate hard currency.

As to contractual stipulations concerning royalty payments, although it has
been suggested that limitation on such payments abroad have been eliminated, the fact is that INPI still monitors such remittances. The policy which INPI currently uses for this monitoring on is the so-called “market conditions” although it remains unclear what these conditions may be. The fact is that the 5% royalty limitation which was enforced in the past (as an analogical construction of the Portaria MF 436/58) still subtly prevails and only exceptionally has been lifted as in the case of high technology transfer agreements concerning capital goods production.

3.5.2 - Trademark license agreements

A trademark license agreement is defined as an agreement for the purpose of authorizing the actual use by third parties of a trademark or advertising slogan duly filed or registered in Brazil which assigns industrial property rights to the licensor under the new Law 9.279. The products or services to be identified by the trademark or advertising slogan covered by the license must be in conformity with the licensor’s activity, pursuant to the registration certificate of the trademark.(Law no. 9.279, articles 122 et al).

The rules on remuneration of the trademark license agreements are quite similar to those in patent license agreements. However, please note that for trademark license agreements, the royalties are still limited to 1% of the so-called “net sales price” as previously defined. Very infrequently the INPI will agree to approve a higher percentage than this as a trademark license fee.

Very important legal changes were introduced in relation to remuneration both of patent and trademark license agreements. In the past, article 14 of law 4131 strictly prohibited payment of royalties under patent and trademark license agreements running between parent and subsidiary companies. Law 8383 enacted on December 30, 1991 changed this dramatically; pursuant this law, subsidiaries may pay to their parent companies abroad royalties under patent and trademark license agreements. Of course, limitations set forth in the preceding paragraph in connection with patent and trademark license agreements are also applicable to such agreements entered into between parent and subsidiary companies. This change met a long time expectation on the part of the multinational companies in Brazil.

Incidentally, the same rights were implicitly granted to licensors under transfer of technology agreements and technical service or assistance agreements when the parties are parent and affiliate companies. Although the previous law never forbade such payments, government authorities had systematically vetoed them whenever a subsidiary was to pay royalties under such an agreement to its parent company abroad. Today, prohibitions have vanished, not least because the law never prohibited such payments under transfer of technology and technical service agreements.

Still in connection with trademarks, the following remarks ought to be made. Trademark rights in Brazil derive only from registration; accordingly, trademark owners must be extremely cautious and aware of the need for registering its trademark in Brazil. Unfortunately, the country has a bad record of “acts of trademarks thievery”. However, courts have been very keen to grant rights to foreign trademark owners when in the absence of a trademark registration in Brazil, notorious use of the trademark internationally may be evidenced.

As a reminder, Brazil is a signatory to the Paris Convention on the protection of trademarks. Accordingly, anyone who has duly filed an application for a trademark in one member country may do so in any other member country within a period of six months, and that for this purpose, the relevant date is the date of the filing of the application in the country of origin. The Paris Convention also enables trademark owners to seek registration of their trademark as a foreign or a national mark. In Brazil, this dual alternative is both possible and feasible. In conformity with article 127 of law no. 9.279, foreign trademark owner may apply for “priority rule” if he has the registration in a country with which Brazil has a treaty concerning trademark protection or registration, and the validity of this registration shall be the term as established therein.

The new law under article 127 provided that internationally notorious trademarks as defined in the Paris Convention shall have special protection in Brazil irrespective of whether or not the said trademark is registered with the INPI. This shall inhibit those who, in the past, were able to register as their own well-known trademarks whose original owners neglected their registration in Brazil prior to the new law.
Trademark registration is valid for ten years in Brazil as per article 133 of the new Law. The term of its validity may be extended for equal periods.

Under the new law, a trademark may be forfeited under the following situations:

a) upon the expiration of the term of the trademark registration certificate if renewal was not obtained;

b) if the trademark certificate owner waives his rights thereunder;

c) if the trademark owner, resident or domiciled abroad, fails to remain represented in Brazil under a power of attorney.

(Law no. 9.279 article 142)

Under the new law, the trademarks are used to identify:

a) products or services;

b) “certification trademarks” (“marcas de certificação”) which are defined by the Law as “the one used to attest the conformity of a product or a service to given norms and technical specifications, namely as to quality, nature, material and applied methods”; and

c) “collective trademarks” (“marcas coletivas”) which are defined by the law as “the one used to identify products or services originated from the members of a given entity”.

(Law no. 9.279 article 123)

The same requirements and restrictions applicable to patent license agreements are valid for trademark license agreements. As for their content, greater freedom to contract has been granted provided that public order and responsible social values are complied with. Accordingly, foreign rules of interpretation and jurisdiction are inapplicable. As we indicated in the first edition of this book, given the high public interest in the matter, Brazilian courts and national laws apply to such agreements. Likewise, restrictions on licensee’s ability to export should definitely be avoided.

3.5.3 - Supply of technology agreements

The industrial technology agreement is an agreement for the specific purpose of acquiring knowledge and know-how unprotected by industrial property rights. The agreement is designed to transfer technology for the production of consumer goods or materials in general.

Many questions asked on this type of technology agreement in the first edition of this book became moot to the extent that INPI Normative Act no. 15 was replaced by INPI Resolution no. 22. This Resolution simplified tremendously the wording and the ultimate registration of these agreements with the INPI. Therefore much of their content was left to the parties' freedom to contract and bargain. However, remarks as to the essential conditions of these agreements must be made.

Current legislation does not afford clear criteria under which royalties or fees under such agreements may be charged. As a matter of policy and practice, it is understood that parties may (as in the past) establish royalties under a fixed fee or a percentage of either the net sales price of the products or the profits made under the agreement. Likewise, royalties may also be payable as an amount per unit of the product being manufactured under the agreement. As a reminder, “net sales price” is the value of the invoice, based on actual sales, less taxes, charges, raw materials and components imported either from the licensor or from any other supplier, commissions, return credit, freight, insurance and packing expenses in addition to other deductions agreed to by the parties. It is unclear however in the new legislation what the limits, if any, are in connection with the royalties under this agreement. In the absence of a clear cut limitation, we construe the rule to be that the parties are free to stipulate royalties under the agreement subject to INPI’s prior approval of the said fees. INPI has the power to approve or disapprove such fee or royalty arrangements between the parties and the criterion upon which the INPI makes its decision is based on “market conditions”. This criterion however is entirely unclear since no definition of “market conditions” is found anywhere. It is therefore advisable for the licensor to consult INPI about royalties prior to application for registration of the license agreement. Once the INPI has approved the royalties, by registering the agreement, BACEN will follow this approval and will allow the licensee to remit royalties to the licensor abroad. We also understand that in order to provide licensee the full command of the
technology, assistance may be provided. For such assistance or training, licensor may be entitled to receive a fee in line with world standards in similar services.

It is also unclear what the term of these agreements may be. Current legislation does not set forth limits on the term of their validity. In the past INPI would generally grant a 5 year term and on the basis of such practice, we think that the 5 year term would be applicable to this category of agreements. In exceptional cases, extension of this term may be granted. In applying for term renewal, licensor and licensee must duly evidence that it is absolutely necessary to complete licensee’s mastering of the technology.

Although current legislation is not so detailed as in the past, it is understood that under a supply of industrial technology agreement, licensor should supply licensee with a complete set of information. This would include the set of formulae and technical data, industrial drawings and models, operating instructions and other elements related to the product under the agreement.

Finally, as a matter of policy, attorneys should be careful about the wording of a supply of industrial technology agreement in order to avoid violating the so-called “public order” provisions. Accordingly, licensor should not claim any sort of property rights as it is assumed that he (or it) has none. Also the agreement should not provide for foreign court jurisdiction and the construction of the agreement under laws other than those of the Federative Republic of Brazil. We have stated that transfer of technology in Brazil is a matter of public order; the national community has an enormous interest in this area and therefore controversies arising from or related to this matter should be governed by Brazilian Law and should be submitted to Brazilian courts of law. Arbitral awards in Brazil may be provided for but attorneys should take the difficulties in their implementation into due consideration. Under Brazil’s current Code of Civil Procedure, arbitral awards, to be valid, must be confirmed by courts. In such confirmation, courts would examine all the formal validity of the arbitral award.

Needless to say, this may be time consuming and it may defeat the purpose intended by the parties when they first thought of arbitration as a form of conflict resolution. Although a new federal law on arbitration was enacted in 1996, we still believe that arbitration remains a problem in Brazil under article 5 (subparagraph XXXV) of the Brazilian Constitution which enables any individual or company to resort to the court system whenever their rights are violated and that no Law shall diminish such constitutional right. As long as this constitutional right exists, arbitral awards may always be questioned in Brazilian courts. Please note, however, that a recent Supreme Court decision (2001) interpreted this 1996 federal Law on arbitration as not being inconsistent with Brazil’s 1988 federal constitution.

