

# ClippingLegis

## Summary

## Highlights

### Amendments to Federal Tax Legislation - Law 11.196/2005

As a result of the Bill for the conversion of Provisional Measure ("MP") No. 255/2005 (Bill No. 2005), which also includes the matters addressed by MP No. 252/2005, Law 11.196 was issued on November 22, 2005 amending a series of legal regulations.

Its main provisions are summarized below:

#### I) TAX BENEFITS

#### REPES (Arts 1-11) – effective as from November 22, 2005

The Special Taxation Regime for the Information Technology Export Platform ("REPES") was created under conditions to be regulated by the Executive Power. Its beneficiaries are any companies that work exclusively in the development of software or the provision of

information technology services, or both, and that at the time they adhere to the Regime commit to export at least 80% of their gross revenues from sales and services (gross revenues considered after the exclusion of taxes and contributions on sales).

This provision does not apply to any company whose revenues, in whole or in part, are submitted to cumulative taxation by the contribution to the Social Integration Program ("PIS/PASEP") and the Social Contribution on Revenues ("COFINS"). Note that in this case a company adhering to REPES is not subject to the provisions of Article 10, XXV, of Law 10833/2003 (which excludes from non-cumulativeness the revenues earned by information technology service companies from the development of software and its licensing or assignment of the right of use, as well as the analysis, programming, installation, setup, advisory and consulting services, technical support, and maintenance or upgrading of software, which includes electronic pages as software – except sales, licensing or assignment of the right to use imported software).

## Main features of the Regime:

- In the sale or import of new goods for development in Brazil of software and information technology services, the following tax payments are suspended: (i) PIS/PASEP and COFINS on gross sales in the domestic market when such goods are purchased by a company beneficiary of the REPES for inclusion in its fixed assets; (ii) PIS/PASEP-Import and COFINS-Import, when such goods are directly imported by a company beneficiary of the REPES for inclusion in its fixed assets. The goods benefiting from tax suspension will be listed in a regulation.
- In the sale or import of services for development in Brazil of software and software and information technology services, the following tax payments are suspended: (i) PIS/PASEP and COFINS on gross revenues earned by the service provider, when the services are received by a company beneficiary of the REPES; (ii) PIS/PASEP-Import and COFINS-Import on services directly imported by a company beneficiary of the REPES.
- These tax suspensions are transformed into a zero tax rate after the 80% threshold mentioned above is met, within the deadlines related to such condition.
- The adherence to the Regime is conditioned to the tax regularity of a company as regards federal taxes and contributions, and will be canceled: (i) in the event of non-compliance of the export commitment referred to in the MP; (ii) whenever it is verified that the beneficiary did not meet the terms and conditions or failed to comply with the adherence requirements, or ceased to meet the terms and conditions or to comply with the adherence requirements; and (iii) if requested. The Law governs the consequences of cancellation (payment of taxes, arrears fine, ex-officio tax assessment, etc.).

The Law also prescribes the rules on and the effects of the transfer of ownership or the assignment of use, under any terms, of the goods imported or purchased in the domestic market with suspension of the taxes.

The import of the goods listed by the Executive Power, which do not have a similar domestic product, made directly by the beneficiary of the REPES for inclusion in its fixed assets, will be made with suspension of payment of Excise Tax ("IPI"). This tax suspension is transformed into a tax exemption if the requirements and terms of the Law are met.

## **RECAP (Arts. 12 a 16) – effective as from November 22, 2005**

As in REPES, the Special Regime for the Purchase of Capital Goods by Exporting Companies ("RECAP") was created under conditions to be regulated by the Executive Power. Its beneficiaries are any companies operating mainly as exporters, that is, companies whose gross revenues from exports for the calendar year immediately prior to adherence to RECAP is at least 80% of their aggregate gross sales and service revenues for the period and that commit to maintain such export percentage during two-calendar years (gross revenues considered after the exclusion of taxes and contributions on sales).

The Regime: (i) does not apply to companies that elect for the simplified taxation regime called "SIMPLES" and whose revenues, in whole or in part, are submitted to cumulative taxation by PIS/PASEP and COFINS; (ii) applies to any Brazilian shipyard, in the case of purchase or import of capital goods listed in the regulations, to be included in its fixed assets and used in the building, maintenance, modernization, conversion, and repair of ships pre-registered or registered in the Special Brazilian Register ("REB"), under the Law.

In the sale or import of new machinery, devices, instruments, and equipment, the following tax payments are suspended: (i) PIS/PASEP and COFINS on gross sales revenues in the domestic market, when the assets purchased by a company beneficiary of the RECAP are for inclusion in its fixed assets; (ii) PIS/PASEP-Import and COFINS-Import, when such goods are imported directly by a company beneficiary of the RECAP for inclusion in its fixed assets. The goods benefiting from tax suspension will be listed in a regulation.

These tax suspensions are transformed into a zero tax rate after the terms provided by the Law to qualify as beneficiary of the Regime are met, including the established deadlines.

The company that agrees to export during a three-year period gross revenues of at least 80% of its total gross sales and service revenue can also, if the same terms of the Law are met, use the PIS/COFINS suspension benefit referred to in Article 40 of Law 10.865/2004.

The adherence to RECAP is conditioned to the tax regularity of a company as regards federal taxes and contributions.

