

1976

# Brazil

Touche Ross International

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business study

# brazil

*Touche Ross International*





# **brazil**

1976 EDITION

## **Contents**

CHAPTER 1 – BRAZIL IN BRIEF  
CHAPTER 2 – INVESTMENT FACTORS  
CHAPTER 3 – LABOR CONDITIONS  
CHAPTER 4 – BUSINESS PRACTICES AND INFORMATION  
CHAPTER 5 – FORMS OF BUSINESS ENTITIES  
CHAPTER 6 – ACCOUNTING AND AUDITING  
CHAPTER 7 – TAXATION IN BRAZIL

## **Preface**

This study is one of a series of business studies designed for the use of Touche Ross professional staff in all countries and for interested clients. The information contained in this study has been obtained by the Touche Ross offices in the country concerned from sources believed to be reliable, but no legal responsibility is taken for the accuracy of any particular statement.

The number of changes that have occurred in Brazil's laws, especially in the investment and tax areas, since this study was first published in 1973 have prompted this second edition. Brazil, however, is in a constant state of flux and the reader is advised to ascertain whether the information given here has been superseded by later developments. The assistance of professional advisors is particularly recommended once a decision is made to enter into business in Brazil as the many legal and tax problems arising in practice are beyond the scope of this study.

May 1976



# Introduction

Brazil, as well as other South American countries, must be viewed by itself. Generalities that apply to all of South America are not appropriate and even national averages for all of Brazil are often misleading.

Brazil's great drive is to build a developed society in one generation. Whether or not this goal is achieved, her industrial progress in recent years has been impressive. Brazil's 1974 growth rate of 9.3% means that Brazil has enjoyed an overall economic growth averaging in excess of 10% for seven consecutive years.

The future trend at this point, however, is difficult to predict. The recent tripling in the cost of petroleum imports and the unexpected accelerated growth of capital goods imports have been major contributors to balance of payments and inflationary pressures. With the largest economy in Latin America and rich in untapped natural resources, Brazil will undoubtedly overcome her present difficulties and become one of the leading contenders for world trade within a few years.

The rapid pace of change in Brazil in all areas, including taxation, has resulted in this Business Study being less detailed than other Touche Ross international publications. The five offices of Touche Ross & Co. in Brazil provided the information contained in this Business Study.

Linda S. Avelar  
Director of International Publications  
May 1976



# Detailed Table of Contents

<b>CHAPTER 1 – BRAZIL IN BRIEF</b> .....	1
<b>THE COUNTRY</b> .....	1
Area .....	1
Terrain .....	2
Seasons .....	2
Climate .....	2
Time Factors .....	2
Principal Cities .....	2
São Paulo .....	3
Rio de Janeiro .....	4
Belo Horizonte .....	4
Recife .....	4
Salvador .....	4
Porto Alegre .....	4
Brasília .....	4
<b>THE PEOPLE</b> .....	5
Population .....	5
Language .....	5
Education .....	5
Literacy Rate .....	5
Religion .....	6
History .....	6
<b>NATURAL RESOURCES</b> .....	6
Minerals .....	6
Petroleum .....	6
Fishing .....	7
Cattle Raising .....	8
Agriculture .....	8
Forests .....	9
Energy .....	9
Uranium .....	9
<b>GOVERNMENT AND THE ECONOMY</b> .....	9
The Government .....	9
The Economy .....	10
Annual Rate of Inflation .....	10
Economic Statistics .....	11
Per Capita Income .....	11
Principal Exports .....	11

# Detailed Table of Contents

---

MAJOR INDUSTRIES .....	12
Steel .....	12
Chemical .....	12
Footwear .....	12
Electricity .....	12
Automobiles .....	13
FOREIGN INVESTMENT.....	13
<b>CHAPTER 2 – INVESTMENT FACTORS .....</b>	<b>15</b>
INVESTMENT INCENTIVES .....	15
TAX MONEY INCENTIVES .....	15
SUDENE .....	16
SUDAM .....	16
SUDEPE .....	16
EMBRATUR .....	16
Reforestation .....	16
EMBRAER .....	16
Overall Limitation .....	16
BACKGROUND OF AREAS RECEIVING SPECIAL DEVELOPMENTAL EFFORT .....	17
SUDENE .....	17
SUDAM .....	17
EMBRATUR .....	18
EMPLOYMENT OF FOREIGNERS .....	18
LAND OWNERSHIP BY FOREIGNERS .....	19
Purchase of Rural Land .....	19
Purchase of Urban Land .....	19
FOREIGN TRADE REGULATIONS .....	19
Similar .....	20
Free Ports .....	20
Transit Zones .....	20
STOCK EXCHANGES .....	21
CURRENCY AND CURRENCY CONTROLS .....	23
Currency Unit .....	23

# Detailed Table of Contents

---

Exchange Rates .....	23
Transfers of Currency .....	24
Transfers of Dividends and Branch Profits .....	24
Foreign Currency Loans .....	25
Interest Payments .....	25
Royalties and Fees .....	25
<b>FINANCING .....</b>	<b>26</b>
Banco Nacional de Habitação (BNH) .....	26
Monetary Correction .....	26
<b>PATENTS, TRADEMARKS AND COPYRIGHTS .....</b>	<b>26</b>
Patents .....	26
Trademarks .....	27
Copyrights .....	27
<b>GOVERNMENT REGULATION OF BUSINESS .....</b>	<b>28</b>
Price Controls .....	28
<b>CHAPTER 3 – LABOR CONDITIONS .....</b>	<b>29</b>
<b>LABOR RELATIONS .....</b>	<b>29</b>
<b>TERMS AND CONDITIONS OF EMPLOYMENT .....</b>	<b>30</b>
Wage Rates .....	30
Working Hours .....	30
Overtime .....	31
Vacations .....	31
Workmen’s Compensation .....	31
Severance Compensation .....	31
<b>SOCIAL SECURITY AND OTHER EMPLOYEE BENEFITS .....</b>	<b>32</b>
Required Payroll Reports .....	33
Plan for Social Integration .....	33
Monthly Cost of Required Fringe Benefits .....	34
Employment of Foreigners .....	34
<b>CHAPTER 4 – BUSINESS PRACTICES AND INFORMATION .....</b>	<b>35</b>
<b>INFORMATION FOR BUSINESSMEN .....</b>	<b>35</b>
Entry Requirements .....	35
Credit Facilities .....	35
Tipping .....	35



# Detailed Table of Contents

---

The Despachante .....	35
Communications and Transportation .....	35
<b>BUSINESS HOURS</b> .....	<b>36</b>
Government Office Hours .....	36
Banking Hours .....	36
Retail Stores .....	36
Factories .....	36
<b>BUSINESS PRACTICES</b> .....	<b>36</b>
Public Holidays .....	36
Weights and Measures .....	37
Electric Current .....	37
<b>CHAPTER 5 -- FORMS OF BUSINESS ENTITIES</b> .....	<b>39</b>
<b>BUSINESS ENTITIES</b> .....	<b>39</b>
<b>CORPORATION – SOCIEDADE ANÔNIMA</b> .....	<b>39</b>
Corporate Name .....	39
Minimum Shareholders .....	39
Capital .....	39
Organizing a Corporation .....	40
The Board of Directors .....	41
Statutory Audit Committee .....	41
Legal Reserve .....	41
<b>LIMITED LIABILITY COMPANY – SOCIEDADE POR QUOTAS DE RESPONSABILIDADE LIMITADA</b> .....	<b>42</b>
<b>BRANCH OF A FOREIGN CORPORATION</b> .....	<b>42</b>
Income Tax Disadvantage .....	43
<b>TRADING COMPANIES</b> .....	<b>43</b>
<b>INSURANCE OBTAINED ABROAD</b> .....	<b>44</b>
<b>CHAPTER 6 – ACCOUNTING AND AUDITING</b> .....	<b>45</b>
Professional Accounting Organizations .....	46
<b>LEGAL REQUIREMENTS</b> .....	<b>46</b>
Required Journals and Ledgers .....	47

# Detailed Table of Contents

---

ACCOUNTING PRINCIPLES .....	.47
Frequent Adjustments of Exchange Rates .....	.48
Loans Subject to Monetary Correction .....	.48
Revaluation of Fixed Assets .....	.49
Reserve for Maintenance of Working Capital .....	.49
Receiving Shares of Other Companies .....	.50
Long-Term Receivables – Real Estate .....	.50
Accounting for Income Tax .....	.50
Accounting for Tax Money Investment Incentives .....	.51
Liability for Severance Compensation .....	.51
AUDITING STANDARDS .....	.52
FINANCIAL STATEMENT PRESENTATION .....	.52
<b>CHAPTER 7 – TAXATION IN BRAZIL .....</b>	<b>.61</b>
Effects of Inflation .....	.61
CORPORATE TAXATION .....	.61
Corporate Income Tax Rate .....	.61
Filing of Tax Returns .....	.61
TAXABLE INCOME .....	.62
Income from Foreign Sources .....	.62
Capital Gains .....	.62
Exclusions from Income .....	.62
Nondeductible Expenses .....	.63
DEDUCTIONS .....	.63
Inventory Valuation .....	.64
Depreciation .....	.64
Losses of Prior Years .....	.65
TAX PAYMENTS .....	.65
TAX INCENTIVES .....	.66
Agricultural Activities .....	.66
REVALUATION (MONETARY CORRECTION) OF FIXED ASSETS .....	.66
Treatment of Foreign Exchange Differences .....	.68

# Detailed Table of Contents

---

OTHER TAXES	.68
Tax on Distributed Profits	.68
Tax on Increases in Capital	.69
Tax on Branches of Foreign Companies	.69
Withholding Tax on Payments to Nonresidents	.69
Tax on Excess Reserves of Corporations	.69
Taxation of General Partnerships	.70
WITHHOLDING TAXES	.70
Income Earned by Employees	.70
Self-Employment Income	.71
Payments to Building Contractors	.71
Freight and Cartage	.71
Payments to Nonresidents	.71
Cash Dividends	.71
Interest Payments	.72
International Tax Treaties	.72
INDIVIDUAL INCOME TAX	.72
Net Taxable Income	.73
Income Taxed Abroad	.73
Capital Gains and Losses	.73
Income from Agricultural Activities	.74
General Deductions	.74
Direct Tax Incentive	.75
Individual Income Tax Rates	.75
Payment of Tax	.75
MISCELLANEOUS TAXES	.75
Tax on Circulation of Merchandise ( <i>ICM</i> )	.75
Tax on Manufactured Products ( <i>IPI</i> )	.76
Municipal Tax on Services	.76
Tax on Credit and Insurance Premiums	.77
Other Taxes	.77



# Brazil in Brief

- THE COUNTRY
- THE PEOPLE
- NATURAL RESOURCES
- GOVERNMENT AND THE ECONOMY
- MAJOR INDUSTRIES
- FOREIGN INVESTMENT

## THE COUNTRY

**Area.** The federal republic of Brazil is composed of 21 states, 4 territories and a federal district. It is the largest country in Latin America and the fifth largest in the world. Brazil's territory is larger than the continental USA (excluding Alaska but including one more Texas). Its borders touch every country in South America except Chile and Ecuador, and its eastern seacoast on the Atlantic Ocean extends over 4,600 miles (7,400 kilometers).