3.5.4 - Technical and Scientific Assistance Service Agreements

A technical and scientific assistance service agreement is an agreement for the specific purpose of planning, programming and preparing studies and projects of a technical or scientific nature as well as executing or rendering services of a specialized nature which are needed by Brazil’s manufacturing system or for scientific development. Such agreements must contain the following:

a) drafts of master plans, technical, scientific, economic and financial preliminary feasibility studies as well as feasibility studies, planning in general including those plans related to engineering services;

b) drafts of plans, preliminary projects and basic executive projects, as well as drafts of the preparation and control of all the divisions and stages of those plans;

c) the installation, assembly and preparation for operation of machines, equipment and industrial units;

d) in case of scientific assistance, the details of such assistance and specification of the purposes of the scientific research;

e) other specialized technical and professional engineering and/or consulting services; and

f) the hiring of foreign technicians to carry out certain specialized professional work for a fixed time.
Under INPI Resolution nº 22, the licensor of these services, whether of a technical or scientific nature, must enable licensee to master and develop its know-how so that effects of permanent dependence may be eliminated.

The new legislation does not set clearly forth maximum remuneration levels or limits for agreements. However, we suggest that the remuneration and fees to be stipulated under these agreements must be in line with standard remuneration for similar services worldwide. The reader should also bear in mind that only technical and scientific assistance services currently unavailable in Brazil would be registered with and approved by INPI.

3.5.5 - The validity of certain provision inserted in transfer and technology agreements in light of new legislation

As previously indicated, much freedom was left to the parties to negotiate and draft their transfer of technology agreements. On the other hand, INPI still has discretionary powers inasmuch as it retained its legal power to approve or disapprove such agreements. To aggravate this apparent dichotomy, the new legislation is rather vague and unclear as to many provisions which caused problems in the past. This segment of this book will endeavor to examine these provisions and our suggested solutions to the problems they create.

a) Can the licensor stipulate that the transfer of the technology be made to the licensee without exclusivity?

Would the INPI allow the licensor to covenant to transfer technology to the licensee without exclusivity? By the same token, would the licensor be able to enter into several agreements in Brazil concerning the same technology? In our opinion, it is unlikely that the licensor would be able to register more than one agreement with the INPI concerning the same technology. The INPI permits foreign currency payments under transfer of technology agreements provided that the technology is new and in the national interest.

b) Can the licensor stipulate that the delivery of the technical information be made contingent upon the payment of the price?

INPI Resolution nº 22 does not prevent the licensor from stipulating with the licensee that the transfer of technology be made at the same time as the price is paid. However, this provision is not feasible in agreements wherein the price must be paid on the basis of a percentage of the net sales price of the products as herein defined. This would presuppose the actual manufacture of the products which, in turn, would require the delivery of all the technical data necessary to their manufacture.

c) Can the licensor stipulate that a price be paid in case of the sale of any products, provided that their manufacture was partly the result of the licensor’s technology?

The licensor may stipulate that the price can be paid as a percentage of the sales price of the product or for a fixed price for each product unit in transfer of technology agreements. For this purpose the parties may:

1. list in an addendum to the agreement the products which shall be covered by the agreement, or

2. indicate that the price shall be due in the event of the sale of “any product manufactured using part of the subject technology”. Is the alternative set forth in this item (2) Lawful under current legislation?

Note that the item (2) alternative is less advantageous to the licensor, since the licensee would be likely to pay a higher price than if he had chosen to limit the number of products covered by the agreement. However, we believe that current law does not prevent the parties from inserting a provision by which the remuneration would be paid to the licensor in case of sales of products manufactured with the subject technology.

d) Can the licensor stipulate that the remuneration be paid not only in case of sales of the products made with the technology but also in case of other forms of their use, such as their rental?

INPI Resolution nº 22 does provide the answer to this question. There are companies whose purpose is not the sale of products but their rental. In the case of transfer of technology agreements, these companies may stipulate that their remuneration be paid not only as a percentage of sales but also of the net rents of the equipment. In our opinion, such a stipulation is valid under current Brazilian Law.
c) Can the parties define the concept of “net sales price”? 

The concept of “net sales price” under current law (INPI Resolution n° 22) is still rather vague for the purpose of establishing applicable criteria of remuneration for transfer of technology agreements. We have suggested on the basis of past experiences and INPI policies that the concept of net sales price be the value of the invoices, based on actual sales, less taxes, charges, raw materials and components imported either from the supplier of the technology or from any other supplier directly or indirectly linked to the former, commissions, return credit, freight, insurance and packing expenses, in addition to any other deductions which may be agreed upon between the parties.

Can the parties, for instance, define what taxes and charges are included? Yes, in our opinion, they certainly can do it. However minimum taxes on sales of products must be excluded, such taxes being the IPI, ICMS, PIS and COFINS. Likewise, the parties may stipulate that the following charges may be deducted from the value of the invoices:

1. the CIF (cost, insurance and freight) import price of the product components when said components are exported by the supplier of the technology or by companies associated or affiliated with the supplier and

2. the value of the commission or the credits from the return of defective components. Such credits, however, shall not be deducted when the exporter covenants to replace the defective components.

f) Can the parties insert a provision in the transfer of technology agreements to the effect that the installments of the price to be paid for the technology shall be indexed?

Unlike in the past, this has become a real problem since current legislation banned indexation in agreements between and among private parties and in fact abolished all value and price indexes which we had known in the past. All this based on the theory that such indexes would themselves fuel inflation. Moreover, in the last three years, Brazil has experienced a successful period of economic and financial stability under the “Plano Real”. During this period, not only was inflation effectively held but deflation has occurred in some months. Therefore, indexation at this time would not make much sense and would perhaps raise objections from the INPI.

g) Can the supplier of the technology stipulate a remuneration based on a fixed price as well as on a percentage of the net sales price of the products?

Under INPI Normative Act n° 15 (no longer in effect) this provision was strictly forbidden. However, under current regulation, INPI Resolution n° 22, there is no article which would explicitly bar this stipulation. Therefore on the basis of the principle of the parties’ freedom to contract, we would suggest that the parties may stipulate that in consideration of the transfer of the technology, licensees would pay royalties based partly on a fixed amount as well a percentage of the net sales price of the products being manufactured and sold under that agreement. This reflects the author’s point of view based upon an acceptable general principle of legal interpretation in Brazil. However, given that government policies in this country change very often, reader would be well advised to seek prior consultation with INPI on this particular matter.

h) Would prepayment provisions be legal?

Current INPI regulations do not clearly provide the answer to this question. However, it is doubtful that INPI would approve and register an agreement whereby licensee would be required to make full payment before licensor fulfills its obligation thereunder. We would think that the same conclusion may be reached if we would apply the “consideration rule” of US law on contracts. And perhaps, this may be true in other legal systems whereby the “consideration rule” prevails such as in Brazil’s Law on contracts. Nevertheless, provisions aiming at requiring licensee’s to make initial and partial down payments for the technology present no problem.

i) Can the supplier of the technology charge interest for late payment of the price?

Yes, in our opinion, the supplier may charge the recipient of the technology interest for late payment of the installments provided that he or she observes the legal rate in force. We wish to call reader’s attention to the fact that under article 192 § 3 of Brazil’s new Constitution enacted October 5, 1988, interest rates have been limited to 12% per year. Strange as it may sound, this article has become rather controversial and in practice this constitutional provision has been frequently violated. The reader may well
realize that the controversy arises from a real paradox that Law and economics always interplay in Brazil. In the first place, this matter should have never been dealt with in a Constitution. Second, the limitation itself is preposterous to the extent that it is not feasible to limit interest to 12% per year in a country where inflation used to be very high. The problem becomes even worse inasmuch as escalation clauses are currently forbidden. However, as we write this fourth edition of the book and in view of the continuing the success of the "Plano Real", we believe that escalation or indexation clauses do not make sense any longer and that 12% interest per year is quite reasonable.

j) Can the supplier of the technology charge the recipient penalties for late payment of the price?

Transfer of technology agreements may provide for penalties in the event of late payment of the installments provided that pursuant to Brazilian Law (Decree 22,636 of April 7, 1933, provs. 8 and 9), the penalty does not exceed 10% of the value of the debt and is for the payment of court and attorney’s fees only. BACEN is unlikely to authorize payments abroad in connection with the penalties provided for in Brazilian Law.

k) In transfer of technology agreements whereby the price is to be paid as a percentage of the products’ net sales revenue, can the supplier stipulate that the agreement may be rescinded if the recipient does not meet a required minimum sales quota?

The transferred technology has a price and this price theoretically reflects the costs which the supplier of the technology had to incur in order to develop it. Therefore, it is fair that the supplier may expect to be remunerated for the transfer of his technology. The price should consist of the above mentioned cost plus a fair profit.

Current legislation, as indicated previously, is silent on the matter of remuneration. However, based on INPI's current policies and practices, we know that licensor may fix a price for the technology based on fixed costs or a percentage thereof. If the price is established as a percentage of the product’s net sales revenue and if the sales of the product are below a certain level, the supplier may consider the remuneration unsatisfactory. Therefore, the supplier may be interested in inserting a provision in the agreement to the effect that if the sales of the products do not generate a minimum remuneration, the agreement can be rescinded.