## **Incentives to technology innovation (Arts. 17 to 26) – effective as from January 1, 2006**

Under the Law, a company is entitled to the following tax incentives:

- deduction, for taxable income calculation purposes, of the amount spent during the calculation period on technological research and development of technological innovation, classifiable as operating expenses under the Corporate Income Tax (“IRPJ”) legislation, or as payment for technological research and development of technological innovation contracted in Brazil with a university, research institution, and/or independent inventor [applicable also to the Social Contribution on Net Income (“CSLL”)].
- 50% reduction of IPI on equipment, machinery, devices, and instruments, and on spare parts and tools related to such goods, to be used in research and technological development;
- accelerated depreciation, calculated by applying the normally accepted depreciation rate, multiplied by two, without affecting the normal depreciation charge of new machinery, equipment, devices, and instruments to be included in technological research and development of technological innovation activities, for IRPJ calculation purposes;
- accelerated amortization, through deduction as an operating expense or cost in the calculation period when these were incurred, of expenditures with the purchase of intangible assets, exclusively related to technological research and development of technological innovation activities, classifiable as deferred charges of the beneficiary, for IRPJ calculation purposes;
- credit of the income tax withheld on the amounts paid, remitted, or credited to beneficiaries resident or domiciled overseas as royalties, technical or scientific assistance, and specialized services prescribed in technology transfer agreements approved or registered under Law 9.279/96, in the following percentages: (a) 20%, for the calculation periods from January 1, 2006 to December 31, 2008; (b) 10%, for the calculation periods from January 1, 2009 to December 31, 2013; and
- reduction to zero of the withholding income tax rate on remittances abroad for the registration and maintenance of trademarks, patents, and cultivars.

Technological innovation is considered the design of a new product or manufacturing process, as well as adding new functionalities or characteristics to the product or process which

result in incremental improvements and an effective quality or productivity gain, resulting in increased market competitiveness.

The Law regulates, amongst other aspects, the deductibility of expenditures on technical, scientific or similar assistance, and royalties on industrial patents paid to individuals or entities overseas, as well as the rendering of information on the programs.

Notwithstanding the incentives mentioned above, as from calendar year 2006 a company can exclude for IRPJ and CSLL taxable income purposes an additional 60% of the total expenditures incurred during the calculation period on technological research and development of technological innovation, classifiable as expenses under IRPJ legislation.

The amounts spent on fixed fittings and the purchase of devices, machinery and equipment to be used in research and technological development projects, metrology, technical standardization, and conformity analysis, applicable to products, processes, systems and personnel, authorizations for registration, licensing, homologation and related procedures, as well those related to intellectual propriety protection procedures, can be depreciated or amortized as provided by current legislation, and the undepreciated or unamortized balance may be deducted in the calculation of taxable income for the period in which its use is ceased.

The Industrial Technology Development Programs ("PDTI") and Agribusiness Technology Development Programs ("PDTA") and the projects approved up to December 31, 2005 will be regulated by legislation effective on June 16, 2005 but are authorized to change to the regime provided herein, as determined in the regulations.

## **Digital Inclusion Program (Arts. 28-30) – effective as from November 22, 2005**

The tax rates of PIS/PASEP and COFINS on gross revenues from retail sales of small capacity, digital processing units/ microprocessors [code 8471.50.10 of the IPI Rate Table ("TIPI")]; automatic data processing machines (codes 8471.30.12, 8471.30.19 or 84.71.30.90 of TIPI); automatic data processing machines/systems (codes 8471.50.10, 8471.60.7, 8471.60.52, 8471.60.53 of TIPI); and keyboard and mouse (codes 8471.60.52 and 84.71.60.53) accompanying the digital processing unit classified under code 8471.50.10 of TIPI, are reduced to zero.

The Program does not apply to a company that elects the SIMPLES taxation regime and considers sales up to December 31, 2009.

## **Incentives to the microregions in the areas where the extinct SUDENE and SUDAM used to operate (Arts. 31 and 32) – effective as from January 1, 2006**

Under the Law, the goods purchased as from calendar year 2006 to December 31, 2013 by companies that have an approved project for installation, expansion, modernization, or diversification in industries qualified as priorities for regional development, in underdeveloped microregions located in the areas where the extinct Superintendency for the Development of the Northeast ("SUDENE") and Superintendency for the Development of the Amazon ("SUDAM") used to operate, will be entitled to:

- accelerated depreciation, for IRPJ calculation purposes (full depreciation in the year of purchase);

- a discount, for 12 months as from the purchase, of the non-cumulative PIS/PASEP and COFINS credits, in purchases of new machinery, devices, tools, and equipment, listed in regulations, to be included in fixed assets (credits will be calculated by applying every month the rate of 9.25% on the amount corresponding to 1/12<sup>th</sup> of the purchase cost of the item).

The microregions covered and the limits and conditions for entitlement to the benefit will be defined in a regulation.

## **II) CHANGES TO PIS AND COFINS LEGISLATION:**

### **Deduction from taxable base – agricultural credits (Article 41) – effective as from October 14, 2005**

Funding expenses incurred by companies engaged in the securitization of agricultural credits, under act of the National Monetary Council, can also be deducted in the calculation of the PIS/COFINS taxable base.

### **Withholding tax – automobile industry (Article 42)**

The payments for purchases of auto parts included in Appendices I and II of Law 10485/2002, except tires, made by a manufacturing company, are subject to the withholding of PIS and COFINS:

- I– parts, components or assemblies to be used in machines and vehicles classified under codes 84.29, 8432.40.00, 84.32.80.00, 8433.20, 8433.30.00, 8433.40.00, 8433.5, 87.01, 87.02, 87.03, 87.04, 87.05 and 87.06, of TIPI (effective as from March 1, 2006);

- II- machines and vehicles classified under the codes described in (I) above (effective as from December 1, 2005).