Brazil's capital, formerly Rio de Janeiro, was transferred in 1960 to the new federal district in the interior of the country where it was called Brasília. The move represented an attempt to open up Brazil's vast land resources, whose development has lagged behind areas on and near the eastern coast.

The uneven development of so large a country has caused observers to view it in terms of specific regions determined more or less arbitrarily. Economic geographers provide the following information about Brazil's regions:

Region	Area (square miles)	Population (in thousands)	National Income (%)
North (Amazonia)	1,372,201	4,144	2
Northeast	595,471	32,546	12
Southeast	354,752	45,776	64
South	217,016	18,936	17
Midwest	725,620	5,865	5
	<u>3,265,060</u>	<u>107,267</u>	<u>100</u>

These five regions contain the following states and territories:

*Northern Region (Amazonia)* – Acre, Amazonas, Pará and territories of Rondônia, Roraima, and Amapá.

*Northeast* – Maranhão, Piauí, Ceará, Rio Grande do Norte, Paraíba, Pernambuco, Alagoas, Sergipe, Bahia, and the territory of Fernando de Noronha.

*Southeast* – Espírito Santo, Rio de Janeiro, Minas Gerais, and São Paulo.

# Brazil in Brief

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*South* – Paraná, Santa Catarina, and Rio Grande do Sul.

*Midwest* – Mato Grosso, Goiás, and the federal district of Brasília.

**Terrain.** Much of Brazil is rough and hilly, but its mountains are not very high – none are over 10,000 feet. Its river system, which includes the Amazon, is very extensive, and Brazil has very good water resources. The Amazon is the world's largest river, with a rate of flow 12 times that of the Mississippi river. Brazil's long coastline has miles of white sandy beaches that can be developed into beautiful resorts (see *EMBRATUR* in Chapter 2).

**Seasons.** As most of Brazil is south of the equator, its seasons are the reverse of those in the northern hemisphere:

Spring	September to November
Summer	December to February
Fall	March to May
Winter	June to August

**Climate.** Most of Brazil is tropical, but the southern region, which includes São Paulo, is in the temperate zone. The warmest areas are the north and northeast where average temperatures are between 75° and 79°F. The mean temperatures of some principal cities are indicated below.

	January		July	
	°F	°C	°F	°C
São Paulo	69	20.5	58	14
Rio de Janeiro	79	26	68	20
Belo Horizonte	71	21	62	16.5
Recife	82	27.5	77	25
Salvador	79	26	75	23.5
Porto Alegre	76	24	55	12.5
Brasília	74	23	72	22

**Time Factors.** Brazil overlaps four time zones, but only two for practical purposes. The entire coastal region, which includes the principal cities, is two hours later than eastern standard time (8:00 a.m. in New York City is 10:00 a.m. in São Paulo, Rio de Janeiro and Brasília).

Daylight saving time is sometimes used in Brazil. Its use is not automatic but is decreed each year by the President of the Republic.

**Principal Cities.** Usually, on their first visit to Brazil, foreigners are impressed by Brazil's larger cities. Not many first-time visitors anticipate the many tall buildings, the general modern appearance and the

rapid pace of life and work that characterize these metropolises. Some of these are listed below with their estimated 1974 population in millions.

	City	Metropolitan Area
São Paulo	6.78	9.12
Rio de Janeiro	4.90	7.82
Belo Horizonte	1.42	1.72
Recife	1.23	1.83
Salvador	1.16	1.25
Porto Alegre	1.02	1.60

The best-known cities are Rio de Janeiro and São Paulo, but government policies and incentives are attracting investment to other cities and areas. Some of those which might be considered by foreigners who wish to invest in Brazil are the cities of Curitiba and Campinas and the booming northeast region.

**São Paulo.** The city of São Paulo is South America's largest industrial-urban center, and both the city and state of São Paulo are playing a major role in Brazil's development. The state occupies 2.9% of Brazil's area and has about 18% of the population but accounts for approximately 58% of Brazil's industrial production.

São Paulo is considered the fastest-growing city in the world. The *paulistanos*, as its residents are called, work hard and fast. They feel that their city is generating the energy that sparks the industrial development of the entire country. Almost all indices show impressive rates of expansion. Electric power consumption increased 13.3% in 1973 and 11.1% in 1974. The steel industry's output increase for 1974 was 4.7% and that of timber and finished wood products was 5.1%. Production of tractors alone increased 30% in 1973 and 20% in 1974.

The huge concentration of industry in São Paulo is not without its problems, however. Air pollution, traffic and construction noise have been steadily growing. Considered to be an unavoidable consequence of industrial development, pollution has finally come to the attention of city, state and federal authorities. Some legislation for its control has been passed and more is in preparation. The first steps are being taken at the same time that a campaign both informing and making the public aware of the problems is being conducted. TV news broadcasts nightly give air pollution levels registered in several parts of the city.

Pollution and congestion problems notwithstanding, foreign technicians and businessmen, as well as the *paulistanos* themselves, are unflinchingly impressed with the rapid pace, continued growth and high productivity of the city.

# Brazil in Brief

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**Rio de Janeiro.** Rio de Janeiro is probably the best known city abroad and the one with the most cosmopolitan flavor. Its steep mountains forming an impressive backdrop to its beautiful beaches, its world-famous carnival, its glamorous night life, and its famous landmarks — Sugar Loaf and Corcovado — have all contributed to making it a tourist mecca. Rio, however, is Brazil's second largest industrial center with some 5,000 industries employing 200,000 workers. It is Brazil's major financial center and its international airport Brazil's busiest. It is also a major center for publishing, communications, film making, shipping, and manufactured goods such as textiles, pharmaceuticals, foodstuffs, and metallurgical products. Residents of this thriving metropolis call themselves *cariocas* and are somewhat more relaxed than the *paulistanos*.

**Belo Horizonte.** Belo Horizonte is the largest mining city in the state of Minas Gerais, and the third largest city in Brazil. It is a major industrial center on the road between Rio de Janeiro and Brasília. Belo Horizonte was the first planned city in Brazil, but its tremendous growth has forced it out of its predesigned mold. This bustling city accounts for about 40% of all industry in Minas Gerais.

The state of Minas Gerais has its own programs for attracting investment. One of them, INDI, offers many incentives to attract and aid investment that will accelerate the state's industrial development.

**Recife.** Recife is a large port city often called the Venice of Brazil because of its many waterways. Along with Rio and Salvador, Recife is known for its beautiful beaches, which are an integral part of the city, and for its annual carnival. At the same time, its modern buildings and its busy thoroughfares attest to its industrial vitality.

**Salvador.** This city was Brazil's first capital, and it is famous for its colonial heritage, although it is a growing industrial center. Tourism is one of its growth industries and many Brazilians regard Salvador as their favorite city to visit. Salvador has a large industrial park and offers free land and other inducements to attract investment.

**Porto Alegre.** Porto Alegre, an industrial center in the south, is the capital of Rio Grande do Sul, known as the wheat and meat state. The city has attracted many Germans as well as immigrants from other European countries.

**Brasília.** Brasília is the new inland capital of Brazil. This capital, planned by Lucio Costa and designed by Oscar Niemeyer, was con-

structed in the midst of a thick forest in the hope that it would accelerate the inland development of Brazil. Although many government officials were reluctant to leave the pleasant atmosphere of the former capital, Rio de Janeiro, the move was forced and Brazil is now governed from the beautiful and functional modern buildings of Brasília.

## THE PEOPLE

**Population.** Brazil's population, estimated at over 107 million, is the sixth largest in the world, only behind China, India, USSR, USA, and Japan. It accounts for about 35% of the total population for Latin America and is growing at the rate of 2.8% a year — one of the world's highest growth rates. Population density averages only 33 inhabitants per square mile, varying from 3 inhabitants per square mile in the Amazon to 129 inhabitants per square mile in the southeast. Although Brazil has absorbed many immigrants from Europe, Japan, Africa, and the Middle East, these diverse groups and the native Indians have blended into a uniquely Brazilian culture. Color discrimination is almost nonexistent. About 60% of the population is classified as white, and most of the remainder are of Negro origin. Indians number fewer than 100,000.

**Language.** The language used is Portuguese. Because Brazil's population is so large, it can be said that as many people in South America speak Portuguese as Spanish, and more people speak Portuguese in South America than in Portugal. There are only slight regional speech differences. English has replaced French as the second language, especially in educated and business circles. These circles also understand Spanish without difficulty.

**Education.** Education in Brazil is both free and compulsory between the ages of 7 and 14; however, shortages of both teachers and facilities make it impossible to educate all at present. This situation has been improving in recent years.

**Literacy Rate.** Literacy varies widely among the regions and between urban and rural areas. Official figures in 1960 estimated that 60% of the population over 10 could read and write. The current estimate is that 70% of those over 15 are literate.

An agency called MOBREAL conducts a nationwide program of teaching adults to read and write. MOBREAL's funds come from the weekly national soccer lottery and from private corporations that may earmark 1% of their federal income tax for this program.



# Brazil in Brief

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**Religion.** Brazil is the world's largest Roman Catholic country; over 90% of the population are baptized church members. Nevertheless, church attendance is quite low, especially by men. There is a real separation of church and state, and other religions as well as spiritual and messianic movements and Afro-Brazilian cults practice with complete freedom.

**History.** Brazil was formally claimed for Portugal by Pedro Álvares Cabral in 1500.

When Napoleon's armies entered Portugal in 1807-8, the Portuguese court fled from Lisbon to Rio de Janeiro — the only instance of a European king residing in Latin America. The Portuguese Dom João VI returned to Lisbon, but his son Pedro remained as Regent of the Kingdom of Brazil. After resisting demands that he return to Portugal, Pedro proclaimed Brazil's independence in 1822 and was crowned Pedro I. Brazil changed from an empire to a republic in 1889, again without bloodshed.