However, we have indicated that transfer of technology agreements represent redeeming social values for the Brazilian community and they would fall into that category of “public order” agreements. In other words, the Brazilian government (representing the Brazilian community) has an interest in such agreements to the extent that they contribute to Brazil’s overall economic development and prosperity. In that respect, technology is the key to the country development and prosperity. Therefore we suggest we examine this provision in view of this doctrine. The INPI was created to guarantee the effective and complete transfer of foreign technology to Brazilian companies. Note, however, that if the above mentioned provision is enforced, the transfer of technology is jeopardized. Thus, believe that the INPI would most likely question the validity of this type of provision whereby the agreement would be terminated if the recipient could not meet a required minimum sales quota. In order to support its position, INPI might argue that when the remuneration was established as a percentage of the product sales revenue, the supplier of the technology agreed to participate in the recipient’s business as if he were a partner; consequently, the supplier would have to share the recipient’s success or failure in the business.

i) Under what circumstances would the INPI allow the termination of a transfer of technology agreement?

For the reasons stated in item “k” above, termination of transfer of technology agreements may not be left to the parties’ free will; it must be made contingent upon certain events which prevent the parties from fulfilling their obligations. Thus, the INPI must allow the parties to terminate the agreement in the following cases: (1) force majeure; (2) extinction, liquidation, bankruptcy or “concordata” (the Brazilian equivalent to the U.S. Chapter XI) of one of the parties to the agreement; and (3) default as defined by the agreement save the exception highlighted in item “k” above.

m) Invoicing services related to transfer of technology agreements after the term of validity of the INPI’s registration for the agreement has expired.

When the INPI approves transfer of technology agreements it issues a registration certificate which contains the essential provisions of the agreement, such as the purpose, price, form of payment and term. Presentation of the certificate to BACEN enables the recipient to remit foreign
currency payments to the supplier under the transfer of technology agreement.

Let us assume that the supplier renders services and invoices the recipient in connection with a transfer of technology agreement after the term of the agreement as stated in the certificate expires. Can the recipient continue to make foreign currency payments to the supplier on the basis of such invoices? We think not. Therefore, in order to avoid this situation, the supplier should make sure that the invoices are issued within the term of validity stated in the certificate.

ii) Alterations in the terms of the registration certificate issued by the INPI for transfer of technology agreements.

Can the terms of the registration certificate issued by the INPI for a transfer of technology agreement be altered? Yes, provided that there is an error or an inconsistency between the terms of the certificate and the terms of the agreement submitted to the INPI for registration.

4. REGISTRATION OF THE ASSIGNMENT OF SHARES OR CREDITS PREVIOUSLY REGISTERED WITH BACEN

Provision 52 of Decree 55,762 provides that:

"The capitalization of profits and the assignment of shares or credits between individuals or companies resident or domiciled abroad are not subject to symbolic exchange operations.

Sole Paragraph - When the above mentioned assignment is made to individuals or companies resident or domiciled abroad, registration shall be canceled".

The Law does not provide for the assignment of shares or credits from individuals or companies resident or domiciled in Brazil to individuals or companies resident or domiciled abroad. Can the assignment of such shares or credits be registered with BACEN as foreign capital? Yes, we think so because this type of assignment would correspond to the entry of cash or goods into Brazil, and such entry would meet the requirements for foreign capital investment pursuant to Provision 1 of Law 4131.

5. CAPITALIZATION OF PROFITS AND RESERVES AND THEIR REGISTRATION AS FOREIGN CAPITAL WITH BACEN

Provision 7 of Law 4131 defines capitalization of profits as "profits earned by companies domiciled in Brazil which could be distributed to shareholders who are resident or domiciled abroad but which are, in fact, capitalized by the companies which produce such profits or are utilized in paying up shares in the capital of some other company".

As part of the federal government’s grand plan to modernize and liberalize the Brazilian economy, foreign capital investment was greatly benefited. Many restrictions that BACEN imposed on the capitalization of profits (whether or not based on written regulations) just vanished. As a rule of thumb, it would be fair to state that, as a matter of Law and policy, BACEN would enable a foreign investor to capitalize its profits under the same conditions and rights which Brazilian Law grants to individuals or companies resident or domiciled in Brazil. In fact, the author has always advocated this doctrine based on the constitutional principle of equality under which “everyone is equal under the Law”, such principle being embodied by Brazil’s Federal Constitution of 1988 (article 5).

Irrespective of the general principle stated in the preceding paragraph, we must examine the few situations where questions as to the capitalization of profits and reserves are still lingering. Before we do that, we must advise the reader that capitalization of profits and reserves for foreign capital investment purposes is regulated by three major bodies of regulations: Law 4131/62, Decree no. 55762/65 and BACEN Circular Letter ("Carta Circular") no.2266 of March 13, 1992. For readers who are totally unfamiliar with the Brazilian legal system, we would like to inform that BACEN has legal powers to issue administrative orders (such as the so-called “Carta – Circular”) which have binding effects to the extent that they do not violate Laws or executive orders. Be that as it may, the fact is that BACEN has resorted to this “law making” functions frequently and in a few instances it has done so, in our judgement, irrespective of laws providing otherwise. Fortunately, this has not been the case with “Carta-Circular"no. 2266 which, in fact, reinforces the Brazilian government disposition and willingness to support foreign capital investment. These general statements having been made, we are ready to examine a few par-
Capitalization for purposes of changing the foreign currency value of the investment registered with BACEN.

5.1.3 - Earnings from the sale of company real estate

In the past, BACEN would not acknowledge for foreign capitalization purpose, earnings derived from the sale of company real estate on the basis that such earnings are not taxed. Frankly this position ought to be reviewed as taxation is absolutely irrelevant for capitalization. The fact is that the profit derived from the sale of real estate (and for that matter the sale of any asset of the company) which can be distributed to shareholders can likewise be destined for capitalization. Accordingly, if shareholders decide to capitalize such profits rather than distributing and remitting them abroad, we understand that they are entitled to do so. Therefore BACEN would not be in a position legally to deny the application for the registration of such profits to acknowledge the increase in the value of the foreign capital certificate as a result of the said capitalization.

5.1.4 - Reserve to offset a company’s eventual losses

Brazil’s corporate Law (Law 6,404, article 195) created a corporate reserve requirement designed to offset a company’s eventual losses. The Law provides that such reserves may be distributed to shareholders as dividends in a tax year when predicted losses do not occur, or in a tax year when losses are completely offset the balance of said reserves may be distributed to shareholders. Whenever this is the case, we believe that BACEN has no legal reasons or grounds to deny the application for capitalization of such profits for the purpose of increasing the amount of the foreign capital certificate.

5.1.5 - Remittance or capitalization of profits derived from financial operation

In the past, BACEN did not acknowledge non-operational profits generated from activities of companies other than their stated corporate purposes. Frequently, subsidiaries of foreign-owned companies (as well as Brazilian companies in general) in order to avoid inflationary erosion of their reserves, invest such funds in an immense gamut of alternatives in the Brazilian capital market. Such investments would generate profit, technically known
as "non-operational profit" or "non-operational earnings". Thus, BACEN in the past had systematically refused to allow the remittance or even the registration of the capitalization of such financial profit as foreign capital investment. The underlying theory for the denial allegedly resides in the fact that, in BACEN’s judgment, those were speculative profits which should not have generated the foreign investor’s right to either remit such profits or capitalize them for the registration of the capital increase and an upward alteration of the hard currency figure as stated in the corresponding certificate of foreign capital investment issued by BACEN. Obviously, BACEN’s allegations were fallacious as it became evident that these investments were not speculative in nature but rather an essential expedient that all Brazilian companies as a matter of caution have taken in order to shield themselves and their investments from Brazil’s past chronic inflation.

In addition, another argument in favor of either such profit’s remittance or its capitalization for foreign capital purposes is the fact that such profit would be eligible for eventual distribution to shareholders. As indicated previously, the general doctrine established by BACEN itself is that all dividends payable to shareholders can be either remitted abroad or capitalized for the purpose of increasing the value of the foreign currency figures stated in the certificate of foreign capital investment issued by BACEN. Finally it is worth remembering that because of the Brazilian constitutional principle of equality, if firms or companies headquartered or domiciled in Brazil can either distribute accruals derived from financial investments as dividends to shareholders or capitalize them, similar companies the shares of which are held by individuals or companies resident or domiciled abroad are entitled to the same privileges and rights in connection therewith.