The amount to be withheld qualifies as an advance payment of PIS and COFINS payable by the supplying companies and will be determined by applying 0.10% for PIS and 0.5% for COFINS on the amount payable.

The withholding does not apply to payments made to companies that elect the simplified taxation regime called SIMPLES and to wholesalers or retailers (effective as from December 1, 2005). It covers, however, payments of manufacturing services to order (effective as from March 1, 2006).

### **Chemical and pharmaceutical products– COFINS (Art. 43) – effective as from November 22, 2005**

The Law introduced new rules that authorize the Executive Power to reduce to zero and reinstate the tax rate on gross revenues from the sales of chemical and pharmaceutical products, classified under Chapters 29 and 30, on products to be used in hospitals, clinics and doctors' and dentists' surgeries, health campaigns carried out by the Government, as well as pathologic, cytological anatomy or medical exam laboratories, as provided previously, classified under positions 30.02, 30.06, 39.26, 40.15 and 90.18, and semen and embryos classified under position 05.11, all of TIPI.

### **PIS/COFINS credits (Arts. 43 and 45) – effective as from December 1, 2005**

In addition to the cases provided for by Article 3 of Law 10833/2003, companies can deduct from the amount calculated for PIS and COFINS under the non-cumulative regime, credits in relation to machinery, equipment and other

assets included in fixed assets, purchased or manufactured for lease to third parties, or to be used in the production of goods for sale or for the rendering of services. Note that, in this instance, the costs referred to in the items of Para 2 of Article 3 are not part of the cost of machinery, equipment and other goods manufactured to be included in fixed assets (not entitled to tax credit).

### **Resale of properties (Article 43)**

As from October 14, 2005, revenues from the resale of properties, subdivisions of properties or plots of land, real estate development and building construction for sale are excluded from the PIS and COFINS non-cumulative regime when arising from long-term contracts entered into before October 30, 2003.

### **Exclusions from the non-cumulative regime - application to PIS (Article 43)**

The Law lists the provisions included in Article 10 of Law 10833/2003 (addressing the exclusion from the non-cumulative regime), which will also be applied to the PIS contribution (effective as from October 14, 2005).

### **PIS/COFINS-Import taxable base (Article 44) – effective as from November 22, 2005**

The ICMS to be included in the taxable base of PIS-Import and COFINS-Import does not include the portion relating to any other taxes, fees, contributions and customs expenses.

### **Beverages - zero tax rate (Article 44) – effective as from November 22, 2005**

The tax rates of PIS/COFINS on imports and on gross revenues from sales, in the domestic market, of non-alcoholic compound preparations, classified under code 2106.90.10 Ex 01 of TIPI, to be used in the preparation of beverages by companies manufacturers of the products mentioned in Article 49 of Law 10.833/

2003 (beer, soft drinks, compound preparations, and water) are reduced to zero.

### **PIS/COFINS-Import credits (Article 44) – effective as from December 1, 2005**

In addition to the instances already established in Article 15 of Law 10865/2004, companies subject to the calculation of PIS/PASEP and COFINS under the non-cumulative regime may deduct a credit for purposes of these calculations relating to imports subject to PIS/COFINS-Import in the instances of machinery, equipment and other items included in fixed assets, purchased for lease to third parties or to be used in the production of goods for sale or for the rendering of services.

### **Suspension on sales to companies operating mainly as an exporter (Article 44) – effective as from October 14, 2005**

In order to benefit from the suspension of PIS/COFINS on sales of raw materials, intermediary products and packaging materials to a company operating mainly as an exporter (Article 40 of Law 10865/2004), the Law considers any company with export gross revenues for the calendar year prior to the purchase of the materials and products, in excess of 80% of its aggregate gross sales and service revenues for the same period, as an exporter.

### **Manufacturing to order – auto parts (Article 46) – effective as from March 1, 2006**

The following tax rates are applicable in the calculation of PIS/PASEP and COFINS on gross revenues earned by the ordering company, in the case of manufacturing to order, as provided by Article 10 of Law 11051/2004, of auto parts listed in Appendices I and II of Law 10.485/2002:

- a) 1.65% and 7.6% (Article 3, I, of Law 10.485/2002), on sales to manufacturers of the vehicles and machinery listed in Article 1 of Law 10485/2002 or manufacturers of auto parts (Appendices I and II of Law 10485/2002) when intended to be used in the production of products listed in such appendices; or
- b) 2.3% and 10.8% (Article 3, II, Law 10.485/2002) on sales to wholesalers or retailers or consumers.

PIS and COFINS are payable on the gross revenues of the company manufacturing the ordered products at the rates of 1.65% and 7.6%, respectively.

For purposes of Article 10 of Law 11051/2004 referred to above, the manufacturing to order criteria for Excise Tax (IPI) purposes are applied.

### **PIS/COFINS - cooperatives (Article 46) – effective as from November 22, 2005**

Loan and road cargo transportation  
cooperatives can exclude from the calculations of the amounts payable as COFINS and PIS, the revenues arising from cooperative services, applying, as appropriate, the provisions of Article 15 of Provisional Measure No. 2.158-35/2001, and other rules relating to agricultural production and infrastructure cooperatives.