## NATURAL RESOURCES

**Minerals.** Brazil is rich in mineral resources. Easily mined iron ore of excellent quality is the richest mineral asset, representing a fourth of the world's reserves and Brazil's main mineral export. Manganese is the second most important mineral. Bauxite (aluminum) is third, but its export position will undoubtedly be altered in the next few years as a result of a joint Brazilian-Canadian venture — *Trombeta's* bauxite project. By 1979, this joint undertaking (Alcan Aluminum Limited for Canada and Companhia Vale do Rio Doce for Brazil) is expected to be exporting 5 million tons of bauxite from the fabulous deposits discovered in the Amazon region. Total investment has been estimated at about 300 million dollars. Cassiterite has also become significant in recent years.

**Petroleum.** Prospecting, drilling and most refining of crude oil is performed by Petrobrás, a state-owned company whose shares may be bought by Brazilians. This giant company, included among the ninety largest in the world, has its own tankers, pipelines and storage plants and has recently gone into distribution, developing a network of gas stations throughout Brazil. Petrobrás produced 63 million barrels of crude oil, which represent approximately 20% of the country's needs. Known reserves run up to 10 years at present production levels. This (rather discouraging) situation has taken on a brighter outlook after recent discoveries at the Garoupa and Namorado oil fields, off the coast of the state of Rio de Janeiro, have shown deposits estimated to double

known reserves. Also, the government has confirmed that risk contracts will be signed for oil exploration within the next few months and that companies from six countries have already shown interest. Petrobrás' present refining capacity — 727,451 barrels per day — practically covers all internal needs for gasoline, fuel oil and other derivatives.

*The Mining Code.* The Mining Code, Decree No. 62,934/70, has been changed as part of an effort to stimulate prospecting. Mining rights now belong to the first finders although the owner of the land is entitled to compensation for damage to his property and to a share of mining profits. These changes have resulted in increased outlays for prospecting.

Decree-Law No. 1096/70 was issued to further stimulate prospecting and mining. It allows mining companies to deduct depletion of up to 20% of gross mine income for the first ten years a mine is worked. Another Decree-Law No. 1240/72 provides the following tax incentives for mining companies or companies engaged in the primary transformation of minerals destined for export:

1. Deduction from taxable profit of the portion related to mineral exports.
2. Reduction of withholding tax from 25% to 12.5% on profits remitted abroad.

The tax incentives contained in Decree-Law No. 1240/72 apply to mining companies that satisfy the following conditions:

1. The majority of voting capital belongs to Brazilians.
2. Prior approvals are obtained from the Finance Ministry regarding the enterprise's financial structure and from the Ministry of Mines and Energy regarding its technical structure.
3. The company exports at least 50% of its production.
4. At the port of embarkation, the FOB unit price of a processed mineral is at least 50% higher than the unprocessed price of the same mineral.

**Fishing.** Fish and shellfish abound off Brazil's coast, but a fishing fleet of approximately 5,000 motor-driven vessels and over 50,000 lesser boats catch only about 500,000 tons per year — a small figure compared with those from countries similarly situated. Brazil's statement that her rights in territorial waters extend 200 miles off the coast and the tax incentives granted for investments in the fishing industry represent attempts to improve the industry — especially the profitable shrimp-banks off the territory of Amapá. Although fish resources have been largely neglected as a source of food, such efforts may eventually change the situation.

# Brazil in Brief

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**Cattle Raising.** Brazil, with an estimated 90 million head of cattle, has the world's fourth largest herd. This figure, however, is lower than the 1969/71 peaks reached during the meat-export boom.

Until about ten years ago, cattle raising was meant solely for the internal market. After introduction by the federal government of international sanitary regulations and processing standards, the Brazilian meat industry entered into the world market. Exports boomed until they became detrimental to internal needs and restrictions were imposed. Meat exports for 1974 have been estimated at 80 thousand tons as compared to 180 thousand tons exported in 1972.

Present internal meat demands are being met. Price levels, however, are a serious deterrent to meat consumption by lower income families, which accounts for a low per capita meat consumption rate as compared to that of the United States and Europe.

Although fourth in herd size, Brazil ranks only 15th among the world's largest milk producers, with approximately 2.5 billion gallons (9 billion liters) a year. The milk industry has not kept pace with the population increase and general economic development. Supply to urban centers like São Paulo, Rio de Janeiro and others is irregular with annual shortages during the dry season. The main responsibility for this situation is attributed to the low-price government policy, which has consistently discouraged investment in the industry.

**Agriculture.** Agriculture is still the mainstay of the Brazilian economy despite the rapid industrial growth of recent years. Over the last ten years, agriculture has grown at an annual average rate of 4.5%, allowing a wide gap to emerge between industrial and agricultural development. The need to close this gap in favor of the overall growth rate of the country has been recognized by the federal government, which has set a growth rate of 6% to 7% as its objective in the next 5 years.

The main problems preventing agricultural development are lack of fertilizers and an adequate credit structure and the need to dramatically improve productivity which, in tons per acre, ranges between a half and a third of that of the United States for the same crops.

Brazil's principal agricultural products which in 1973 contributed 57% of the country's foreign exchange were:

Coffee	Cotton
Soybeans (soja)	Cocoa beans (cacau)
Sugar	Bananas

**Forests.** Brazil's forest areas are estimated to exceed those of all other countries with the exception of Russia and Canada. Forests cover about 40% of Brazil but their utilization rate is only about 20%.

**Energy.** Brazil has extensive water resources for hydroelectric plants. Ninety percent of Brazilian power is hydro-generated, and the climate is such that energy is not needed for heating purposes. On the other hand, oil and gas represent about 48% of Brazil's energy consumption. This is due in part to Brazil's heavy reliance on cheap oil which had her develop an extensive network of highways while neglecting the use of railroads and shipping for transportation purposes.

**Uranium.** Recently, Brazil signed an international agreement to obtain technical and scientific cooperation for the development of a nuclear energy program for peaceful uses. The agreement provides for the installation of facilities such as plants for producing nuclear reactors and fuel and reprocessing irradiated materials. Brazil will participate through a state corporation, Nuclebrás, in which she owns 51% of the shares.

## GOVERNMENT AND THE ECONOMY

**The Government.** A military takeover in 1964 resulted in the promulgation of a new Constitution in 1967, which was reformulated in 1969. Castelo Branco was the first president after the 1964 change, followed by Arthur da Costa e Silva and Emilio G. Medici. The current president is Ernesto Geisel, whose term expires in March 1978.

Under the Constitution, the President of the Republic, the governors of the states and the mayors of the municipalities are all elected officials. The governors of the territories are appointed by the President. Powers not granted to the federal government by the Constitution are reserved to the states. However, the executive branch of the federal government has more power than is generally the case in other republics.

The President and Vice President are elected for five-year terms by an electoral college comprised of members of the national congress and delegates chosen by state assemblies, and they are not eligible for consecutive terms.

Below the state level, the governmental organization consists of municipalities (3,952), which are composed of districts (7,884).

The national congress, composed of a chamber of deputies and a senate, is the legislative branch of the federal government. Each state

# Brazil in Brief

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has a chamber of deputies, and each municipality has a board of aldermen that exercises legislative powers.

The principal judicial organs of the federal government, as provided in the Constitution, are the Supreme Court, Courts of Appeal, a system of federal judges, and separate court systems for military, electoral and labor matters.

**The Economy.** Brazil's economic performance in recent years has been among the world's best, as noted in the introduction to this Business Study. Considering a 1964 rate of inflation of 90.8%, the economic improvement since then has been remarkable. The major steps that turned the economy around seem to have been:

1. Neutralization of inflation through monetary correction and frequent but small currency devaluations.
2. Emphasis on exports.
3. Generous tax incentives to promote private investment in the backward regions and in the stock markets.
4. Increase in the level of national savings.
5. Government stability to increase foreign confidence and therefore promote foreign investment.
6. Large investment in basic necessities such as new highways, increased electrical generating capacity, nuclear energy, and communications.
7. Improvement in the policies and operations of the tax system.

**Annual Rate of Inflation.** As shown in the following chart, the annual rate of inflation had been steadily decreasing. However, principally because of the increase in the price of oil and other external inflationary pressures, the inflation rate increased perceptibly in 1974 and 1975. The government has forecast that inflation will begin to decline again in 1977.

Annual Rate of Inflation					
	%		%		%
1957	14.1	1967	24.5	1973	15.7
1960	28.8	1969	20.1	1974	34.5
1963	80.7	1970	19.3	1975	30.0
1964	90.8	1971	19.0	1976	30.0 est.
1965	45.4	1972	18.0		

Brazil has not, of course, solved all of its economic problems. The

distribution of income is uneven. Only 8% of the population enjoy an annual income of over US \$3,000. Nevertheless, in 1974 the Brazilian market absorbed some 860,000 new automobiles and trucks.

**Economic Statistics.** Economic data about Brazil are often not up to date and are not always accurate. The following statistics are based on the best available data.

1969	1970	1971	1972	1973	1974
Total imports CIF in millions of US dollars					
2,265	2,849	3,699	4,783	6,999	12,500
Total exports FOB					
2,311	2,739	2,904	3,981	6,200	7,968
Coffee exports only					
813	939	773	962	1,193	877
Gross domestic product in millions of cruzeiros (at current prices)					
133,117	174,624	194,300	214,600	239,300	263,200
Consumer Price Index (1965-67=100)					
200	238	288	340	392	491

**Per Capita Income.** Newspapers report 1974 per capita income of US\$748. As with other statistics, these must be analyzed. Many Brazilians live, effectively, outside the economy on a bare subsistence level. Their contribution to the economy is nil, but they are included in income statistics. If per capita income were determined on the basis of population actively engaged in the economy, the per capita figure would be much higher.

**Principal Exports.** Brazil's efforts to break away from reliance on coffee exports are meeting with success. The following comparison of principal exports in 1972, 1973 and 1974 tells the story, and indicates that the incentives offered to promote exports of manufactured goods have been accomplishing their purpose.

Principal Exports	1972	1973	1974
Coffee	26.5%	21.7%	11.0%
Cotton	4.7	3.5	1.2
Mineral ores	5.8	5.9	7.1
Manufactured products	28.9	29.7	29.2
Sugar	10.1	8.9	12.2
Others	24.0	30.3	39.3
	<u>100%</u>	<u>100%</u>	<u>100%</u>

# Brazil in Brief

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## MAJOR INDUSTRIES

The principal industries are listed below to indicate their relative importance (1970 statistics compared with 1973 statistics):

Industry	Percent of Total Production Value	
	1970	1973
Foodstuff	25.12	22.6
Mechanical, electrical material, communications, and transportation	17.20	21.5
Chemical, pharmaceutical, and perfume	14.18	16.7
Textile and apparel	11.72	10.8
Metallurgical	10.32	14.4

As percentages of the increasing gross national product, the following comparisons between 1947, 1967 and 1973 are interesting.