Due to the strength of the reasoning set out in the preceding paragraph, BACEN reviewed its previous position on the matter. In effect, BACEN, in Circular Letter 2266 clearly admitted the registration of the capitalization of the so-called "financial profits" or "non-operational earnings" for the purpose of increasing the hard currency figures stated in the certificate of foreign capital registration. However, BACEN admitted such registration (as well as the remittance of dividends in case foreign shareholder chooses not to register such dividends) in compliance with the rule of proportionality. The rule of proportionality consists of pegging a limit for either the profit remittance or its capitalization (and ulterior registration as foreign capital reinvestment) in proportion to the percentage of the foreign capital participation vis-à-vis the overall capital of the Brazilian company which receives the foreign capital investment. Accordingly, let us assume that a foreign investor possesses 50% of the shares of a Brazilian company; in applying the proportionality rule, and assuming that the Brazilian company had generated profit from the financial investments of their funds amounting to US$1,000, the foreign investor in this case, would be able to either remit US$500 or to seek BACEN’s registration of US$500 to be accrued as profit reinvestment to its original capital investment with BACEN. Assuming for instance, that the certificate of foreign capital investment reflects an original capital, as registered of US$2,000, after the registration of the capitalized profit, the certificate will reflect a total amount of US$2,500. Although this can be seen as a lingering limitation, it is a quite rational use of BACEN’s limiting powers and obviously an immense improvement in its attitude towards foreign investors. This attitude will undeniably bring a more favorable response from foreign investors who now consider Brazil as a better place to allocate their savings. We are all looking forward to seeing the continuation of this trend on the part of BACEN and other Brazilian government authorities so that rhetoric and practices can combine to effectuate Brazil’s great advancement in social and economic development.

5.1.6 - Questions as to remittance and registration of interim dividends

In the past many questions and doubts have arisen in connection with Brazilian companies’ ability to pay and remit abroad to their parent companies interim dividends. BACEN has strongly resisted against the idea of allowing remittances of interim dividends. The problem is a bit more complex than what it appears to be at first glance.

Brazil’s corporate Law (art. 204 and. 182 § 1 of Law 6404/76) allows corporations to distribute interim dividends for periods less than one semester provided that total dividends paid up in each six month period do not exceed the company’s total reserve at the time. This is true for Brazilian corporations; Brazil’s limited liability companies (“sociedades limitadas”) based on Brazilian New Civil Code that does not have similar requirements. Given the shareholders’ freedom to stipulate in the absence of legal provisions to the contrary in a limited liability company, it is understood that shareholders may provide for dividend distribution in period of less than 6 months (e.g. on a quarterly basis) irrespective of the limitation indicated above, provided that a proper provision to that effect is inserted in the charter of the limited liability company. Therefore, in view of these legal provisions and under BACEN current regulation (“Carta- Circular” nº 2.266), interim dividends may be either remitted abroad or registered with BACEN as profit.
reinvestment in capital for the purpose of increasing in the value of the foreign capital investment certificate, provided that pertinent articles of Law 6404 cited above are complied with or the provision of the charter of the limited liability company enables the company to make such interim profit distribution (or their respective capitalization) in the period set forth therein.

However Circular Letter BACEN n°2266/92 article 4 provides that in connection with interim dividend distribution or capitalization, recipient companies must submit at the end of the tax year a final balance sheet of such year to BACEN for examination. Upon such BACEN examination, if BACEN finds that the company recorded losses in its balance sheet, and the amount of profit as shown in the balance sheet is lesser than the gross amount of profits remitted or capitalized in the same tax year, BACEN will demand the foreign investor bring back to Brazil the profits unduly remitted plus fines. If profits were capitalized as foreign capital rather than remitted, BACEN will cancel the registration. However, in either case, the liability to return profit or cancellation will be limited to the amount of profit either remitted or registered as profit reinvestment vis à vis the actual profit of the company in the respective tax year as shown in the company's balance sheet. Obviously, that is not the case if the company had inurred losses in the corresponding tax year. In this event, the company would be required to return all profit remitted abroad in that tax year or will be subject to full cancellation of the profit registered with BACEN as capital increase due to dividends reinvested. This seems quite fair and beyond any complaint on our part.

5.1.7 - Cash investments in Brazil resulting in advanced sums for future capital investment

Foreign investors may remit hard currencies in order to pay future capital increases in the Brazilian company, the recipient of such investment. Due to inflation, questions have arisen in the past concerning how to index the corresponding amounts in cruzeiros (prior to the adoption of the new Brazilian currency, the "real") to such fund remittances before the actual capital increase took place. Circular Letter of BACEN n°2198 enacted on August 15, 1991 provided the answer to this question. It is provided thereunder that the funds should be indexed to the exchange rate fluctuation (related to the currency which was brought to Brazil) assessed in the period. No other index was allowed.

5.2 - Documents and information required by BACEN for the registration of capitalization of profits and reserves for purposes of changing the value of the foreign capital investment certificate

For purpose of requesting registration of the capitalization of profits and reserves, the following information and documents should be produced and provided to BACEN:

1. the name and address of the individual or company resident or domiciled abroad and the number of the registration certificate of the investment;

2. the name, address and purpose of the company which generated the profits or the reserves to be capitalized;

3. the years when the profits were generated and the value of net dividends to be distributed to shareholders resident or domiciled abroad;

4. the receipt for the tax payment, indicating the number of the receipt date and place of payment, value of the tax paid and the value on which the tax was levied;

5. if the profits were reinvested in the capital of a company other than the company which generated the profits, the name, address and purposes of said company;

6. a copy of the minutes of the shareholders' meeting which approved the capital increase; said minutes must be filed with the appropriate board of trade;

7. a copy of the entries in the company books concerning the capital increase resulting from the capitalization of profits or reserves; this copy should be signed by the company's director or chief accountant;

8. a copy of the company's balance sheet and profit and loss statement.
5.2.1 - Documents required for the capitalization of royalties under patent, trademark, transfer of technology license, technical services and scientific assistance agreements with BACEN

Royalties under the above mentioned agreements rather than being remitted abroad to licensors may be converted into shares of the licensee, such shares being assigned to licensees. In the event of capitalization of royalties under such agreements, the following documents must be presented to BACEN:

a) the application for registration of foreign capital investment form properly completed;

b) clear indication by licensor as to its willingness or intention to capitalize the royalties to which he or it is entitled;

c) certificate of the patent or trademark registration and its effectiveness in Brazil as issued by INPI and documentary evidence as to its nonforfeiture in the country of origin of the patent or trademark owner;

d) certificate of registration of the respective registration of the license agreement issued by INPI;

e) copy of the minutes of shareholders meeting or charter amendment (in the case of limited liability companies) concerning the shareholders approval of the capitalization increase resulting from the capitalization of royalties, such corporate documents being duly filed with the proper Trade Board; and

f) copies of all book entries of the company related to the capitalization of royalties, such copies being duly signed by the company's official directors (e.g. the licensee) or its chief accountant.

As mentioned before, whereas this list (as well as the other list previously mentioned in this chapter) of documents required by BACEN is subject to change, we would strongly recommend that interested individuals or corporations check with BACEN on any future changes when they apply for registration.

Brazilian law enables foreign investors holding their certificate of registration of foreign capital investment to remit their profits abroad. Brazil has greatly simplified the process of profit remittance. Nowadays, companies may remit their dividends to their shareholders abroad, whether individuals or companies, through a bank duly authorized to deal in exchange operations. Such companies should display the certificate of foreign capital investment which would entitle beneficiaries abroad to receive their dividends. Banks (or exchange brokers) will enter the profit remittance in the certificate and such banks or brokers are legally responsible vis à vis BACEN for any violation of Brazil's exchange control Law on such remittances. Likewise, banks and brokers are jointly responsible for violation of Brazil's tax law on such remittances. Please also note that under new regulations, companies can register and/or file all remittances abroad by means of a modern system of electronic data retrieval before actually remitting the funds abroad.
CHAPTER III

TAX LAW ON THE REMITTANCE OF PROFITS, DIVIDENDS AND ROYALTIES ABROAD

This chapter does not purport to be a treatise on Brazil’s tax Law. It only comprises in a summarized form, the current tax rules on remittance of profits, dividends and royalties abroad.

First we must inform the reader that in 1991 and years thereafter, the federal government of Brazil introduced drastic changes in the tax regulations governing foreign capital investment and profit remittance derived therefrom. This chapter is designed to highlight such changes.
1.1 - The general rule of taxation on profits, dividends, royalties, interest and capital gains remittances abroad

As a general rule, the income earned by people or companies resident or domiciled abroad is subject to a 15% withholding tax. This tax is due when the income is distributed, paid, transferred, credited or remitted to people who are resident or domiciled abroad. As opposed to the past, this 15% withholding tax is triggered at the very moment the company credits the income (dividends, royalties, etc.) on its books and such credits are assignable to individuals or companies resident or domiciled abroad. Therefore, the 15% withholding tax is levied on dividends, royalties and other payments abroad, including capital gains from foreign investments. Generally, interest remitted abroad on registered loans is also subject to the 15% withholding tax. Please note that as of January 1, 1996 (Art. 10 Law 9249/93) profits remittance abroad are exempted as the law considers such profits already taxed on the books of the company which generates and distributes them.