### **PIS/COFINS credits (Arts. 47 and 48) – effective as from March 1, 2006**

The use of PIS/COFINS credits is forbidden in relation to goods and services used as inputs in the rendering of services and the production or manufacture of goods or products for sale (including fuels and lubricants and other conditions specified in the Law), in the purchase of waste, residues or chips of plastic, paper or cardboard, glass, iron or steel, copper, nickel, aluminum, lead, zinc and tin, classified in

positions 39.15, 47.07, 70.01, 72.04, 74.04, 75.03, 76.02, 78.02, 79.02 and 80.02, respectively, of TIPI, and other metal residues and waste of Chapter 81 of TIPI.

PIS/PASEP and COFINS contributions are suspended in sales of waste, residues or chips to any company that calculates income tax based on actual taxable income. This suspension does not apply to sales made by a company that elects the SIMPLES taxation regime.

### **PIS/COFINS – suspension (Article 49) – effective as from November 22, 2005**

The payment of PIS/PASEP and COFINS is suspended on sales of a manufacturer of packaging materials to a company headquartered abroad and delivered in Brazil to be fully used for packaging of products for export.

The tax suspension referred to in this article is transformed into a zero tax rate after the export of the packaged products and this benefit can only be enjoyed after the terms and conditions in the Executive Power regulation are met.

A company that has not exported the goods packed with the packaging materials received with the suspension of these taxes within 180 days of the date of sale must pay the taxes plus arrears interest and fine as from the date of the sale, as provided by the Law, and as liable taxpayer, in conformity with the other legal requirements.

### **Special customs regimes (Article 50) - effective as from November 22, 2005**

The suspension of the payment of PIS-Import and COFINS-Import on imports by companies located in the Manaus Free-Trade Zone on goods used to manufacture raw materials, intermediary products, and packaging materials used during manufacturing processes by

establishments located therein, pursuant to a project approved by the Board of Directors of the Manaus Free-Trade Zone Superintendency "SUFRAMA", is also applicable to imports of new machinery, devices, tools, and equipment to be included in the fixed assets of the importing company. This tax suspension is transformed into a zero tax rate 18 months after the goods have been included in the fixed assets of the importing company. Machinery, devices, tools, and equipment benefiting from the suspension of PIS/PASEP and COFINS will be listed in regulations.

### **PIS/COFINS – zero tax rate (Article 51) - effective as from March 1, 2006**

The tax rate of PIS/COFINS on the import and gross revenues from sales in the domestic market of pasteurized milk or processed milk, as ultrapasteurized milk, and powder milk, whole or skimmed, to be used for human consumption is reduced to zero; also, of mozzarella, fresh white, domestic Swiss, curd, ricotta, and cream cheeses.

### **PIS/COFINS Import - Special customs regimes (Arts. 52 to 54) – effective as from November 22, 2005**

The Law creates a Special Customs Regime for Import of packaging for water and soft drinks classified under codes 22.01 and 22.02 of TIPI (mentioned in Article 51, heading, II, b, of Law 10.833/2003), which permits calculating PIS/PASEP-Import and COFINS-Import using special tax rates. Only a trading company that imports this type of packaging for resale to a manufacturing company can apply for the special regime.

### **PIS/COFINS – paper manufacturing (Article 55) – effective as from November 22, 2005**

The sale or import of machinery and equipment used to manufacture newsprint or paper classified under codes 4801.00.10, 4801.00.90, 4802.61.91, 4802.61.99, 4810.19.89 and 4810.22.90 of TIPI, used to print magazines, will be carried out with the suspension of payment of: (i) PIS/PASEP and COFINS on gross sales revenues in the domestic market, when such goods are purchased by a manufacturing company to be included in its fixed assets; or (ii) PIS/PASEP-Import and COFINS-Import, when such goods are imported directly by a manufacturing company to be included in its fixed assets.

This benefit only applies in the case of purchases or imports made by a company that has sales of the paper in question in amounts equal to or higher than 80% of its gross revenues from the total sales of paper; it does not apply in the case of purchases or imports made by companies that elect the SIMPLES taxation regime or whose revenues, in whole or in part, are subject to the cumulative PIS/PASEP and COFINS regime; and can be used in purchases or imports made up to April 30, 2008 or until domestic production supplies 80% of domestic consumption.

The Law provides the other conditions and consequences of the suspension benefit.

### **PIS/COFINS – petrochemical naphtha (Arts. 56 a 59) – effective as from March 1, 2006**

PIS/PASEP and COFINS payable by the producer or importer of petrochemical naphtha on gross revenues from the sales of this product to petrochemical centers, will be calculated at 1% and 4.6%, respectively.

On calculating PIS/PASEP and COFINS on the non-cumulative regime, a petrochemical center can deduct credits calculated at 1.65% and 7.6%, respectively, on the purchase or import of petrochemical naphtha.

When the import of petrochemical naphtha is carried out by petrochemical centers, the PIS/COFINS Import rates are 1% and 4.6% respectively.

The possibility of reducing the rates of PIS/PASEP and COFINS on gross revenues the sale of petrochemical naphtha to petrochemical centers to zero was eliminated from the new wording of Article 14 of Law 10336/2001.

### **Products subject to control stamps (Article 60) – effective as from March 1, 2006**

A manufacturing company or importer of products **subject to** control stamps (referred to in Article 46 of Law 4.502/64) can deduct from PIS/PASEP or COFINS payable in each calculation period a presumed credit corresponding to the refund of costs and other charges (referred to in Article 3 of Decree Law 1.437/75), effectively paid in the same period.