	Agriculture	Manufacturing	Services	Total
1947	28.5%	20.7%	50.8%	100%
1967	19.3	26.2	54.5	100
1973	15.2	32.3	52.5	100

**Steel.** From production of 36,000 tons of steel ingots in 1927, steel output increased to 7.5 million tons in 1974. The industry consists of five major producers (three government-controlled and two privately-owned companies) and about 40 smaller companies. Per capita consumption of steel, at approximately 188 pounds (70 kgs.) per person, is still low compared to that of the USA, Japan and the USSR. The government plans to increase production to 25 million tons by 1980.

**Chemical.** Chemical industries constitute about 20% of all processing industries. In 1975, the petrochemical industry was expected to be able to supply almost all basic inputs for the chemical industry.

**Footwear.** Shoes are one of Brazil's fastest growing exports. Exports increased from 1.9 to 8.3 million dollars between 1969 and 1970, were 93 million in 1973 and about 120 million in 1974.

**Electricity.** Installed generating capacity had reached 17 million kilowatts by 1974 and was planned to increase to 20 million kilowatts by 1975. The construction of the Itaipu Hydroelectric, a Brazilian-Paraguayan joint venture, was begun in 1974, and it is scheduled to start generating electricity by 1982. Its nominal capacity is 10 million kilowatts.

**Automobiles.** Established only fifteen years ago, by 1974 the automobile industry had produced 860,000 units – an increase of 18% over 1973.

## FOREIGN INVESTMENT

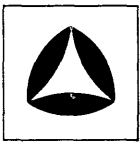
Total foreign investment in Brazil at the end of 1971 and 1974 was estimated at (in millions of US dollars):

	<b>1971</b>	<b>1974</b>
USA	1,096	2,022
West Germany	331	710
Japan	125	598
Switzerland	224	560
Canada	294	401
United Kingdom	273	401
France	130	242
Other	<u>437</u>	<u>1,093</u>
Total	<u><u>2,910</u></u>	<u><u>6,027</u></u>

Although USA investment is by far the largest, investments from Japan, the UK and West Germany have been increasing rapidly. In 1974, most foreign investment was centered in the following industries (in millions of US dollars):

	<b>1974</b>
Chemical	972.7
Transportation	813.4
Metallurgical	453.9
Electrical and communication equipment	424.8





# Investment Factors

- INVESTMENT INCENTIVES
- TAX-MONEY INCENTIVES
- BACKGROUND OF AREAS RECEIVING SPECIAL DEVELOPMENTAL EFFORT
- EMPLOYMENT OF FOREIGNERS
- LAND OWNERSHIP BY FOREIGNERS
- FOREIGN TRADE REGULATIONS
- STOCK EXCHANGES
- CURRENCY AND CURRENCY CONTROLS
- FINANCING
- PATENTS, TRADEMARKS AND COPYRIGHTS
- GOVERNMENT REGULATION OF BUSINESS

## INVESTMENT INCENTIVES

Foreign investment is welcomed by Brazil and is treated no differently from domestic investment. Investment incentives offered by Brazil range from exemption of import duties on industrial equipment for approved projects to special consideration for enterprises considered to be in the national interest.

Studies have been made and negotiations conducted with several foreign governments to avoid double taxation in international operations. The countries with which treaties have been ratified are listed in Chapter 7.

The northeastern and Amazon regions are major underdeveloped areas and important incentives are offered for investments in these regions. The Superintendency for Development of the Northeast (SUDENE) grants exemption from income tax for up to ten years to enterprises that manufacture products not currently produced there. If the investment is unusually risky, the tax exemption may be granted for up to fifteen years. These tax exemptions, however, cannot be passed on to shareholders, but must be capitalized by transfer to a reserve. The reserve may be used for stock dividends only, which must be issued within one year, and do not incur any taxes. Approved enterprises are also exempt from import duties, and may obtain loans at favorable interest rates. SUDENE also assists in feasibility studies, training of new employees, etc. The Superintendency for Development of Amazonia (SUDAM) offers similar incentives for investment in the Amazon region of northern Brazil.

Guarantees for US investors are included in the Investment Guarantee Agreement between the USA and Brazil which has been in effect since 1965. The US also offers guarantees to its nationals for investment in Brazil through the Agency for International Development (AID).

## TAX MONEY INCENTIVES

In addition to the above incentives for investment in the SUDENE and SUDAM areas, prescribed portions of the income tax liability of

# Investment Factors

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foreign and domestic companies may be invested, in lieu of payment to the government, as follows.

**SUDENE.** Up to 25% of a company's income tax liability may be invested in approved projects of any nature in the SUDENE area. The funds must be deposited in a blocked account in the Bank of the Northeast while the investment proposal is being studied by SUDENE and given a priority rating. A company that invests up to 25% of its income tax liability in the SUDENE in any one year is not, necessarily, required to add new funds in future years. The company may remain a passive investor.

**SUDAM.** Up to 25% of a company's income tax liability may be used for investments of any nature located in the SUDAM area.

Investments in the SUDENE and SUDAM areas can be in the form of loans, which will be redeemable five years after the conclusion of the entire project and in maximum portions of 20%.

**SUDEPE.** Up to 12.5% of a company's income tax liability may be used for investments in fishing activities anywhere in Brazil. If the investment is in the SUDENE or SUDAM area, the limit is 25% instead of 12.5%.

**EMBRATUR.** Up to 6% of a company's income tax liability may be used for investments to develop tourism (hotels, mineral water resorts, facilities near international airports, etc.) anywhere in Brazil. If the investment is in the SUDENE or SUDAM area, the limit is 25%. The long Brazilian coast is mainly undeveloped and its favorable climate and natural beauty offer potential for development.

**Reforestation.** Up to 17.5% (in 1977) of a company's income tax liability may be invested during the base tax year in reforestation or reforestation projects. If the investment is in the SUDENE or SUDAM area, the limit is 25%.

**EMBRAER.** Up to 1% of a company's income tax liability may be invested in projects related to the development of the Brazilian aeronautical industry.

**Overall Limitation.** A company may make one or more of the above types of investment each year, but not more than 25% of the income tax otherwise due to the government may be deducted for such investments. Including EMBRAER, 26% of a company's income tax liability may be invested in these incentive areas. The investments are made through the government, which selects the investment projects.

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## BACKGROUND OF AREAS RECEIVING SPECIAL DEVELOPMENTAL EFFORT

**SUDENE.** The area covered by the Superintendency for the Development of the Northeast (SUDENE) includes the states of Maranhão (except the western part), Piauí, Ceará, Rio Grande do Norte, Paraíba, Pernambuco, Sergipe, Alagoas, Bahia, and some northern portions of the state of Minas Gerais — over 600,000 square miles, or about 19% of Brazil's territory, and a population of about 30 million. This area has adequate transportation; communication via telephone, radio and telex is good; and adequate electric power is available. Labor is in good supply and minimum wage rates are about 33% lower than in São Paulo.

**SUDAM.** The area covered by the fiscal incentives program known as Superintendency for Development of Amazonia (SUDAM) includes the states of Acre, Pará, and Amazonas; the federal territories of Rondônia, Roraima, and Amapá; the northern portions of the states of Mato Grosso and Goiás; and the western part of Maranhão. This area, known as Brazilian Amazonia, extends over 1.93 million square miles — almost 60% of the total area of Brazil.

Many highways are being built to open up this huge territory. The Belém/Brasília highway, which was completed about fourteen years ago, has had important results. One of them, for instance, has been the much higher concentration of population along this highway corridor, which increased from about 50,000 to almost a million people. Cattle raising along the same area has also benefited from the greater facilities available with the number of cattle increasing from one million to about five million.

Now underway is the construction of Transamazonica, a 2000-mile highway through tropical jungle, which will establish the first overland connections between the main cities of the Amazon region, up to now linked only by navigation through the Amazon river. As construction proceeds, 'work fronts' are being established thus forming the nuclei of future cities. Homes are constructed in these work fronts, and the impetus for growth is provided by establishing banks, medical services, seed distribution centers, and maintenance and storage facilities for agricultural equipment.

The socio-economic development of the SUDAM region is being carried out by several government agencies, the armed forces in particular, as well as by private enterprise. The overall plan includes these goals:

1. To make the greatest possible use of Amazonia's natural resources and to introduce rational exploitation of agriculture and cattle raising,

# Investment Factors

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2. To attract large amounts of capital through credit facilities and tax incentives, especially in the sectors of mining, forestry and production and processing of beef.

3. To have production units on a scale commensurate with the region's huge natural resources and to support them with an adequate infrastructure of electric power, transportation and communications. Transportation is the government's responsibility and includes the linking of highways, rivers and air routes.

EMBRATUR. All planning and control to develop tourism in Brazil is in the hands of the public enterprise known as EMBRATUR, which channels the tax incentives granted by the government into various projects.

Although Brazil's huge territory encompasses a variety of landscapes and an enormous number of beaches and seaside resorts, foreign tourists spend much less money in Brazil than Brazilians do in foreign countries. EMBRATUR hopes to induce more foreigners to visit Brazil and more Brazilians to travel within their own country.

Investment of up to 6% of a company's income tax liability is only one of the tax incentives offered by EMBRATUR. Other incentives include special loans and tax reductions for the construction of hotels, motels and other tourist-oriented developments.

## EMPLOYMENT OF FOREIGNERS

Brazil does not allow the number of foreign employees to exceed one third of a company's total work force. This limitation also applies to compensation. If the work force is reduced, foreigners must be dismissed before qualified Brazilians doing the same work are dismissed. For this purpose, persons resident in Brazil for more than ten years and who have a Brazilian wife or child are not considered foreigners. These employment rules can be waived if it is shown that qualified Brazilians are not available.

Foreigners who enter Brazil to work for an indefinite period must obtain a permanent visa. If the visit is for a business purpose of short duration, a temporary visa valid for 180 days can be obtained. This temporary visa is renewable for the same period.

To obtain a permanent visa, a foreigner should contact the Brazilian consular office nearest his residence. He will need:

1. Letter from his prospective employer containing information about the type and terms of employment, and including a guarantee of responsibility for the employee.

2. Chest X rays and a certificate of good health from a doctor.
3. Certificate from the local police department testifying to his character.
4. Passport and an international vaccination certificate.
5. Photographs.

After arriving in Brazil, a foreigner must obtain an identification card and a work permit from the Ministry of Labor before he can be registered as an employee and start his employment.