1.2 - Exemption provided for in the Law in connection with the 15% withholding tax on income distributed, paid, transferred or remitted to individuals or companies resident or domiciled abroad

In addition to the tax exemption referred to in 1.1, the following remittances abroad are also exempted from the 15% withholding income tax:

a) payments of fees for teaching materials and instructions to educational establishments overseas;

b) capital repatriation up to the value of the certificate of foreign investment duly registered with BACEN;

c) sums remitted as sale proceeds of properties and or goods inherited by or donated to individuals or companies resident or domiciled abroad;

d) remittances to individuals who are temporarily abroad as living allowances within the limits set forth by BACEN;

e) dividends and capital gain or repatriation abroad concerning investments made by the United Nations Joint Staff Pension Fund in the Brazilian stock market exchanges;

f) remittances to the International Finance Corporation-IFC as dividends, capital repatriation, capital gains, or loan repayment (including interest thereon);

g) resulting from investments or lending to Brazilian companies; and

capitalization of profits and reserves under the conditions which we shall examine later in this chapter.

2. TAXATION OF CAPITAL GAINS FROM THE SALE OF SHARES REGISTERED WITH BACEN AS FOREIGN CAPITAL

As we saw in the preceding chapter, the foreign investor must register his investment with BACEN in the form of shares in the capital of a Brazilian company. This type of registration is a requirement for the repatriation of the capital and the remittance of profits thereon. Is the repatriation of capital subject to taxation under Brazilian Law?

The repatriation of capital up to the value of its registration with BACEN is not subject to taxation according to a tax ruling issued by the Brazilian Internal Revenue Service still in effect (CST 997/71 and CST 23 1/71). But what happens if the foreign investor obtains capital gains in the sale of his shares? Can he transfer the sum above the value of registration abroad, and if so, would this sum be subject to taxation? Let us assume that the foreign investor registered an investment of US$ 1,000,000 with BACEN. He sold these shares for US$ 1,500,000. Could he repatriate US$ 500,000 and if so, would this amount be subject to taxation? Yes, he could, since there is no law or regulation which would prevent him from remitting this capital gain. Moreover, pursuant to the current Brazilian income tax Law and save the exceptions highlighted in this chapter, this capital gain would be subject to a 15% withholding tax. (Income Tax Regulation of Brazil, RIR - 97 art. 745 incs. 1, II).
2.1 - The sale of foreign capital shares for a price above or below their registered value with BACEN

Let us assume that foreign investors (resident or domiciled abroad) enter into an agreement pursuant to which one sells to the other the shares above their registered value with BACEN. For instance, the shares registered with BACEN total US$ 1,000,000 and, foreign investor sells the shares to the other investor for US$ 1,500,000. Can he alter the registration certificate of the investment with BACEN in order to register the additional US$ 500,000? No, because the price is paid to the foreign investor abroad; in other words, the money paid for the shares (US$ 1,500,000) in excess of the value on the certificate (US$ 1,000,000) does not enter Brazil. Note that pursuant to Brazilian Law (Law 4131, provision 1), it is essential that the funds be invested in Brazil in order to qualify as foreign capital investment. Therefore, in the example we are considering, the new owner of the shares, irrespective of the fact that he paid US$ 1,500,000, will hold a registration certificate for the investment in the amount of US$ 1,000,000. In sum, the terms of the certificate remain unchanged.

Conversely, if the foreign investor sells the shares registered with BACEN abroad for an amount below their registered value, we believe that the certificate will still remain unaltered. In this case, the funds have already been introduced into Brazil and we assume that no repatriation of capital has been made before the sale.

3. SPECIAL RATES FOR WITHHOLDING INCOME TAX ON EARNINGS ASSIGNED TO INDIVIDUALS OR COMPANIES RESIDENT OR DOMICILED ABROAD

This segment of the chapter will highlight the cases under which the tax rate on foreign companies’ and individuals’ earnings is other than 15%. One of such cases is related to special tax rates set forth in the tax treaties entered into between Brazil and several other countries to avoid double taxation on income earned by their respective citizens and companies. In item 3.1 we will summarize the contents of these tax treaties with reference to different rates of tax on foreign companies’ and individuals’ incomes. The reader will note that the United States is not included below, as Brazil and the U.S. have not entered into such a tax treaty up to the present.

3.1 - Tax treaties between Brazil and various countries to avoid double taxation

a) Argentina

Under the tax treaty signed between Argentina and Brazil, dividends, interest and royalties paid to individuals or companies resident or domiciled in Argentina will be subject to the regular 25% withholding tax.

b) Austria

Pursuant to the treaty between Brazil and Austria, payments of dividends and interest to companies or individuals domiciled in Austria shall be subject to a 15% withholding tax. As a general rule, royalty payments to Austria are subject to a 15% withholding tax. Royalties under license agreements for the use of trademarks are subject to the regular 25% withholding tax.

c) Belgium

Pursuant to the treaty between Brazil and Belgium, payments of dividends are subject to a 15% withholding tax and interest payments may be subject to either a 10% or a 15% withholding tax, depending on the conditions stated in the treaty. Royalties under license agreements are subject to a 15% withholding tax and under trademarks, a 25% withholding tax.

d) Canada

Pursuant to the treaty between Brazil and Canada, dividends paid to shareholders resident or domiciled in Canada are subject to a 15% withholding tax. Interest payments are either subject to a 10% or 15% withholding tax contingent upon the conditions set forth in the treaty. Royalties under license agreements may be subject to either a 10 or 15% withholding taxes; royalties under trademark license agreements would be subject to the regular 25% withholding tax.

12. Tax treaty between Brazil and Argentina, Legislative Decree no. 74/81, Decree nº 87976/82.
13. Tax treaty between Brazil and Austria, Legislative Decree nº 9575, Decree no. 78 107/76.
14. Tax treaty between Brazil and Belgium, Legislative Decree nº 76/72, Decree nº 925427/73.
15. Tax treaty between Brazil and Canada, Legislative Decree nº 28/83, Decree nº 923 18/86.
c) Czechoslovakia

Pursuant to the treaty between Brazil and Czechoslovakia, dividends are subject to a 15% withholding tax; interest payments are either subject to a 10 or 15% withholding tax, contingent upon the conditions set forth in the treaty. Royalties can be taxed at either 15% or 25% depending on the conditions stated therein.

After the second edition of the book was published, the map of Europe was rewritten and many new countries have emerged therefrom. Two such new countries resulted from the split of the former Czechoslovakia, such new countries being, the Czech Republic and the Slovak Republic. It is not clear now, whether or not this treaty has been confirmed by both new countries.

f) Denmark

Pursuant to the treaty between Brazil and Denmark, dividends are subject to a regular 25% withholding tax; interest payments at 15%. Royalties in general are taxed at 15%; royalties under trademark license agreements are taxed at the regular 25% withholding tax.

g) Ecuador

Under the tax treaty between Brazil and Ecuador, dividends are taxed at 15%; interest payments at 15%. Royalties are taxed at 15% except for royalties under trademark license agreements which are taxed at 25%.

h) Finland

Under the tax treaty between Brazil and Finland, dividends are subject to a regular 25% withholding tax; interest is subject to a 15% withholding tax. Royalties can be taxed at 10%, 15% or 25% subject to the conditions set forth in the tax treaty.

i) France

Under the tax treaty between Brazil and France, dividends are subject to a 15% withholding tax and interest is subject to either a 10% or a 15% withholding tax, depending on the conditions stated in the treaty. Royalty payments to individuals or corporations resident or domiciled in France are subject to a 15% withholding tax, except for royalties under license agreements for the use of trademarks which are subject to the tax at the regular 25% rate.

j) Hungary

Under the tax treaty between Brazil and Hungary, dividends are subject to a 15% withholding tax; interest payments are either subject to a 10% or a 15% tax contingent upon the conditions stated in the treaty. Royalties are normally taxed at 15% and in case of trademarks, 25%.

k) Italy

Under the tax treaty between Brazil and Italy, dividends and interest payments are subject to a 15% withholding tax. Royalties are normally subject to 15% tax except for trademark license agreements whereby royalties thereunder are subject to the regular 25% withholding tax.

l) Japan

Under the tax treaty between Brazil and Japan, dividends, interest and royalties are subject to a 12,5% withholding tax. Exceptionally, royalties under license agreements may be subject to a 25% withholding tax.