### **Presumed credit – PIS/COFINS (Article 63) – effective as from November 22, 2005**

As known, companies, including cooperatives, that produce animal or vegetal goods classified in the Chapters listed in Article 8 of Law 10925/2004, to be used for human or animal food, can deduct from PIS/COFINS a presumed credit calculated on the amount of the goods used as inputs to produce or manufacture goods or products for sale, purchased from individuals or received from an individual member of a cooperative.

The Law introduced new rules that extend such provisions to purchases from cereal producers that cumulatively engage in activities such as cleaning, standardizing, storing, and selling unprocessed vegetal products, classified in codes 09.01, 10.01 a 10.08, except codes 1006.20 and 1006.30, 12.01 and 18.01, of the Mercosul Common Nomenclature (“NCM”) (note that drying activities were excluded).

### **Manaus Free-Trade Zone – zero tax rate of PIS/COFINS (Arts. 64 and 65) – effective as from March 1, 2006**

Sales of alcohol fuel for consumption or manufacturing in the Manaus Free-Trade Zone carried out by a distributor established outside the Zone are subject to the zero rate of PIS/PASEP and COFINS, referred to in Article 2 of Law 10.996/2004. In this instance, these taxes are referred to on sales by the buyer at rates of 1.46% and 6.4%.

Sales of products listed in Article 2, Para 1, I-VIII, of Law 10.833/2003, for consumption or manufacturing in the Zone, carried out by a producer, manufacturer or importer established outside the Zone, are also subject to the zero rate of PIS/PASEP and COFINS referred to in Article 2 of Law 10.996/2004. In this instance, resales by the buying company are subject to the tax rates established in the new Law.

### **PIS/COFINS – contracts with predetermined price (Article 109) – effective as from November 1, 2003**

Article 10 of Law 10833/2003, XI, “b” and “c” excludes from the PIS and COFINS non-cumulative regime revenues from contracts: (i) entered into before October 31, 2003 with a term of more than one year, involving turn-key construction or supply at predetermined prices; and (ii) turn-key construction or supply, at predetermined prices, entered into with government entities, state-owned companies,

and public/private companies or their subsidiaries, as well as contracts subsequently entered into arising from proposals filed in tender process by October 31, 2003.

Article 109 of the new Law under review, effective as from November 1, 2003, establishes that price adjustments based on production cost or inflation index that reflects the weighted changes in the costs of the inputs used (Article 27, Para 1, II of Law 9069/95 – Real Plan), cannot be considered for purposes of disqualifying a predetermined price.

### **III) CHANGES IN OTHER FEDERAL TAXES AND CONTRIBUTIONS**

#### **SIMPLES – (Arts. 33 and 75)**

For purposes of the provisions of Law 9317/96, which provides on the differentiated, simplified, and favored tax treatment applicable to microcompanies and small businesses, as from January 1, 2006:

- a microcompany is a company that in the calendar year earned gross revenues equal to or lower than R\$ 240,000 (current amount – R\$ 120,000);
- a small business is a company that in the calendar year earned gross revenues higher than R\$ 240,000 (current amount – R\$ 120,000) and equal to or less than R\$ 2,400,000 (current amount – R\$ 1,200,000).

The Law also presents certain changes in the SIMPLES legislation as regards the exclusion from the program effective as from October 14, 2005.

Article 75 of the Law under review addresses the deadlines for the payment of taxes and contributions payable by entities enrolled with the SIMPLES (effective as from January 1, 2006).

#### **Monthly IRPJ and CSLL - Taxable base (Article 34) – effective as from January 1, 2006**

The monthly IRPJ and CSLL calculation percentage also includes financial income of a company that engages in real estate transactions relating to sales of plots of land, real estate development, construction of buildings for sale, and the sale of properties built or acquired for resale, when arising from the sale of properties and determined based on indices or coefficients prescribed by contract.

#### **CSLL – credit on purchases of fixed assets up to December 31, 2006 (Article 35) – effective as from November 22, 2005**

Companies taxed on the basis of actual taxable income that in the period from October 1, 2004 to December 31, 2006, purchase new machinery, devices, tools, and equipment listed in regulations, to be included in fixed assets and used in the manufacturing process of the buyer, can use CSLL-related credits of 25% of the amount of the accounting depreciation of these assets.

The period previously stated by Article 1 of Law 11051/2004 was from October 1, 2004 to December 31, 2005.

#### **Transfer prices (Article 36) – effective as from November 22, 2005**

Article 19 of Law 9430/96 determines that revenues earned in transactions with a related party are subject to arbitration when the average sales price of the goods, services or rights of exports during the related calculation period of the taxable income is lower than 90% of the average sales price charged for the same goods, services or rights in the Brazilian market, during the same period, under equal payment terms.

Under the new Law, the Minister of Finance is authorized to apply during a certain period, an adjustment mechanism to determine transfer prices related to the above, as well as the calculation methods to be specified, applicable to exports, in order to mitigate the impacts of the appreciation of the Brazilian currency against other currencies. The Secretary General of the Federal Revenue Service can determine the application of this adjustment mechanism to the instances mentioned in Article 45 of Law 10.833, of December 29, 2003 (which prescribes the implementation of rules to simplify the calculation of the transfer pricing methods and to establish a percentage margin of maximum departure between the adjusted price, to be used as a benchmark price, according to the methods prescribed by the Law, and the price mentioned in the import and export documentation).