## LAND OWNERSHIP BY FOREIGNERS

**Purchase of Rural Land.** The purchase of rural property by a non-resident (individual or legal entity) requires prior authorization from the National Institute of Agrarian Reform (INCRA). The purchase, after being approved, must be executed by sealed deed.

In accordance with Decree No. 74.965 of November 26, 1974, total ownership by foreign individuals and legal entities may not exceed one fourth of the land of the municipality in which it is located. Individuals or legal entities of the same nationality may not own, in each municipality, more than 40% or 1/4 of its land.

These restrictions are easily waived for industrial or agricultural projects that will benefit the area.

**Purchase of Urban Land.** No restrictions exist on the purchase of urban land by foreigners. Urban land is defined as land endowed with at least two of the following betterments:

1. Curb or sidewalk with gutter
2. Water supply
3. Sewerage
4. Public lighting
5. Elementary school or public health services within approximately 5 miles (three kilometers) of the property.

## FOREIGN TRADE REGULATIONS

Brazil is a signatory of the General Agreement of Tariffs and Trade (GATT) and uses Brussel's Tariff Nomenclature.

Import duties are based on quantities when a specific rate is applied, and on normal selling price for delivered goods at the port when an ad valorem rate is applied. Most goods are ad valorem.

# Investment Factors

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All importers must be registered with CACEX (the foreign trade department of the Central Bank). Import licenses must be obtained for most goods, and the imports may be on an open account, collection or commercial credit basis.

Import duties vary widely. Most goods are in the 25% to 60% range, but some run to 205%. In addition to import duties, various surcharges are levied such as a port improvement tax of 2% of CIF value, a merchant marine renewal tax of 20% of ocean freight, an industrialized products tax (IPI) ranging from 4% to 30% of the landed cost, and the ICM (tax on circulation of merchandise) of 14.5%, which is based on the landed cost plus the IPI tax. In 1976, the ICM rate will be 14% (see *Miscellaneous Taxes* in Chapter 7). Raw materials imported for further industrial processing are exempt from the ICM.

Customs duties are used for revenue purposes and for the protection of Brazilian industry. Exemption or reduction of duties is granted to foreign products considered necessary for Brazil's economic development. A Decree Law issued in September 1972 exempts from import duties components of complete industrial complexes if geared primarily for export. Prior authorization from the President is required.

**Similar.** Similar is the term for imports that can be replaced by a Brazilian product of equivalent purpose, price and quality. If a Brazilian product is classified as a similar, the foreign import loses eligibility for duty exemption, foreign financing and other government incentives, and becomes subject to import duties approximately 30% higher than usual for that type of goods. A Brazilian manufacturer may request the Customs Policy Council at any time to declare his product a similar.

At present, imports of merchandise and equipment are subject to a prior deposit equal to the FOB value of said imports. This requirement came into effect as a temporary measure to bring the balance of payments back into line. After 360 days, the deposit, which has not earned any interest or monetary correction, is refunded.

**Free Ports.** Manaus on the Amazon is Brazil's only free port. Both customs duties and certain indirect taxes and import permits are waived on imports and on goods shipped to Manaus from other parts of Brazil (except for automobiles, weapons and jewelry). When processed goods are shipped out of Manaus, duty is then paid on the imported components of the finished product.

**Transit Zones.** Goods in transit through the national territory to other countries by the usual trade channels are exempt from import

duties. The following ports of entry have been designated as transit zones:

Belém	for Peru and Bolivia
Corumbá	for Bolivia
Manaus	for Ecuador
Paranaguá	for Paraguay
Porto Velho	for Bolivia
Santos	for Bolivia and Paraguay

Perishable goods in transit may be stored for up to three months and other merchandise for up to one year (extendable for a further six months).

## STOCK EXCHANGES

The Rio de Janeiro and São Paulo stock exchanges started in the 1890's, but the public has been investing seriously only since 1967.

Brazil's wealthy class originally preferred to invest in real estate (later in promissory notes, then bills of exchange and then in US dollars as a defense against galloping inflation). The economic boom that began in 1967, however, served to attract funds from these Brazilians as well as from other Latin American investors.

The government offers the following tax incentives to obtain a stronger stock market with greater public participation:

1. Capital gains resulting from the sale of stock are not taxable to individuals.

2. Individuals can allocate between 10% and 24% of their income tax liability for the purchase of mutual funds in lieu of making such tax payments to the government.

3. Individual taxpayers who subscribe to shares of publicly-held corporations may deduct up to 12% from their income tax liability.

4. To offset currency devaluation, it is mandatory that fixed assets be revalued each year. This revaluation generates the issue of new shares which may be distributed to shareholders tax free.

5. Capitalization of profits or free reserves generates the distribution of new shares that are also exempt from tax.

6. The 5% tax on distributed profits applies only to individuals and foreigners who receive dividends, not to legal entities.

These incentives have greatly increased the volume of trading, and Brazilian firms have turned to the stock exchanges for long-term funds. Selling shares in the stock market is particularly advantageous as Brazilian banks often cannot provide sufficient funds for companies to plan on a long-term basis. The 'democratization of capital,' as it is

# Investment Factors

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referred to by Brazilians, is the least costly method of obtaining long-term resources. The basic preconditions for companies that wish to sell shares to the public are listed below.

1. Study of the feasibility, convenience and timeliness of the move.
2. Analysis of the economic-financial situation of the company.
3. Decision on offering part of current shares to the public or issuing new shares.
4. Determination of proper offering price.
5. Establishment of policy for price support of shares on the stock exchange. This is generally accomplished by the *Fundos de Sustentação*, a group formed by the stockholders who control and administer the enterprise and a financial company (usually the underwriter). The object is to provide the cash necessary to guarantee the liquidity of newly issued shares and to prevent those shares from falling below their offering price.
6. Registration of the company at the Central Bank, which involves the presentation of audited financial statements, consolidated bylaws and other company data.
7. Listing of the shares, which occurs after a company is listed on a stock exchange as a publicly-held company. For a company to be considered publicly held, at least 20% of its common shares with full voting rights must be owned by a minimum number of shareholders, each of whom owns a minimum number of shares – the minimums vary with a company's capital and location. A company with capital of over one million cruzeiros will be considered publicly held by the stock exchanges of São Paulo and Rio de Janeiro if it has at least 500 stockholders, each of whom owns at least 100 shares.
8. Application for the *Certificado de Capital Aberto*.

After a company is registered at the Central Bank, it must send its audited financial statements to the bank each year.

No stocks or bonds of foreign companies are listed on the stock exchanges, but several Brazilian companies whose shares are controlled by foreign companies are listed. Foreign capital may be invested in the stock exchanges provided that certain requirements (set forth in Decree-Law 1.401/75) are observed. Such investments must be made by subscribing for shares in investment companies whose sole objective is to attract foreign resources. Such companies are exempt from income tax, which is only assessed on earnings distributed to foreign stockholders at the rate of 15%. If the foreign capital remains in Brazil for more than six years and up to seven years, that rate is reduced to 12%;



if more than seven years and up to eight years to 10%; and for capital remaining in Brazil over eight years to 8%.

An additional income tax will also be due if the net remittances exceed, in each fiscal year, 12% of the initial investment registered in the name of the foreign investor. This additional tax is calculated in accordance with the following:

- a. on the excess of 12% of initial investment up to 15% – 40%
- b. on the excess of 15% of initial investment up to 25% – 50%
- c. over 25% of initial investment – 60%

It is important to emphasize the following characteristics of this additional tax (which includes the aforesaid assessment of 15%):

1. The additional tax is calculated on the basis of the original investment entering the country, and not on any reinvested earnings.
2. The additional tax is calculated on remittances relating to each fiscal year, not on remittances of every three years.
3. Up to 36% may be remitted in one year, without incurring the additional tax, provided that this excess of 24% is offset by reduced remittances (or no remittances in this case) in the preceding two years.
4. No additional tax is assessed after eight years from the date of registration of the initial investment.

## CURRENCY AND CURRENCY CONTROLS

**Currency Unit.** Brazil's unit of currency is the cruzeiro (Cr\$), which is divided into 100 centavos. Inflation had so eroded the old cruzeiro that a new cruzeiro (NCr\$), equivalent to 1,000 old cruzeiros, was issued in 1967. The term *new cruzeiro* and the symbol (NCr\$) was dropped in 1970, although the equivalency to 1,000 old cruzeiros was maintained.

**Exchange Rates.** Brazil follows a policy of mini-devaluations under which official rates for foreign currencies are adjusted frequently to avoid speculation. The mini-devaluations for the second half of 1975 were:

Date	Rate per US Dollar	
	Buying	Selling
June 26	8.020	8.070
July	8.080	8.130
August 6	8.235	8.285
August 26	8.130	8.360
September 23	8.470	8.520
October 27	8.620	8.670
November 12	8.725	8.775
November 25	8.850	8.900
December 16	9.020	9.070

# Investment Factors

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The pricing and tax structures that surround coffee and cocoa exports result in differential exchange rates for those products.

The Brazilian government attempts to control the purchase of foreign exchange and has almost completely eliminated transactions in the unofficial market, which are prohibited. The black market transactions that occur are at exchange rates only slightly higher than the official rate, since the official rate is realistic.

**Transfers of Currency.** All resources from abroad, whether in the form of direct investment, loans, reinvestments, or machinery and equipment are regarded as foreign capital and must be registered within 30 days of entry at the Central Bank, both for control purposes and for the eventual remittance abroad of profits. There are no restrictions on capital entering Brazil as long as the registration requirement is satisfied.

All remittances to foreign countries require approval of the Central Bank. Approval is easily obtained, within limits, provided the original receipt of foreign currency was registered at the Central Bank or the agreements for technical, scientific and administrative assistance as well as any other agreements that involve foreign currency leaving Brazil have been registered. There are no restrictions on the repatriation of registered capital.

**Transfers of Dividends and Branch Profits.** Annual remittances of dividends and branch profits cannot exceed 12% of the investment registered at the Central Bank. A limitation of 8% for nonessential goods and services is mentioned in the law, but 'nonessential' has not been defined and therefore has no practical application.

Under existing regulations, remittances of profits and dividends, up to a limit of a net annual return on investment of 12%, are subject to a withholding tax of 25%. When profit and dividend remittances exceed the net average of 12% (16% less the withholding tax) over a three-year period, the following additional withholding taxes are imposed:

Return on Investment (%)	Rate of Tax (%)
12 to 15	40
15 to 25	50
Over 25	60

The 25% rate is applied to total distributions and the additional levies are applied to the excess portion.

**Foreign Currency Loans.** Loans in foreign currency to Brazilian borrowers must be registered at the Central Bank, which reviews the interest rate, repayment period and other terms before approving the loans. The interest rate is particularly important as the Central Bank does not generally approve foreign currency loans at interest rates in excess of its own limits, which generally follow those of the world's financial markets. The minimum term of loans in foreign currency is five years. Other terms and conditions required for approval of foreign currency loans change periodically.