16. Tax treaty between Brazil and Czechoslovakia, Decree no. 43/91, Decree no. 92318/86.
17. Tax treaty between Brazil and Denmark, Legislative Decree no. 90/74, Decree no. 75106/74.
18. Tax treaty between Brazil and Ecuador, Legislative Decree nº 4/86, Decree nº 95717/88.
19. Tax treaty between Brazil and Finland, Legislative Decree no. 86/72, Decree no. 73496/74.
20. Tax treaty between Brazil and France, Legislative Decree no. 87/71 Decree no. 70550/72.
21. Tax treaty between Brazil and Hungary, Decree no. 53/91.
22. Tax treaty between Brazil and Italy, Legislative Decree no. 77779, Decree no. 89985/81.
23. Tax treaty between Brazil and Japan, Legislative Decree no. 4391, Decree no. 61997/76 and 8194/78.
m) Luxembourg

Under the tax treaty between Brazil and Luxembourg, dividends may be taxed at either 15% or 25% contingent upon the conditions stated in the treaty. Interest payments are taxed at either 10% or 15% depending on the conditions stated in the treaty. Royalties are normally taxed at 15% except for royalties under trademark license agreements which are subject to the regular 25% withholding tax.

n) Norway

Under the tax treaty between Norway and Brazil, dividends and interest payments are taxed at 15%. Royalties are normally taxed at 15% except for royalties under trademark license agreements whereby such royalties are taxed at the regular 25% rate.

o) Portugal

Under the tax treaty between Brazil and Portugal, dividends and interest payments are taxed at a 15% rate. Royalties in general are taxed at 10% except for royalties under trademark license agreements which are taxed at 15%.

p) Spain

Under the tax treaty between Brazil and Spain, dividends are taxed at a 15% rate. Interest may be either taxed at 10% or 15%. Royalties may be taxed at 10%, 15% or 25%.

q) Sweden

Under the tax treaty between Brazil and Sweden, dividends may be taxed at either a 15% or 25% rate depending on the conditions set forth thereunder. Royalties are normally taxed at 15% and in case of royalties under trademark license agreements, at 25%.

r) Germany

Under the tax treaty between Brazil and Germany, dividends may be taxed either at 15% or 25% rates. Interest payments are either taxed at 10% or at 15% rates. Royalties are taxed at 15% rate except for royalties under trademark license agreements which are taxed at 25% rate.

3.2 - Differential tax rates on the remittances of dividends and capital gains from investments in the Brazilian capital market made by individuals or companies resident or domiciled abroad

As a general rule, income derived from securities earned by individuals or companies resident or domiciled in Brazil are currently taxed at 10% withholding income tax at the source.

However, there are certain investments held by individuals or companies resident or domiciled abroad which are taxed at different rates. The following cases are described below.

3.2.1 - Dividends remittances under D.L. 1401 investments

Dividends remitted to individuals or companies resident or domiciled abroad under the D.L. 1401 are subject to a 15% withholding tax. This tax rate may be reduced according to the length of time of the corresponding investment in Brazil in accordance with the following table:

24. Tax treaty between Brazil and Luxembourg, Legislative Decree no 78/79 and Decree no. 8545/80.
25. Tax treaty between Brazil and Norway, Decree law 50 1/69, Decree no. 661 10/70, Legislative Decree no. 5081 and Decree no. 86710/81.
26. Tax treaty between Brazil and Portugal, Legislative Decree no. 59/71, Decree no. 6939/71.
27. Tax treaty between Brazil and Spain, Legislative Decree no. 6275. Decree no. 7697/76.
28. Tax treaty between Brazil and Sweden, Legislative Decree no 93/75, Decree no. 77053/76.
29. Tax treaty between Brazil and Germany, Legislative Decree no 92/75 and Decree no- 76988/76.
### Length of time of the investment (as of the date of registration) vs. Tax Rates

<table>
<thead>
<tr>
<th>Length of time of the investment</th>
<th>Tax Rates</th>
</tr>
</thead>
<tbody>
<tr>
<td>From 6 to 7 years</td>
<td>12%</td>
</tr>
<tr>
<td>From 7 to 8 years</td>
<td>10%</td>
</tr>
<tr>
<td>Over 8 years</td>
<td>8%</td>
</tr>
</tbody>
</table>

#### 3.2.2 - Dividends derived from investments in mutual funds (D.L. 2285)

Dividends derived from investment in mutual funds created under the DL 2285 of July 23, 1986 are taxed at 15% (Law 8383, art. 32-1)

#### 3.2.3 - Dividends derived from investments in securities portfolio also under the D.L. 2285 paid to shareholders resident or domiciled abroad are equally taxed at a 15% rate. (Law 8383, art. 32-1)

#### 3.2.4 - Remittances of dividends abroad to shareholders resident or domiciled overseas derived from investments under art. 49 of Law 4728 companies. (Law 6303, ad. 32, II)

Remittances of dividends abroad derived from investment under article 49 of Law 4728 are taxed at 15% rate. Article 49 of Law 4728 provided for investment companies only engaged in organizing and managing portfolio securities. Individuals or companies resident or domiciled abroad may invest in the Brazilian capital market thorough such investment companies; dividends remittable abroad under such investment are subject to a 15% withholding income tax.

#### 3.3 - Interest paid to holders of commercial papers issued by Brazilian companies abroad

Due to the “moratorium” in 1987, Brazil has had a hard time obtaining new money from abroad in loans. One of the solutions was to encourage Brazilian companies to seek their own funding abroad. Legislation was enacted in order to help Brazilian companies to obtain their own foreign funding; accordingly Brazilian companies were empowered to issue commercial paper in foreign capital markets provided that they register their paper with the Central Bank of Brazil (BACEN) under the conditions which BACEN establishes on a case by case basis. Commercial paper issuance is currently provided for under BACEN Communiqué, 2,513, of August 27, 1991. In order to promote investors’ interest in such commercial paper, BACEN, by means of its Resolution n° 644 of October 22, 1980, has reduced to 0% the tax rate on remittances abroad of interest, commissions and expenses in connection with or in relation to the placement of such commercial papers issued by Brazilian companies abroad. Incidentally this has been a very successful program from its very commencement.

#### 4. TAX LAW ON THE CAPITALIZATION OF PROFITS AND RESERVES

As to Brazilian companies the shares of which are held in whole or in part by individuals or companies resident or domiciled abroad, the tax implications of the capitalization of profits and reserves are currently regulated by article 71 of Law 7,799 of July 10, 1989. The profits assignable to individuals or companies resident or domiciled abroad which are allocated to capital increase are not subject to taxation.
CHAPTER IV

Registration of foreign loans, comments on the new changes.

Since the first edition of this book was published, Brazil has undergone tremendous changes. In fact, not only Brazil but the world as a whole has changed. In first place, Brazil has been detrimentally affected by the oil crisis which took some years eating up Brazilian hard currency reserves. World prices for commodities have gone down sharply causing a detrimental effect on the Brazilian exports of agricultural products. In addition, Brazil started the eighties with enormous political and social upheavals which contributed to worsen the country’s economic situation. This caused Brazil to deteriorating in the decade (which has been recognized as the “lost decade”) and causing Brazil’s inability to cope with the service of its foreign debt amounting to US$ 100 billion.

The sparkling seventies, saw massive funds transferred to Brazil by means of equity investments and financing; this brought about an equally impressive mass of legislation especially on foreign lending. Much of this legislation is still on the books but in practice it seems to be dormant in many ways since very little money was lent to Brazil in the eighties especially after President Sarney’s “moratória” whereby the country actually discontinued to service its huge foreign debt. We will therefore take note
again of the basic rules which still govern foreign lending to Brazil but we must call reader’s attention to the fact that this legislation may be subject to change as Brazil has greatly changed during the period.

In the early nineties, Brazil finally came to terms with the international banking community. Such negotiations were modeled after the Brady Plan under whose auspices, the negotiations became feasible. It is not the purpose of this chapter to highlight the terms of what was the final settlement between Brazil and its creditors. As the nineties evolved, forms of finance throughout the world dramatically changed. Much of the funding for straight loans destined for the emerging capital markets dried up. Therefore, Brazil had to adapt to the trends as they have existed since 1997. Rather than straight loans, Brazilian companies have sought to obtain their funding by means of issuing debentures abroad or through issuing American Depository Receipts (ADRs). However, for the sake of completeness, this chapter will discuss the legal rules on straight loans irrespective the changes in the financial markets as described.

For purposes of registration with BACEN, foreign loans have been classified as:

1. Loans governed by Law 4131;
2. Loans governed by Resolution 63; and
3. Loans governed by ‘Circular’ 2731. In this chapter, we shall briefly study the regulations governing each of these loans.

1. **GENERAL RULES APPLICABLE TO LOANS UNDER LAW 4131 AND RESOLUTION 63**

All foreign loans must be previously registered with BACEN. The loan conditions must be previously approved by BACEN on a case by case basis as to payment and grace periods and interest rates.

2. **LOANS GOVERNED BY LAW 4131**

Loans governed by Law 4131 can be subdivided into two categories: loans governed by Communiqué 10 and loans governed by Resolution 229.

2.1. Loans governed by Communiqué Firc 10

Communiqué Firc 10 enacted on September 12, 1969 provides for foreign loans to Brazilian companies without intermediaries; such loans must be previously approved by BACEN before being entered into between the foreign lender and the Brazilian borrower.