### **IRPJ and CSLL – depreciation charges (Article 37) – effective as from December 1, 2005**

The difference between the amount of the charge calculated based on the annual depreciation rates established by the Federal Revenue Service and the amount of the charge based on the annual depreciation rates established by specific legislation applicable to fixed assets, except land, purchased or constructed by power generation concessionaires, licensees and companies authorized to generate electric energy, can be deducted in the calculation of taxable income for IRPJ and CSLL purposes. These provisions apply only to new goods purchased or constructed from November 22, 2005 to December 31, 2013.

The difference between the amounts of these charges must be controlled in the tax ledger used to determine taxable income, and the total accumulated depreciation, including the accounting and tax depreciation, cannot exceed the cost of the depreciated asset. As from the calculation period in which this limit is reached, the amount of the depreciation charge recorded in the

books must be added back in the calculation of taxable income for IRPJ and CSLL purposes, with the concurrent adjustment in the control account in the tax ledger.

Note that these provisions only have tax effects and do not change the attributions and competences established in the legislation for the National Electric Energy Agency (ANEEL) and cannot directly or indirectly result in an increase of electric energy prices and tariffs.

### **Personal income tax (IRPF) - Capital gain on the sale of goods and rights (Arts. 38, 39 and 40) – effective as from October 14, 2005**

Any capital gain on the sale of goods and rights of small value is exempt from income tax if their unit sales price, in the month the sale occurs, is equal to or lower than: a) R\$ 20,000, in the case of sale of shares traded in the over-the-counter market; b) R\$ 35,000, in the remaining cases.

Moreover, the Law provides that the gain of an individual resident in Brazil on the sale of residential properties is exempt from income tax if the seller applies, within 180 days after the contract is signed, the proceeds in the purchase of residential properties located in Brazil. In the case of the sale of more than one property, the deadline will be counted as from the date the first contract is signed.

The partial investment of the sales proceeds will entail the taxation of the gain proportionally to the amount not applied.

In the case of purchase of more than one property, this exemption is applied to the capital gain corresponding only to the amount used to purchase residential properties.

Non-compliance with the above conditions will entail payment of the capital gain tax, plus interest and fine, under the Law.

An individual can only use this benefit once every five years.

Also under the Law, reduction factors (FR1 and FR2) will be applied to the capital gain to determine the tax payable on the sale, under any terms, of properties by an individual resident in Brazil (the reduction factors will be determined in accordance with the formula established in the Law).

### **Withholding of CSLL/PIS/COFINS (Article 74) – effective as from January 1, 2006**

Payments made by companies to other private companies for the provision of cleaning, maintenance, preservation, security, and other services described in Article 30 of Law 10833/2003 are subject to the withholding of CSLL, COFINS, and PIS/PASEP. The amounts withheld during a two-week period must be paid in a centralized manner by the company's Head Office, by the last business day of the two-week period subsequent to the two-week period when the payment to the supplier or service provider was made.

The same deadline is established for purposes of the provisions of Art. 34 of Law 10833/2003, which addresses the withholding of CSLL/PIS/COFINS on payments made by government agencies.

### **Pension plans and life insurance (Arts. 76 to 88) – effective as from January 1, 2006**

Open-end pension entities and insurance companies can, as from January 1, 2006, establish investment funds, with segregated assets, tied exclusively to pension plans or life insurance with survival coverage clauses, structured as variable contribution plans, sold and administered by them. These funds can only be administered by institutions authorized by the Brazilian Securities Commission ("CVM").

In the event of bankruptcy or extrajudicial liquidation of the company owner of the fund shares, the ownership of such shares, linked to the individual participants or insured persons, will be transferred to such participants or insured persons and the ownership of shares which are not linked to any individual participant or insured person will be transferred to all participants or insured persons proportionally to the number of shares held by such participants or insured persons, pursuant to other provisions of the Law under review.

The assets of these investment funds is not associated to the assets of the open-end pension entities or insurance companies that establish such funds, and cannot be attached, even if by association, to their debts. In the event of bankruptcy or extrajudicial liquidation of the open-end pension entity or insurance company, the assets of the funds will not be part of the bankrupt or liquidating estate.

The assets and rights of the funds cannot be pledged, attached, seized, or subject to any other type of court restriction because of debts of the open-end pension entity or insurance company.

The supplementary pension plans and life insurance with survival coverage clause sold up to December 31, 2005 can be adapted by the open-end pension entities and insurance companies to this structure.

A participant of a supplementary pension plan compliant with the structure described can pledge, as guarantee of real estate loans, shares that he or she holds in the investment fund addressed herein, in conformity with the other rules provided by the Law in this regard.

The institutions authorized by the CVM to administer a securities portfolio are also authorized to establish investment funds that allow their shares to be pledged in guarantee of property leases, to be formalized through the registration with the fund administrator, by the

shareholder, of a deed of trust assignment together with a copy of the lease contract, transferring to the creditor the non-cancelable ownership of the shares. The pledge in guarantee creates a trust over the shares assigned, which cannot be sold or pledged and the financial institution administrator of the fund becomes the trustee.

### **Income Tax - Taxation on pension benefit plans, insurance, and investment funds of a pension nature (Article 91)**

Certain changes were introduced by Law 11053/2004 to permit participants that join, from January 1, 2005, pension benefit plans, structured as defined contribution or variable contribution plans, of supplementary pension entities and insurance companies to elect a differentiated income tax taxation regime (variable tax rates established according to the period of accumulation).