**Interest Payments.** Interest payments are not restricted, provided the loan has been registered at the Central Bank and the interest rate is not in excess of the normal rate of interest prevailing in the country from which the loan originated.

**Royalties and Fees.** Royalties and fees for technical, scientific, administrative, and similar assistance may be freely remitted within certain limits. The principal limits are that the agreement providing for royalties or fees must be registered at the Central Bank, that the services embodied in the agreement are rendered and that the royalties or fees are within prescribed ranges. The current range is between 1% and 5% of sales, depending on the particular industry involved. Central Bank Regulation No. 436 prescribes the maximum range allowed in each industry. In the case of royalties for the use of trademarks or trade names, the maximum allowed is 1% of sales.

For income tax purposes, these remittances are deductible for a five-year period, which is renewable for an additional five years. After that, the payments may still be remitted but they will not be deductible.

Special restrictions apply to a branch of a foreign company or a Brazilian subsidiary, 50% of whose capital is owned directly or indirectly by foreign shareholders. In these cases, fees for technical assistance of any kind are nondeductible, although they still may be remitted. However, royalties for the use of patents or trademarks by a branch of a foreign company or a 50% owned subsidiary are neither remittable nor deductible.

The general policy of the government is to limit royalties and fees paid to foreigners to the maximum extent possible. The government agency, INPI, examines all contracts involving royalties and technical assistance fees before sending them to the Central Bank. Restrictions and limitations on these contracts were recently delineated by the INPI in *Ato Normativo* No. 15, which should be consulted in all cases involving royalties and fees.

# Investment Factors

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## FINANCING

Brazil's financial institutions have changed considerably since 1964, although inflation has retarded the development of the long-term capital market. The 1964 banking reform law created the Central Bank (Banco Central do Brasil) and the National Monetary Council, whose financial policies are executed by the Central Bank.

The major source of short-term credit is the commercial banks — which include private institutions and some that are partially owned by the government.

Government lending agencies comprise the major sources of long-term credit. The National Bank for Economic Development (BNDE) is a particularly important agency in lending long-term funds.

**Banco Nacional de Habitação (BNH).** Housing is one of Brazil's fundamental problem areas, and the BNH was formed in 1964 to control the financial system for housing as well as to finance housing construction.

BNH became particularly important when FGTS was instituted. The resources of FGTS, which consists of 8% of the monthly pay of all employees, are controlled by BNH and are used to finance housing projects. Unless this situation is changed, BNH will eventually control huge funds and will be in a position to greatly stimulate housing construction. Many BNH housing projects have already been started.

**Monetary Correction.** The term 'monetary correction' refers to the system used to protect the currency against internal inflation. Monthly or quarterly adjustment indices are compiled to measure the rate of inflation. These indices are applied to long-term saving accounts, time deposits and private and government bonds to compensate for the effects of inflation. Interest is then paid on the capital as monetarily corrected. This system helps to protect savings against inflation and maintains confidence in Brazilian currency.

## PATENTS, TRADEMARKS AND COPYRIGHTS

Brazil is a signatory of the International Convention for the Protection of Industrial Property, and foreign applications for patents and trademarks may be entitled to the priority afforded under that convention. Brazil has an Industrial Property Code, Law No. 5,772/71 (*Código de Propriedade Industrial*), that covers trademarks and patents, including patents for utility models, industrial models and industrial designs.

**Patents.** Foreign companies selling a patented product in Brazil should protect themselves by obtaining a Brazilian patent. Promptness

is important as inventions that have been divulged may be considered in the public domain and not patentable. Patents of invention are now granted for a term of 15 years from date of filing, rather than from date of issue, after which they become public property. Patents for utility models, industrial models and designs are granted for ten years from date of filing. Non-patentable inventions include chemical, feeding and pharmaceutical products and processes for their manufacture.

Patent applications must be published in the *Diário Oficial*, the official gazette, within 18 months from the earliest date filed abroad or in Brazil.

Patents not used within three years from their granting are subject to compulsory licensing. If a license has been ordered, and the patent has, nevertheless, not been worked properly within five years of original issue, it will be terminated. Holders of patents may grant licenses to third parties, which should be accomplished in an agreement containing the terms of payment and use of the patent. Such an agreement, and all contracts for transfers of technology that involve payments abroad, must be registered with the National Institute of Industrial Property (*Instituto Nacional de Propriedade Industrial* or *INPI*). The agreement cannot impose restrictions on the marketing, including export, of the product. Contracts involving payments abroad should also be registered with the Central Bank.

**Trademarks.** The first applicant for a trademark, commercial name, title, or the like is entitled to register it for a ten-year period, renewable for an unlimited number of similar periods, provided the request for renewal is timely. The law provides for registration of a 'house mark,' to identify a company that originates a series of products. A house mark may only be used in conjunction with a specific product mark. In the case of pharmaceuticals, house and product marks must be equally prominent.

Foreign trademarks may be registered under the following conditions:

1. The country of origin offers reciprocal registration for Brazilian trademarks.
2. The trademarks are registered in the country of origin.
3. The certificates of registration are deposited at INPI.

**Copyrights.** Copyright protection in Brazil is for the life of the author plus a sixty-year period following his death. Protection granted to foreign works, however, cannot be for a longer period than is granted by the country in which they were first published.

# Investment Factors

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## GOVERNMENT REGULATION OF BUSINESS

**Price Controls.** One of the measures adopted to fight inflation gave the government control over prices of manufactured goods. The current price control law is Decree No. 63,196 of August 1968. This decree created the International Pricing Board (*Conselho Interministerial de Preços* or *CIP*). Price adjustments in the principal industries (automobiles and trucks, home appliances, etc.) are effected through a system called 'guarded liberty.' Companies that come under this system can adjust their prices without prior authorization from the CIP. However, the necessary claims justifying the increase must be sent to the CIP. If the CIP concludes that the increase was excessive, the companies involved will be forced to reduce prices to a level considered reasonable. Furthermore, they may be excluded from the 'guarded liberty' system, in which case, any future price increases will require prior approval by the CIP.

Under the decree, requests for price increases that are not approved within 45 days are considered to be approved. However, should fraud later be proved in the information or documents submitted or price increases be found to be higher than the increase in the cost of living index, the CIP will:

1. Restore the former price levels.
2. Impose administrative, tax and legal measures contained in Delegated Law 4 of November 26, 1962 and Law 4,137 of October 10, 1962.



# Labor Conditions

- LABOR RELATIONS
- TERMS AND CONDITIONS OF EMPLOYMENT

- SOCIAL SECURITY AND OTHER EMPLOYEE BENEFITS

Brazil's labor force of approximately 36 million people, about one-third of the population, is employed in the following areas:

Agriculture	44%
Services	38%
Industry	18%

The 34% of the population that is economically active compares to a world average of 43%. In Brazil, as in other Latin American countries, female participation in the labor force is at a lower level than in other industrialized nations.

Unemployment is estimated at 8% of employables over 15. However, this percentage may be misleading; many persons who work part-time or in rural areas do not appear statistically as being employed. Also, regions subject to periodic droughts are afflicted by a higher unemployment rate.

## LABOR RELATIONS

The Constitution provides for free occupational associations (*sindicatos*), which are regulated by law and must be recognized by the Ministry of Labor to function as a union. However, there is considerable apathy towards unionism — partly because unions are tightly controlled, and partly because benefits obtained by unions are provided also to non-union employees. Only a few million out of the 36 million labor force are unionized. The union of metallurgists is the largest and the one which does most for its members.

Unions usually do not collect dues, but are supported by a tax of 1/30th of one month's salary per year. This tax is levied on employees and is deducted by employers each March. Employers remit the funds in April to the Bank of Brazil or other establishment designated by the local office of the Ministry of Labor, and the funds are distributed to the various labor organizations. Employers are also free to form associations (*sindicatos*), and they exist in almost all industries.

Many labor issues that are normally the subject of collective bargaining are handled by legislation in Brazil. The Consolidation of the Labor Laws (hereafter referred to as the Labor Law) is a lengthy and detailed law that controls most major aspects of the employer-employee relationship and such lesser matters as safety requirements, lighting, special conditions of work for women, etc.

# Labor Conditions

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The Labor Law guarantees the right to strike, but this is subject to approval by a general assembly of union members, requires notice to employers and arbitration or a Labor Court decision that must be rendered within 20 days. In practice, strikes have been few and far between; most labor disputes that arise are settled by conciliation or decision of the Labor Courts.

Employment contracts may be made with individual employees or with unions under a collective contract. The collective contract is generally used by larger firms, where more employees tend to be members of a large union that negotiates with a group of employers. An industry-wide collective contract can apply to an entire industry, including employers who have not signed the contract. Collective contracts must be approved by the Ministry of Labor. The contract's provisions are often influenced by Labor Courts, especially in determining the amount of the annual industry-wide wage increases.

## TERMS AND CONDITIONS OF EMPLOYMENT

**Wage Rates.** Minimum wages are set by federal law. New minimum wage rates are legislated each year or two and vary in different areas, depending on the cost of living and other factors. The highest minimums are in the areas of Rio de Janeiro, São Paulo, Belo Horizonte, and Porto Alegre.

The Labor Law requires equal pay for equal work, regardless of nationality, age, sex or marital status, but this provision frequently is not enforced. Wages are commonly paid once or twice monthly for both salaried and hourly-paid workers.

The minimum monthly wage in São Paulo (May 1975) is Cr\$ 532, about US\$ 53, and is considerably lower in other areas. The following are actual monthly salary ranges, in US dollars, in São Paulo for 1975:

	Monthly Salaries US\$
Unskilled laborer	65 to 120
Skilled laborer	150 to 400
Clerk	150 to 500
Bilingual secretary	500 to 1,200
Accountant, senior	1,000 to 2,000
General financial manager	2,000 to 3,000

**Working Hours.** Normal working hours in industry are eight per day and six days per week (48 hours). However, employers are tending to increase the workday in order to give employees both Saturday and Sunday off. Typically, this is done by working 9½ hours per day Monday through Thursday, and ten hours on Friday. Although normal



working hours are 48 per week, hourly-paid employees are paid for 56 hours, as Sunday is a paid day of rest.

Normal working hours in offices are 40 with no work on Saturday. Regular office hours are from 8:00 a.m. to noon, and from 2:00 to 6:00 p.m.

Employees must be paid for 6 national and 4 religious or municipal holidays, and are also entitled to 3 days' pay for marriage or mourning. Women are entitled to 12 weeks' maternity leave with pay. Employees must be paid for the first 15 days of an illness.