2.2. Loans governed by Resolution 229

Resolution 229, enacted on September 1, 1972 also provides for foreign loans to Brazilian companies without intermediaries. Such loans must also be previously approved by BACEN. However, unlike the Communiqué Firc 10 loans, resolution 229 loans can be made to several borrowers in Brazil simultaneously provided that the minimum maturity terms of the loans as approved by BACEN is not diminished.

3. **LOANS GOVERNED BY RESOLUTION 63**

Foreign loans governed by Resolution 63 are always made through Brazilian financial institutions, such as commercial banks, investment or development banks. The purpose of Resolution 63 loans is to expand Brazilian companies’ fixed assets or working capital. Brochure and insurance companies cannot receive such loans. Intermediary financial institutions generally apply the financial conditions to borrowers provided that the financial conditions of such loans are compatible with the conditions and terms approved by BACEN to repay the ultimate loan to the lender abroad. The lending conditions change often and the reader should check with BACEN on current conditions before applying for registration of the loan. The balance of Resolution 63 loans which is not allocated to new borrowers in Brazil must be deposited with BACEN (until the date when the principal of the loan can be fully amortized to the foreign lender abroad). BACEN covenants to remuneration such deposits with interest at the LIBO Rate for deposits in the same currency as the loan.
4. LOANS GOVERNED BY “CIRCULAR” 2731

BACEN issued “Circular” 2731 on December 13, 1996 to regulate the finance of the importation of goods into Brazil. This regulation covers financial transactions with reference to minimum payment terms of 360 days. The “Circular” 2731 gives great flexibility to the parties to stipulate the terms of the finance. They are free to stipulate the timing for the payment of the installments (e.g. monthly, quarterly, semi-annually, etc) and they can also provide for a percentage of the principal to be paid for at the time of embarkation of the goods. Interest payments must previously be approved by BACEN.

Interested parties are advised to check with BACEN at the time of applying for registration of these loans as terms and conditions for their registration by BACEN often change.

5. TAXATION ON INTEREST DERIVED FROM REGISTERED LOAN

Except as stipulated in double tax treaties as entered into by Brazil with various countries, interest remitted abroad on registered loans is subject to a 15% withholding tax.

CHAPTER V

SUMMARY OF BRAZIL'S FOREIGN EXCHANGE CONTROL LAW

1. Brazil's major regulation on foreign exchange

The regulations governing Brazil's exchange control Law is contained in Law 4131. The first rule on exchange control is stated in Provision 23 of Law 4131. This provision establishes that all exchange operations must be performed by duly authorized institutions, although in certain circumstances the intervention of an official broker is required. In any event, both the institution in charge of the exchange operation and the broker must be responsible for the correct identification of their client; false statements with reference to the client's identity shall subject the exchange control institution and the broker to fines of up to three times the value of the exchange operation. However if the false statement is the sole responsibility of one of the parties to the exchange operation (herein referred to as the client), only the client will be liable for the fine, which is equivalent to 100% of the value of the operation.

30. Law 4131, prov. 23 § 1.
31. Law 4131, prov. 23 § 3.
Finally, the bank and the broker in charge of the exchange operation shall be liable for a fine ranging from 5% to 100% of the value of the operation in case of incorrect classification of the client’s data when completing the exchange agreement form.\footnote{Law 4131, prov. 23 § 4.}

In case of a recurrence of any violation of the exchange control legislation, it becomes BACEN’s responsibility to revoke the operating license of the bank or the broker in charge of the exchange operation.\footnote{Law 4131, prov. 23 § 5 and Law 4595/64, prov. 10, item VIII.}

The banks in charge of the exchange operation must report daily to BACEN with the data on their purchase and sale of foreign currencies.\footnote{Law 4131, prov. 24.} Banks which do not comply with this obligation shall be subject to fines up to thirty times the value of Brazil’s minimum annual wage.\footnote{Law 4131, prov. 25.} However, the banks may avail themselves of judicial remedies against any decision which imposes a fine on them.\footnote{Mandado de Segurança (Writ of Mandamus) pursuant to Law 1533 of Dec. 31, 1951.}

Provision 27 of Law 4131 establishes a very interesting rule:

The Superintendency of Money and Credit (presently, the National Monetary Council) may determine that exchange operations concerning capital investments be made at different rates from the ones prevailing in the import and export markets, whenever the country’s exchange situation recommends such a decision.

Brazilian economists have long advocated the existence of separate exchange rates for foreign capital investments and remittance of profits thereon and for import and export operations. They have also advocated that exchange rates should be free of government intervention; such rates would be determined by the inflow and outflow of foreign currencies and the value of the national currency vis-à-vis those currencies would be determined accordingly.\footnote{Helio Jaguaribe “Efeito Espoliativo e Capacidade de Investimento” in “O Nacionalismo na Atualidade Brasileira”, p.91 cited by Herculano Borges da Fonseca in “Regime Jurídico do Capital Estrangeiro” (Rio de Janeiro, Editora Lemos e Artes, 1963).} In addition, the Brazilian government would fix exchange rates exclusively for import and export operations in order to discourage the former and to encourage the latter.

Therefore, the government has adopted the policy of establishing a single exchange rate for both foreign investment and for export-import purposes, eliminating the so-called free exchange market rates. Moreover, in order to cushion the deleterious effects of ever-increasing oil prices on the Brazilian economy, the government has also adopted in the past, the practice of minidevaluations of the dollar vis-à-vis the former cruzeiro (Please note that the Brazilian currency is now the “Real”). In sum, for the above mentioned reasons Provision 27 of law 4131 is not likely to be enforced.


Provision 28 of Law 4131 establishes that:

"Whenever serious problems in the balance of payments arise, or if there is reason to believe that such problems may arise, the Superintendency of Money and Credit (presently the National Monetary Council) may impose restrictions on imports and remittance of profits and foreign capital investment for a limited period of time, and for this purpose may delegate powers to the Bank of Brazil so that the Bank may exert a monopoly on exchange operations".

Currently the National Council has only imposed restrictions on the importation of certain goods and expenses related to Brazilian residents' travels abroad.

The first paragraph of Provision 28 of Law 4131 provides that, in case of balance of payments problems, the remittances of profits and the repatriation of capital is limited to 10% per year of the value of the capital and capitalized profits registered with BACEN. The question before us is whether under the above mentioned circumstances, the federal government may limit remittances to rates below 10%, or whether the 10% mark would be guaranteed to foreign investors in any event. We believe that foreign investors would be guaranteed the 10% limit and that the Brazilian federal government could not establish limits lower than 10%, except by promulgating another Law.

We must also remark that, up to the present, the Brazilian federal government has never enforced this provision. In fact, we believe that it would be unlikely for the Government to enforce it because of the harmful effects that such a measure would have upon the influx of foreign capital into Brazil. Thus, it would be more likely for the Brazilian government to take less stringent measures to alleviate the balance of payments difficulties. Nevertheless reader should take note that in the early nineties, for few months, BACEN temporarily enjoined foreign investors from remitting dividends abroad due to Brazil's tight exchange situation. However as the plight of the country improved, BACEN lifted the temporary prohibition. Currently, as this book is being re-written (2001), there is no limitation on the remittance of dividends abroad and it is unlikely that the federal government would impose such restrictions on such remittances.

The second paragraph of Provision 28 of Law 4131 provides that the foreign investor must advise BACEN of profits which exceed the limit set forth in Provision 28, that is, 10% of the value of the capital plus capitalized profits registered with BACEN. After receiving this information BACEN may, if the adverse exchange situation persists, authorize the remittance of the excess amounts for the following tax year.

Paragraph 3 of Provision 28 of Law 4131 establishes that, in the event of serious problems in the balance of payments, Brazilian government may restrict royalty payments under license and technical assistance agreements up to five percent of the company's gross revenue.

Although the law does not so state, presumably the limit is related to the company's yearly gross revenue. One should differentiate this five percent limit from the INPI's past policy which sets the maximum remuneration that the licensor may receive from licensee, transfer of technology and technical and scientific assistance agreements at five percent of the licensee's or grantee's net revenue from the sale of the products manufactured with the technology transferred.

Paragraph 4 of Provision 28 of law 4131 provides that, in case of serious balance of payments difficulties, the Brazilian government may also enact legislation to limit foreign currency expenses incurred in travels abroad. The Brazilian government has often resorted to this legal expedient. Today, the rules are much softer and Brazilians may travel abroad without any specific restrictions. However, the reader should note that these governmental policies change quite often.

39. The restrictions on imports were imposed by CACEX Communiqué 614, Decree-Law 1427 of Dec. 2, 1975 and BACEN Resolution 35475.

40. For a more comprehensive study on current government strategies to alleviate the balance of payments difficulties without jeopardizing the interests of foreign investors, see: Attila de Souza Leão Andrade Jr., "Brazil balances foreign investments, sovereignty" in Brazil Herald (Rio de Janeiro, Sept. 7, 1976), pp.11-15.