Under the new Law, the deadline to elect this regime was changed to the last business day of the month subsequent to the month the participant joins a benefit plan operated by a supplementary pension company, an insurance company, or a individual programmed pension fund ("FAPI") and will be non-cancelable (effective as from July 4, 2005).

Moreover, the new Law provides that the participant, insured, or shareholder that has joined the benefit plan by November 30, 2005 must exercise the option by the last business day of December 2005 and, exceptionally during this period, those that have joined the plan between January 1 and July 4, 2005 can cancel their option (effective as from November 22, 2005).

The application for this option for the special withholding income tax taxation regime, for participants that had joined pension benefit plans up to January 1, 2005 structured as

defined contribution or variable contribution plans, must be filed by the participant, insured or shareholder with the related supplementary pension company, insurance company, or FAPI administrator, as applicable, by the last business day of December 2005 (effective as from July 4, 2005).

The administrative funds established by private pension funds and the provisions, technical reserves, and welfare plan funds referred to in Article 76 of Supplementary Law 109/2001 (effective as from July 4, 2005) are waived from withholding income tax and the separate taxation referred to in Article 5 of Law 11053/2004.

### **CPMF - zero tax rate – pension benefit plans (Article 92) - effective as from July 4, 2005**

The rate of the Tax on Bank Account Outflows ("CPMF") charged on entries relating to the transfer of technical plan reserves, funds, and provisions of a pension benefit nature between supplementary pension entities or insurance companies is reduced to zero, including those arising from corporate restructuring, as provided by Article 92 of the Law under review.

### **Private or open-end supplementary pension entities, insurance companies, and FAPI administrator - special taxation regime (Arts. 93 a 95) – effective as from November 22, 2005**

A taxpayer that elected the special taxation regime provided by Provisional Measure (MP) No. 2222/2001 and that paid taxes and contributions based on Article 5 of this MP in an amount lower than the amount due, can settle the remaining debt by the last day of December 2005, plus arrears or ex-officio fine, as applicable, and interest equal to Brazil's base rate (SELIC), for federal securities, accumulated

on a monthly basis, calculated as from the month following the due date of the tax, plus 1% in the month of payment, in compliance with the other conditions established by the Law under review and regulations to be issued by the Executive Power.

The payment made as described above will settle the tax liabilities relating to the related taxable events, even if recognized or not as a tax debt.

Supplementary pension entities, insurance companies and Individual Programmed Pension Funds (FAPI) that have paid the taxes and contributions established thereby and have withdrawn individual court actions to ensure the benefit provided by Article 5 of MP No. 2.222/2001, must evidence to the Federal Revenue Service Office in their jurisdiction, the withdrawal of class court actions and the irrevocable and unconditional waiver of any allegation of entitlement to such court actions by the last business day of December 2005. This benefit will be effective while there is no court approval of the application, and will become definitive after this court approval, in compliance with the other conditions provided by Article 94 of Law 11196/2005 under review.

In accordance with the conditions provided by Article 95 of Law 11196/2005 under review, in the event of payment of unscheduled benefits offered in pension benefit plans, structured as defined contribution or variable contribution plans, after the participant option for the taxation regime addressed in Article 1 of Law 11.053/2004, income tax will be payable at the rate of:

- I- 25%, when the period of accumulation is less than or equal to 6 years; and
- II– provided by Article 1, IV, V or VI, of Law 11.053/2004 (20%, 15% and 10%), when the period of accumulation exceeds 6 years.

This rule also applies to the unscheduled benefit granted by benefit plans whose participants have elected the taxation regime addressed in

Article 1 of Law 11053/2004, under Article 2 of this Law.

### **IR/CSLL/PIS/COFINS - financial institutions – futures market (Article 110)**

To determine the taxable base of PIS, COFINS, IRPJ, and CSLL, financial institutions and other institutions authorized to operate by the Brazilian Central Bank must include as income or expense incurred on transactions carried out in futures markets:

- I- the difference, determined on the last business day of the month, between fluctuations in interest rates, prices, and contracted indices (curve difference), the balance being determined upon the settlement of the contract, assignment, or position closing, in the cases of:
  - a) swap and forward contracts;
  - b) futures and other derivatives with daily or periodic financial adjustments of positions, whose underlying assets are spot interest rates or fixed income instruments for which it is possible to determine the criterion herein.
- II– the result of the total of the adjustments determined on a monthly basis, in the case of the markets mentioned in I “b”, whose contract underlying assets are commodities, currencies, variable income assets, forward interest rates, or any other asset or economic variable for which it is not possible to adopt the criterion herein;
- III- the result determined upon the settlement of the contract, assignment or position closing, in the cases of options and other derivatives.

The Executive Power shall regulate the above provisions.

When the transaction is carried out in the over-the-counter market, the recognition of expenses or losses is only accepted if the transaction has been registered in a system that provides the criteria to verify if the prices, at the opening and closing of positions, are consistent with market prices.

In the case of hedge transactions carried out in futures markets in foreign exchanges, the income or expenses addressed herein will be recognized as the result of (i) the total of the adjustments determined on a monthly basis, in the case of contracts subject to position adjustments; (ii) determined on the settlement of the contract, in the case of other derivatives.

For purposes of calculating PIS and COFINS, it is forbidden to recognize expenses or losses incurred on transactions carried out in markets other than in formal foreign exchanges.

The above provisions become effective as from the issue of the act regulating this matter, within the minimum deadline:

- For PIS/COFINS: March 1, 2006.
- For IRPJ/CSLL: January 1, 2006.