**Overtime.** Employers are permitted to require a maximum of two overtime hours per day, with premium pay of at least 20%. Overtime of more than two hours requires a special agreement that must be registered with the Ministry of Labor, unless such overtime is due to an emergency situation.

**Vacations.** After full-time employment of one year, employees are entitled to a vacation of 20 working days. Shorter vacations accrue to those employed less than a year or where absences have exceeded the number of days allowed by law. More than six absences reduce the vacation entitlement to 15 working days. Vacations represent an average cost of about 8% per year. Dismissed employees must be paid for accrued vacations.

**Workmen's Compensation.** Premiums to insure employees against injuries (required by law) are based on a special rate for each risk or group of risks and calculated on the total salaries of the employees subject to such risk. Published figures indicate average premiums are about 3% of factory payrolls.

**Severance Compensation.** Two systems of providing severance compensation have been in effect until recently. Under the older system, now restricted to employees who in 1967 chose that system, the first year of employment was considered a trial period. After the first and up to the tenth year, dismissal without just cause required one month's remuneration (at employee's highest normal earning rate) per year of service or fraction over six months. After ten years of service (not necessarily continuous), tenure was required and severance compensation for dismissal without just cause was at the rate of two months per year of service.

The newer system, in effect since 1967 by the law establishing the Fund for Guarantee of Time of Service (FGTS), is the only one now available to new employees. Under FGTS, each employee has a frozen

# Labor Conditions

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bank account in his own name, to which employers make monthly deposits. This bank account can be utilized by the employee in case of dismissal, unemployment, sickness, retirement, or for purchase of his own home. However, an employee who resigns cannot withdraw funds from his account. The account still belongs to him, even though it is frozen, and his subsequent employer will simply continue to contribute to the account. Under FGTS, employers are less concerned about permanent employees, whose dismissal is not only onerous but normally causes problems. FGTS operates as follows:

1. The employer deposits monthly in a blocked bank account, in the employee's name, 8% of the employee's salary. For employees who did not opt for the new system, deposit is made in the company's name.

2. The bank pays interest and monetary correction on these deposits, so that after one year the balance of the account, theoretically, equals a current month's salary.

This system has been widely accepted both by employers and employees. If an employee who did not opt for the new system in 1967 resigns voluntarily, the company can withdraw his funds in the account. If he is dismissed, the employer must provide severance pay but can still retain the proceeds of the account as full or partial reimbursement.

## SOCIAL SECURITY AND OTHER EMPLOYEE BENEFITS

Brazil has a comprehensive social security system which is financed by employers and employees. Employee contributions are:

Social security	8% of monthly salary
Labor union	1/30th of one month's salary per year

Employer contributions, which are based on the employee's monthly salary but limited to a maximum of ten or twenty times Cr\$ 501.00, as noted below, are calculated as follows:

	Up to 10 x Cr\$ 501.00	Up to 20 x Cr\$ 501.00
	%	%
Social security		8.0
Social security on 13th month bonus		0.6
Family allowance		4.0
Maternity allowance		0.3
Education allowance		2.5
Apprenticeship service (SENAI or SENAC)	1.0	
Social service (SESI/SESC)	1.5	
Rural social service	2.6	
	<u>5.1</u>	<u>15.4</u>

**Example:**

Salary of Cr\$ 10,020.00	
5.1% x 5,010	Cr\$ 255.51
15.4% x 10,020	1,543.00
Total Employer Contribution	Cr\$ 1,798.51

*Notes on Employer Contributions:* (1) Employers provide a family allowance of 5% of the local minimum salary for each employee's child under 14. Employers also provide a maternity allowance to female employees of full salary from four weeks before to eight weeks after childbirth. Such payments are deducted from total employer contributions of 20.5%. (2) The 13th month bonus is compulsory and is generally paid in two installments – half between February and November (usually at vacation time) and half between November and December 20. (3) Social security on the 13th month bonus is paid by the employer at the monthly rate of 1.2%. However, when the bonus is paid, the employer deducts 7.2% from the bonus so that the social security contribution is finally borne equally by employer and employee.

**Required Payroll Reports.** Employers are responsible for the following payroll reports:

Type of Report	Frequency
List of employees hired and discharged	Monthly
List of employees and their salaries for required bank deposit of 8% of gross salaries in the Fund for Guarantee of Time of Service (FGTS)	Monthly
Social security forms	Monthly
List of employees under 18	Annually
Form for payment of labor union tax	Annually
2/3rds list – proportion of staff that must be Brazilian	Annually

**Plan for Social Integration (Plano de Integração Nacional or PIS).** This plan, which embodies a form of compulsory profit sharing, was established to enable employees to share in Brazil's economic growth. Employees participate through a government administered fund (*Caixa Econômica Federal*) to which employers contribute in one of two ways:

1. A monthly contribution of a percentage of sales, as follows:

July 1975 to June 1976	0.615%
Subsequent to June 1976	0.75%

# Labor Conditions

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2. Companies that do not sell goods make annual contributions of varying portions of their income tax liability.

Each employee receives a passbook in which his participation in the fund (based on salary and years of service) is recorded. Employees also receive annual interest of 3% and monetary correction based on the official indices, and they may withdraw their annual interest and share of investment profits at any time. However, the balance of the contributions recorded in the employees' passbooks may be withdrawn only within established limits such as to buy a home, for medical or retirement purposes, etc. The PIS fund is expected to become Brazil's largest source of investment funds within a few years, and may be used to finance private commercial and industrial projects.

**Monthly Cost of Required Fringe Benefits.** As the social security component of fringe benefits is limited to wages not in excess of twenty times Cr\$ 501.00 (adjusted yearly), the following table of fringe benefits is based on a supposed wage of Cr\$ 10,020.00. As indicated in the table, the comparatively low wages in Brazil are somewhat offset by the cost of fringe benefits.

	%	Cr\$
Social security	20.5	2,054.00
Vacation	8.0	801.60
13th month bonus	8.3	831.66
Workmen's compensation	3.0	300.60
Severance fund	8.0	801.60
	<u>47.8</u>	<u>4,789.46</u>

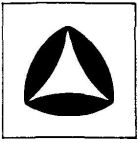
*Notes:* Fringe benefits not quantifiable on the basis of monthly wages have been omitted from the above table. The omissions include:

1. In the case of laborers paid on an hourly basis, the cost of paid holidays and Sundays would add about 23.4% or Cr\$ 1,095.00 to the above totals. For monthly-paid employees, the cost of holidays and other non-working days is an implicit part of their base salary.

2. Costs of the plan for social integration.

3. Over and above severance pay, employees are entitled to 30 days' notice of dismissal or to receive pay in lieu of such notice.

**Employment of Foreigners.** See Chapter 2.



# Business Practices and Information

- INFORMATION FOR BUSINESSMEN
- BUSINESS HOURS
- BUSINESS PRACTICES

## INFORMATION FOR BUSINESSMEN

**Entry Requirements.** Travelers need a passport, a visa and an international certificate of smallpox vaccination to enter Brazil.

**Credit Facilities.** Credit sales predominate in commercial transactions, with payment being deferred for 30, 60 or 90 days or more.

Credit cards are widely accepted but are not popular. The credit card system provides central reference files on consumers in each city. This system is particularly used by stores that sell clothing, electric home appliances, furniture, and automobile parts, and also by restaurants and hotels.

In the case of more expensive sales such as real estate and automobiles, the buyer's credit is secured by the property itself or by co-guarantors.

Checks are accepted and circulate freely.

**Tipping.** Tipping is a widespread practice for all services. It is customary to tip waiters 10% to 15% and taxi drivers 10%. Hotels generally add a 10% service charge to the bill, but porters, chambermaids, etc. usually receive token gratuities.

**The Despachante.** The *despachante* is a typically Brazilian institution. The term refers to a semi-official person who, for a fee, aids in processing papers (*processos*) through official channels in government offices. *Despachantes* are knowledgeable about bureaucratic requirements and have official sanction in most government departments. Customs-house *despachantes* must be officially approved by the customs authorities.

The use of a *despachante* is optional. However, he provides a convenient and, usually, necessary service and saves time and money.

**Communications and Transportation.** All forms of communication between cities — telephone, telegraph, mail, and telex — are available. Direct dialing is possible to most major cities. A shortage of telephones is being overcome. Mail to, from and within Brazil is often unsatisfactory; extensive delays are not unusual.

Most intercity transportation is effected through a highway network

# Business Practices and Information

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which moves about 70% of all merchandise and about 90% of all passenger traffic. Air travel is also extensively used, however, in view of the long distances, with three major commercial airlines providing transportation facilities. Rio de Janeiro and São Paulo have a special air connection, with planes flying out every half hour from 6:00 a.m. to 10:00 p.m. From the USA, the following airlines have regularly scheduled flights to Brazil:

Varig Brazilian Airlines	Pan American Airways
Argentine Airlines	Braniff International

Taxis in the major cities have meters and are comparatively inexpensive. Bus transportation is good both within and between cities. Car rentals are available in the larger cities.

In São Paulo, the first line of its planned subway (*Metro*) is functioning. Other lines are in the planning and construction stages.

## BUSINESS HOURS

**Government Office Hours.** Government departments have variable hours, depending on their services or functions. None are open on Saturday.

**Banking Hours.** Banks are open on weekdays from 9:00 a.m. to 5:00 p.m., and are closed on Saturday.

**Retail Stores.** Retail stores are open on weekdays from either 7:00 or 8:00 a.m. to noon, and from either 1:00 or 2:00 p.m. to 6:00 or 7:00 p.m. Most stores do not close at midday, and some stores in São Paulo remain open until 10:00 p.m. On Saturday, retail stores generally close at 1:00 p.m.

**Factories.** Most factories work one shift from 7:00 a.m. to 5:00 p.m.

## BUSINESS PRACTICES

**Public Holidays.** The following holidays, established by Federal Law, are observed throughout Brazil:

January 1	Universal Brotherhood Day
April 21	Tiradentes*
May 1	Labor Day

\*Nickname of Joaquim José da Silva Xavier, held responsible for the first insurrectionary movement for independence (*Inconfidência Mineira*) and executed in 1792.

September 7	Independence Day
November 15	Proclamation of the Republic
December 25	Christmas Day

There are four municipal holidays, of which two are mandatory

April (varies)	Good Friday
November 2	All Souls' Day

and two are at the discretion of each municipality. Generally, municipalities adopt Corpus Christi and the date of the city's foundation.

