

BRAZIL

A – Corporate Taxation

INTRODUCTION

Brazil is a federal republic of states. It includes 27 states and the federal district. The capital city is Brasília.

The framework of the Brazilian tax system is set forth in the Brazilian Constitution, as amended, and the Brazilian Tax Code. The Constitution attributes taxing powers to federal, state (including the federal district) and municipal governments.

Corporate taxpayers are subject to corporate income tax (IRPJ) and social contribution on net profits (CSLL), hereinafter collectively referred to as the corporate income taxes. In addition to IRPJ and CSLL, the federal government levies taxes on foreign trade (import and export taxes), a value added tax on industrial production (tax on manufactured products, IPI), and a tax on financial transactions (IOF). The federal government also imposes social contributions on the gross income derived by resident legal entities (PIS and COFINS contributions). There is also a federal contribution imposed on cross-border payments of royalties and certain technical, administrative and scientific assistance services (CIDE contribution). Taxes that may be imposed by states include a value added tax on sales (ICMS), as well as a gift and inheritance tax (ITCMD). Taxes that may be imposed by municipalities include a tax on services (ISS), and a tax on real estate and transfer of property (ITBI).

The federal tax administration agency in Brazil is the *Receita Federal do Brasil* (RFB, or Brazilian Revenue Service). The Brazilian Revenue Service is also in charge for inspection activities and the collection of social security contributions. States and municipalities have their own tax administration agencies.

The currency is the real (R\$ or BRL).

1. CORPORATE INCOME TAXES

Any income or revenue received by a corporate taxpayer is subject to income tax. The taxable event for income tax purposes occurs when the income becomes economically or legally available to the recipient.

1.1. Type of tax system

The Brazilian corporate tax regime is a classical system, with no interaction between the tax imposed on a company's profits and the tax imposed on

distributions received by shareholders. In respect of profits generated as of 1996, economic double taxation is avoided via a dividend exemption system under which dividends distributed to either resident or non-resident shareholders from after-tax profits are not subject to further taxation.

1.2. Taxable persons

Corporate income taxes are levied on income derived by all legal entities established in or operating within Brazil. Resident legal entities are those incorporated under Brazilian law. Branches, agencies and representative offices of non-resident entities are also regarded as corporate taxpayers for purposes of corporate income taxes. Unincorporated business units, silent partnerships (*sociedade em conta de participação*) and some types of investment clubs are also treated as corporate taxpayers.

Non-profit legal entities are exempt from corporate income taxes, provided that certain conditions are fulfilled.

Brazilian law does not recognize the concept of hybrid entities, i.e. entities with legal personality that are not regarded taxable units for tax purposes, such as transparent partnerships.

This chapter is restricted to resident corporations (*sociedade anônima*, SA) and limited liability companies (*sociedade por quotas de responsabilidade limitada*, referred to as simply *limitada*), as well as to non-resident entities having branches, local agents or representative offices operating in Brazil, which are deemed to be corporate taxpayers. These entities will be collectively referred to as companies.

1.2.1. Residence

Under domestic law, a company is deemed to be resident in Brazil for tax purposes if it is incorporated under Brazilian law. There are specific situations in which non-residents may be treated as residents due to their branches, local agents or representative offices operating in Brazil, which are deemed to be corporate taxpayers. See A.6.2.

1.3. Taxable income

1.3.1. General

Companies resident in Brazil are subject to income tax on a worldwide basis. A resident company must include not only the foreign-source income that it derives (either directly or through a foreign permanent establishment), but also the profits earned by its foreign controlled or affiliated companies (i.e. shareholdings greater

than 10%), proportionally to the percentage that the Brazilian parent company holds in the capital of the foreign subsidiary.

As a general rule, income is taxable in the taxable period in which it accrues, and the related expenses are deductible in the taxable period in which they are incurred, regardless of when receipt and payment occur (accruals basis). Exceptionally, income and expenses may be determined on a cash basis, as defined under applicable laws.

Income is broadly defined as all revenue received as the product of capital or services, or a combination thereof, as well as any and all gains resulting from the disposal of a taxpayer's assets or rights. Corporate income taxes are, therefore, imposed on income derived from industrial and commercial transactions, as well as the rendering of services. Financial revenue, income from portfolio investments and gains from the disposal of other assets or rights are also included in taxable income.