### **Real estate developments – special taxation regime (Article 111) – effective as from October 14, 2005**

Law 11196/2005 introduced certain changes in the special taxation regime applicable to real estate developments, under Law 10931/2004. Basically, this regime establishes that the developer of any real estate development subject to the regime is subject to payment of 7% of the monthly revenues received, which will correspond to the monthly, joint payment of IRPJ, PIS, CSLL, and COFINS

Under the new Law under review, the payment of taxes and contributions is considered final, and does not entail, in any circumstances, the refund or offset against taxes determined by the developer.

Revenues, costs, and expenses related to the development subject to special taxation should not be included in the calculation of the taxable bases of these taxes and contributions, payable by a developer arising from other activities, including real estate developments not affected, as long as the other rules in the Law as regards the recognition of indirect costs and expenses paid by the developer are complied with.

### **Refund/reimbursement of federal taxes and contributions (Article 114)**

Before refunding or reimbursing taxes, the Federal Revenue Service must verify if the taxpayer is in debt of federal taxes.

If there are tax debts on behalf of the taxpayer, the amount of the refund or reimbursement will be fully or partially offset against the debt. If there are debts related to social security dues or contributions created as substitutive taxes, with respect of the Recorded Debt of the National Institute of Social Security (“INSS”), the refund or reimbursement will be fully or partially offset against the debt.

The above rules become effective after the issue by the Ministries of Finance and Social Security of a joint act establishing the rules and procedures required for their enforcement.

### **Incorrect offset – levy of isolated fine (Article 117) - effective as from October 14, 2005**

The Law introduced certain changes regarding the levy of an isolated fine because of non-homologation of an offset reported by a taxpayer.

Under the Law, an isolated fine is levied on the total tax payable incorrectly offset, when such offset is considered unreported in the instances in which it involves third-party credits, refers to “bonus credit” (Decree Law 491/69), government securities, arises from a court decision which is not final, or does not refer to

taxes and contributions administered by the Federal Revenue Service ("SRF"), applying the following percentages:

- I - 75%, in the cases of non-payment, payment after the due date without arrears fine, non-reporting or incorrect reporting;
- II - 150%, in the cases of clear intention of fraud (Arts. 71, 72, and 73 of Law 4.502/64), regardless of other applicable administrative or criminal penalties.

If the taxpayer fails to meet, within the established deadline, the subpoena to provide information, the fines mentioned in I and II above will be 112.5% and 225%, respectively.

### **Income Tax exemption – Income distributed by Real Estate Investment Funds (Article 125) – effective as from November 22, 2005**

The income distributed to individuals by Real Estate Investment Funds whose shares are listed exclusively in stock exchanges and organized over-the-counter markets are exempt from withholding income tax and from income tax payable in the annual tax return. This benefit will only be granted when the Real Estate Investment Fund has at least 50 shareholders; it will not, however, be granted to individual shareholders holding 10% or more of the shares issued by the Real Estate Investment Fund or whose shares entitle such shareholders to receive income in excess of 10% of the total income earned by the fund.

### **Fine on import transaction (Article 126) – effective as from November 22, 2005**

Law No. 10755/2003 that addresses the fines chargeable on any importer that carries out a foreign exchange transaction or makes a payment in reais without complying with the

terms and other conditions established by the Brazilian Central Bank, and without paying the import within 180 days as from the first day of the month subsequent to the import payment due month, as prescribed in the Import Document ("DI") or the Financial Transaction Register ("ROF"), when financed, was also changed.

Under Law No. 11196/2005, this fine will also be charged on the irregularities provided by previous legislation if pending final trial at the administrative level.

### **Information technology products - Manaus Free-Trade Zone – tax incentives (Article 128) – effective as from November 1, 2005**

The investment percentages established in this Law are reduced by one percent as from November 1, 2005, for companies benefiting from the tax and by financial incentives to manufacture information technology products in the Manaus Free-Trade Zone, established in Law 8248/91, which manufacture polychromatic video output units (monitors), under NCM subposition 8471.60.72, exclusively on the gross billings from the sales of such products in the domestic market.

### **Rendering of intellectual services (Article 129) – effective as from November 22, 2005**

For tax and social security purposes, the rendering of intellectual services, including services of a scientific, artistic or cultural nature, personally provided or not, with or without the assignment of any obligations to partners or employees of the service provider, when such services are provided, is subject only to the legislation applicable to companies, with due regard for the rules governing the qualification as a corporate identity, provided by Article 50 of Law 10.406/2002 - Civil Code.

## **IV) REVOCATIONS**

Article 133 of Law 11.196/2005 revokes Article 36 of Law 10.637/2002, which stated that the excess of the payment of an unpaid capital contribution for an investment over the amount at which the investment is recorded in the accounting records of the company, would not be included in the calculation of taxable income for IRPJ and CSLL purposes, and will only be taxed in the circumstances described in Para 1 of the revoked statute.

### **Brazil and Israel Double Taxation Treaty – Federal Decree 5.576/2005**

Federal Decree 5576 of November 9, 2005, enacts the Taxation between the Governments of the Federative Republic of Brazil and the State of Israel to avoid double taxation and prevent tax evasion relating to taxation of income.

This Treaty, entered into in Brasilia on December 12, 2002, was approved through Legislative Decree 931 on September 15, 2005.

Under this Decree, the Treaty will be executed and fully complied with, and any acts that might result in its revision, as well as supplementary adjustments that result in charges or onerous commitments to Brazil's finances, must be approved by the National Congress.

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