41. The INPI policy is based on the Ministry of Finance Portaria 436, enacted on Dec. 30, 1958.
Finally, the fifth paragraph of Provision 28 of Law 4131 provides that, irrespective of the existence of abnormal exchange situations in Brazil, remittances of interest on foreign loans cannot be subject to restrictions. Obviously this paragraph is a long forgotten legal provision as it is widely known that Brazil has defaulted in its obligation to pay interest on its immense foreign debt despite its obligations under the respective agreements and covenants with the International Monetary Fund. However, as this book is being re-written, we must inform the reader that the Brazilian government has settled with all its creditors and that currently the country is meeting all its external obligations.

Provision 29 of Law 4131 states that whenever Brazil’s exchanges situation requires retention of foreign currencies, the Brazilian federal government may impose a deposit on the importation of goods up to 10% of the value of the imported goods and up to 50% of the value of any remittance abroad, including expenses incurred in travels abroad. Note that this deposit is in addition to the ad valorem import taxes and other taxes levied on the transfer of funds abroad analyzed in Chapter III. Please also note that Brazil has often resorted to such deposit requirements in connection with the importation of goods and travel expenses remittances. Currently, the country’s plight has considerably improved and the federal government liberalized the system, such deposits are no longer required. Likewise, Brazil’s foreign trade practices have been designed to foster importation in order to force domestic prices down as a policy against inflation and price increases in the internal market. Since 1997, this liberalization has increased to the extent that it has badly hurt certain segments of the Brazilian economy such as the textile and the shoe industries.

Provision 30 of Law 4131 establishes that the amounts collected by the Brazilian federal government from the deposits required under Provision 29 above are placed in a reserve account which shall eventually be utilized to purchase gold and hard currencies to build up Brazil’s exchange reserves. This provision reflects the lingering effects of the gold exchange policy on Brazilian legislation.

Provision 34 of law 4131 establishes a very important rule, which reinforces what we have said about the Brazilian government’s unwillingness to encourage the creation of multiple exchange rates. The provision states that under no circumstances can the Brazilian government create more favorable exchange rates for the remittance of profits, royalties and interest than the prevailing rates for the payment of Brazilian imports.

2. VIOLATIONS OF BRAZIL’S EXCHANGE CONTROL LAW

Brazilian Law defines several violations of exchange control regulations. Under Brazilian Law, every resident of the country is required to declare property and earnings which he (she or it) possesses abroad to BACEN and to Brazil’s Internal Revenue Service. Violation of this Law may result in the confiscation of the person’s property. In case of cash deposits and securities, the money or the securities must be deposited with the Bank of Brazil in a special account. In the case of other chattels, they must be deposited with an agency of the Ministry of Finance, with reference to real estate, it must be assigned to a special Federal Government agency.

Failure to disclose the existence of savings and property abroad may subject the violator to short prison terms of up to ninety days contingent upon the decision of the Federal court. Moreover, if the violator is a corporation or a partnership, the directors and managers of the corporation may receive jail sentences. If there is evidence that shareholders or partners have profited from the failure to disclose the existence of savings and property, they may also subject to prison terms. The judge who sentences the defendant to a prison term must ex officio appeal his decision to Brazil’s equivalent of the U.S. Court of Appeals (“Tribunal Regional Federal”).

42. Brazil signed a convention with the International Monetary Fund. This convention was promulgated in Brazil by Decree 8, 479 enacted on CD. 27, 1945 and Decree 21, 177 of May 27, 1946.

44. Decree Law 1060, prov. 3, § 1 and 3.
45. Decree Law 1060, prov. 3 § 3.
The sentence which determines either the prison terms or the confiscation of property or both, in case of a corporation, may also determine the confiscation of the directors', managers' or shareholders' private property to compensate for damages to the National Treasury arising from the non-disclosure. Finally, in addition to these liabilities under the exchange control Law, violators may also be liable for penalties under the tax Law.

Brazilian Law also provides for penalties and liabilities in the event of fraud in import operations. It is unlawful to import without a license or to over-price or under-price goods as stated on the pro forma invoices to receive a tax benefit from the importation. In either case, the violator is subject to a penalty equivalent to 100% of the value of the import, in the case of importation without a license or a penalty of 100% of the difference between the real value of the goods imported and the value as stated on the invoices. However, if this difference does not exceed 10% of the real value of the goods imported and if it was not due to fraud, deceit or any mischievous intent, Brazilian Law exempts the importer from liabilities. If the fraud is related to the quantity or weight of the goods being imported, the above mentioned penalty if 100% of the difference between the real quantity or weight and the quantity or weight stated on the invoices. In this case, if this difference does not exceed five percent of the real quantity or weight of the imported goods and no fraud or deceit is evidenced the importer will not incur liabilities.

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46. Decree Law 1060, prov. 3 § 4.
Art. 176 - .................................................................

§ 1 - The research for mineral resources and the exploration of the resources referred to in the head of this article shall only be undertaken by means of authorization and grant issued by the Union, in the national interest, to Brazilians or companies organized under the Laws of Brazil and shall have their office and administrative in the Country, pursuant to the Law which shall establish the specific conditions when such activities shall take place in frontier land or in Indian land).

Art. 2 - The following art. 246 in Title IX “General Constitutional Dispositions” is deleted:

“Art. 246 - The enactment of provisional Law (“medida provisória”) to regulate matters dealt with in the Constitutional Amendments enacted as of 1995 shall be forbidden.”

Art. 3 - Art. 171 of the Brazilian Constitution is revoked.

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EXHIBIT 2

Constitutional Amendment nº9 of November 9, 1995

It provides a new language for article 177 of the Federal Constitution

House of Representative and the Federal Senate, pursuant to paragraph 3 of art.60 of the Federal Constitution, promulgate the following Constitutional Amendment:

“Art. 1 - Paragraph 1 of art. 177 of the federal constitution shall read as follows:

Art. 177 - .................................................................

Paragraph 1 - The Union may hire state or private companies to undertake the activities envisaged in items 1 to IV of this article, provided that the conditions set forth in the Law are complied with.”
Art. 2 - A new paragraph, numbered 2 shall be included in art. 177 which shall read as follows:

“Art. 177 - ..........................................................”

Paragraph 2 - The Law referred to by paragraph 2 shall provide for:

I - the warrant that oil by products shall be supplied throughout the national territory;

II - the conditions of the subcontract; and

III - the structure and powers of the agency which shall represent the monopoly of the Union”.

Art. 3 - The enactment of provisional Laws to regulate the issues dealt with under art. 177 paragraphs 1 and 2, subparagraphs 1 to IV of the Brazilian federal constitution shall be forbidden.

Exhibit 3

Constitutional amendment no. 5 of August 15, 1995

The House of Representatives and the Federal Senate, pursuant to the terms of paragraph 3 of art. 60 of the Federal Constitution promulgate the following Constitutional Amendment:

Sole Article - The paragraph 2 of art. 25 of the Federal Constitution shall be in effect with the following Language:

“It is incumbent upon the states to explore directly or by means of grant, the local natural gas services, pursuant to the Law, and the enactment of provisional Law concerning herewith shall be forbidden.”
Constitutional Amendment nº 7 of August 15, 1995

It alters art. 178 of the Federal Constitution and provides for the non-adoption of provisional Laws.

Article 1 - Art. 178 of the Federal Constitution shall read as follows:

"Art. 178 - The Law shall provide for the air, sea and terrestrial transportation, including the international transportation, and the international agreements as entered by the Union concerning therewith shall be complied with, provided that the reciprocity rules be complied with."

Sole Paragraph - The following art. 246 in Title IX on "General Constitutional Dispositions" is included:

"Art. 246 - Provisional Laws to regulate this article of the Constitution as amended shall not be enacted."
Exhibit 5

Constitutional Amendment n° 8 of August 15, 1995

The House of Representatives and the Federal Senate, pursuant to paragraph 3 of art. 60 of the Federal Constitution promulgate the following constitutional amendment:

Art. 1 - Subparagraph XI and provision “a” of subparagraph XII of art. 21 of the Federal Constitution shall read as follows:

"Art. 21 - The Union shall be empowered to:

XI - to explore, directly or through grant, the telecommunication services, pursuant to the Law, which shall provide for the organization of the services, the creation of a regulatory agency and other institutional aspects thereto;

XII - to explore, directly or through grant:

a) Television and radio broadcasting;

Art. 2 - Provisional Laws to regulate subparagraph XI of art. 21 of the Constitution as herein amended shall not be enacted."
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Guidelines on Brazilian Foreign Investment. Lay a clear, concise descriptive analysis and interpretation of the laws governing foreign investments in Brazil. The book is divided into five chapters plus a brief introduction. In chapter I, the legal concept of foreign capital registration with the Central Bank of Brazil is studied. In chapter II, the registration of and taxes on foreign investments in the Brazilian capital market are described and interpreted. In chapter III, Brazil’s exchange control law is explained.

This book caters mainly to lawyers, accountants, businessmen and everyone who directly or indirectly deals with foreign capital investments in Brazil. It is an excellent practical guide for consultation and solution of problems on the subject.