Brazilian law recognizes four calculation regimes for corporate income taxes, namely (1) the real profit regime, (2) the presumed profit regime, (3) the profit as determined by the tax authorities and (4) the simplified regime of collection of federal taxes. Other specific regimes for some determined activities are also available (such as the Special Tax Regime for Real Estate Development, among others).

Real profit regime

Certain legal entities are obliged to calculate their corporate income tax liability under the real profit regime, namely: (1) legal entities having total gross income in the previous year exceeding BRL 48 million, (2) financial institutions, insurance companies and other similar entities, (3) legal entities that derive profits, income or capital gains from abroad (this item does not include the export of goods or services), (4) entities that have been granted a tax exemption or reduction and (5) companies engaged in factoring activities.

Under the real profit regime, companies calculate annually or quarterly their income tax liability on net profits for the taxable period, adjusted by additions and exclusions provided by tax law, and with due regard for generally accepted accounting principles.

With regard to net profit adjustments, (1) income is recorded on an accruals basis, (2) only necessary and usual expenses and costs incurred by companies are deductible and (3) income of controlled or affiliated companies must be recorded by applying the equity-pick-up method. See A.1.3.5.

Corporate income tax (IRPJ) is due at the rate of 15% on net profits with tax adjustments. The portion of net profit, adjusted by tax additions and exclusions,

which exceeds BRL 240,000 per year, is subject to additional income tax of 10%. Also, the social contribution on net profits (CSLL) is imposed at a rate of 9%.

A recent Provisory Measure issued by the Executive increased, as from 1 May 2008, the CSLL rate applicable to financial institutions to 15%. This Provisory Measure has yet to be approved by the Federal Congress and converted into law in order to have permanent effects.

As an alternative to the quarterly assessment system, companies may choose to make tax payments every month on an estimated basis. In this case, companies calculate the total and definitive amount of tax only on 31 December of each year. Monthly tax payments are determined by applying percentages to monthly-earned income, similar to the presumed profit regime (see below), increased by capital gains and other gains arising from secondary activities.

Presumed profit regime

Entities that are not obliged to adopt the real profit regime may calculate the corporate income tax liability under the presumed profit regime. This is a simplified tax method under which the legal entity chooses to calculate its taxable base by applying a percentage to its total gross income earned during the quarter (presumed profit). The applicable percentage ranges from 1.6% (for income from the sale of fuel and natural gas) to 32% (for income from the rendering of services). Income tax is imposed at the rate of 15% on the presumed profit. Additional income tax of 10% is imposed on the quarterly presumed profit in excess of BRL 20,000 per month accrued during the taxable period. With regard to the CSLL, the taxable base (presumed profit) is determined by applying a percentage of 12% or 32% (depending on the activity of the company) to the gross income earned for the quarter. CSLL is levied at a rate of 9% on the presumed profit (15% as from 01 May 2008). Tax losses may not be carried forward under the presumed profit regime.

Capital gains, as well as earnings on investments and other secondary activities of the company are fully subject to corporate income taxes (i.e. no percentage applies to determine the taxable base).

Determined profit regime

An income tax assessment based on profit as determined by the tax authorities is generally applicable where:

- the taxpayer fails to maintain commercial and tax books in accordance with applicable tax laws;
- the taxpayer's bookkeeping evidences fraud, defects or errors which make it impossible to verify actual transactions undertaken or to determine the corporate income taxes due and payable by the taxpayer based on the actual profit; or

- the taxpayer inappropriately opts to calculate and pay corporate income taxes under the presumed profit regime.

Under the determined profit regime, the taxable base is calculated by applying percentages specified by law, to the gross income derived by the company. These percentages may range from 1.92% to 45%, depending on the business activity of the taxpayer.

Income tax is payable at the rate of 15% on the determined profit. Additional income tax of 10% is levied on the determined profit in excess of BRL 20,000 accrued monthly. Also, CSLL is imposed at the rate of 9% (15% as of 1 May 2008).