June (varies)	Corpus Christi
January 20 – Rio de Janeiro	Date of city's foundation
January 25 – São Paulo	

In addition, businesses usually close on Shrove Tuesday and for a half day on Ash Wednesday (Carnival), although these are not legal holidays.

**Weights and Measures.** The metric system has been the official system since 1862. In addition, the following unofficial measures have become established by usage:

#### City Areas

1 duzia (dozen)	=	12 units
1 grossa (gross)	=	12 dozen

#### Rural Areas

1 alqueire paulista (São Paulo)	=	24,200 sq. meters
1 alqueire mineiro	=	48,200 sq. meters
1 alqueire nordestino	=	27,225 sq. meters
1 légua (league)	=	6 to 6.6 kilometers
1 arroba	=	15 kilograms

In navigation, the unit for distance is the nautical mile (*milha marítima*), which equals 1.852 meters.

Temperatures are measured in centigrade.

**Electric Current.** Most Brazilian cities supply 110 to 127 volts AC, but the cycles vary from 50 to 60. Electric outlets accept round-pronged plugs, but flat-pronged plugs are being introduced.



# Forms of Business Entities

- BUSINESS ENTITIES
- CORPORATION – SOCIEDADE ANÔNIMA
- LIMITED LIABILITY COMPANY – SOCIEDADE POR QUOTAS DE RESPONSABILIDADE LIMITADA
- BRANCH OF A FOREIGN CORPORATION
- TRADING COMPANIES
- INSURANCE OBTAINED ABROAD

## BUSINESS ENTITIES

Federal legislation governs the formation and operation of Brazilian business entities. The principal entities are:

Sole proprietorship	<i>Firma individual</i>
Corporation	<i>Sociedade anônima</i>
Limited liability company	<i>Sociedade por quotas de responsabilidade limitada</i>
Partnership	<i>Sociedade civil, sociedade em comandita simples, sociedade em nome coletivo</i>
Joint venture	<i>Sociedade em conta de participação</i>
Branch of foreign corporation	

The entities likely to be of most interest to foreign investors are the corporation, the limited liability company and, occasionally, the branch of a foreign corporation. For this reason, they will be discussed together with the trading company, a new type of entity.

## CORPORATION – SOCIEDADE ANÔNIMA

The basic law governing the formation and operation of a corporation is No. 2,627 of September 26, 1940. The Brazilian Congress is currently preparing a major modification of company law and may enact such legislation in 1977. This discussion reflects the law in effect in 1975.

Brazilian corporations are basically the same as similar entities in Europe and North America.

**Corporate Name.** A corporation must use a name that indicates its purpose, and that includes the words *Sociedade Anônima* or *Companhia* or their respective abbreviations *S.A.* or *Cia.* The company's name must be registered with the State Board of Trade.

**Minimum Shareholders.** Corporations must have at least seven shareholders at all times. The seven shareholders may also be the organizers. Shareholders are not required to be Brazilian citizens or residents, nor need they take an active interest in the operations of the corporation.

**Capital.** A corporation's capital must be stated in Brazilian currency. Capital must be divided into shares (*ações*) of equal value, and share



# Forms of Business Entities

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certificates must be in Portuguese. All shares must have a par value; the minimum par value being Cr \$1.00. Shares may be issued for cash or property or both, but may not be issued as payment for services. Shares may be issued in exchange for a patent. When shares are issued for property, the value of the property must be established and approved by a board of appraisers and, also, by a vote of the shareholders.

Formerly, all corporations were required to have fully-subscribed capital when organized. Although only 10% of the subscribed capital was required to be paid before the company was formed, the shareholders were liable for the full value of their subscribed shares. Since 1965, however, corporations may be formed with an 'authorized capital.' An 'authorized capital' corporation may redeem its own shares, and has greater flexibility in issuing shares within the limits of the 'authorized capital.'

A significant increase in the capital of an ordinary corporation requires altering its bylaws. The new capital must be fully subscribed with at least 10% of the value paid in. The same increase in the capital of an authorized capital corporation need not be fully subscribed nor 10% of its value paid in immediately. The board of directors of an authorized capital corporation can sell its treasury shares privately or on the stock exchange, and it can issue the shares as they are needed; there is no need to alter the bylaws — an important consideration from a practical point of view. Another advantage of an authorized capital corporation is that it can trade its own shares or retain them as treasury stock, options not available to ordinary corporations.

Shares may be common or preferred and may be nominative (*ações nominativas*) or bearer (*ações ao portador*), with the provision that until shares are fully paid they must be issued to a registered name. Thereafter, they may be converted to bearer shares. Corporations may also issue founders shares (*partes beneficiárias*) that are not part of corporate capital and have no par value, but that allow their owners to participate in net annual profits to a maximum of 10%. Bearer shares may be identified for personal income tax purposes, thus becoming equivalent to nominative shares for that purpose.

**Organizing a Corporation.** Organizing an S.A. requires about one month's time; the cost is nominal. The inaugural meeting must consist of at least seven prospective shareholders. At this meeting, the statutes are normally approved, the members of the board of directors are elected and the members of the statutory audit committee (*conselho fiscal*) are appointed. The normal procedure following the inaugural meeting is to deposit the following documents with the Commerce Registry:

1. A certified copy of the minutes of the inaugural meeting, including the approved bylaws.
2. A complete list of subscribers to the capital.
3. If the corporation is formed by public stock subscription, a copy of the prospectus signed by the founders and notarized.
4. A document proving that at least the required 10% of capital has been deposited in a bank.

These documents are published in the official gazette and a certificate is issued authorizing the corporation to commence operations.

Many facets of an S.A.'s operation must be published in the official gazette and one other newspaper, including incorporation, meetings, financial statements, appointment of directors, and changes in capital.

**The Board of Directors.** Under Brazilian company law, each director is an executive officer who has full responsibility for the active operation of the company. A corporation must elect at least one director; no maximum number is specified in the law. Directors must be Brazilian residents but, unless legally required in special cases, there is no restriction as to nationality.

**Statutory Audit Committee.** A corporation must elect annually a statutory audit committee (*conselho fiscal*). This committee may appoint a representative of an auditing firm to assist in the examination of the accounts but, in practice, few do so. Foreign subsidiaries, however, frequently arrange for representatives of their local auditors to be appointed to the statutory audit committee.

Until recently, the statutory audit committee's function was more honorary than real. However, a recent law has greatly increased the committee's responsibilities in financial companies, especially those handling public funds such as banks, mutual funds, etc. Under this law, in the event of a financial company's bankruptcy, the property of the statutory auditors is subject to debtors' claims.

**Legal Reserve.** A legal reserve must be maintained to which 5% of annual net profit must be transferred until the reserve equals 20% of the capital. After the 20% is reached, annual additions are discretionary. The legal reserve may be charged with losses but, subsequently, the reserve must be restored to the 20% level. This reserve cannot be used for distributions, unless the company is being liquidated.

# Forms of Business Entities

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## LIMITED LIABILITY COMPANY – *SOCIEDADE POR QUOTAS DE RESPONSABILIDADE LIMITADA*

A limited liability company (*sociedade por quotas de responsabilidade limitada*) is similar to a limited liability company in the United Kingdom. It has the advantage of a corporation in limiting the liability of its members, and it is not subject to the legal formalities and publication requirements imposed on partnerships. A *limitada* is not required to publish its financial statements, to register on the stock exchange or to maintain a legal reserve. Instead of shares, capital is divided into equal quotas, and each quotaholder's liability is limited to the total amount of the capital.

The limited liability company, also known as *sociedade limitada*, must have a minimum of two quotaholders, with three the recommended number. In a case of only two quotaholders, the death of one would dissolve the company. It is not customary for quota certificates to be issued. The original quotaholdings and later assignment of quotas (agreement of all members is usually required for quotas to be transferred) are merely recorded in the Commercial Register as a change in the contract of organization.

Voting rights and profit shares are normally in accordance with capital holdings, but the contract of organization may provide otherwise.

Companies as well as individuals may be quotaholders. A nonresident quotaholder must give a power of attorney to a resident of Brazil to act on his behalf. The firm's manager is required to be a resident of Brazil.

The firm's name may include the name of one or more quotaholders. The name should be followed by 'Limited' (*Limitada* or *Ltda.*); otherwise, the quotaholders will be jointly and severally liable without limitation.

There is no minimum capital requirement. The entire capital must be subscribed (but no required percentage has to be paid in). However, until the full capital is paid in, the quotaholders are jointly and severally liable for the total subscribed capital. Consequently, if one quotaholder has not paid in his entire subscribed capital, the other quotaholders may be liable for this deficiency.

A limited liability company may easily and inexpensively be converted to a corporation (and vice versa) without incurring income tax liability.

## BRANCH OF A FOREIGN CORPORATION

To set up a branch, a foreign corporation must obtain authorization from the federal government of Brazil. Applications must contain proof

of the appointment of a Brazilian resident with sufficient power to act as a representative within all of the conditions under which the concession to operate as a branch is granted. All necessary documents are sent to the Ministry of Foreign Affairs and then to the Ministry of Industry and Commerce. After approval, which takes approximately six months, a Presidential Decree is published that authorizes the branch to commence operations. Whenever an alteration is made in the bylaws of the head office abroad, the branch must apply to the federal government to continue its operations under the altered arrangements. In each such case, an ordinance issued by the Ministry of Industry and Commerce is required.

The foreign corporation must operate in Brazil under its own name, but may add the words *do Brasil* (of Brazil) or *para o Brasil* (for Brazil), if it so desires.

The entire initial capital assigned to a branch must be deposited in full, but this deposit can take the form of plant and machinery or equipment. The principal corporation is liable for debts and claims against the branch to the extent of all other properties in Brazil.

**Income Tax Disadvantage.** From an income tax standpoint, branches are at a disadvantage. This stems mainly from the fact that the profit shown in the financial statements is automatically regarded as distributed, and is subject to withholding at the minimum rate of 25%. The withholding tax must be paid within 120 days of the date of the financial statements prepared at the end of the branch's calendar or fiscal year, even though the profit is not remitted abroad.

In practice, few foreign corporations operate in Brazil through a branch. It is usually more advantageous to set up a *limitada* or *sociedade anônima*.

## TRADING COMPANIES

Brazil's economic planners have authorized an entity known as a 'trading company.' This type of company is defined in a Presidential Decree as a commercial export company. Basically, it is a large, well-financed company, similar to the Japanese trading company, that concentrates on selling industrial products in foreign markets.

Minimum capital for trading companies is Cr \$20 million, of which half must be paid in immediately and the balance within 12 months. A trading company may obtain up to half of its capital by selling non-voting preferred shares to the public. They are operating on an over-prize basis or on commissions of up to 7%. Foreign participation in ownership is not restricted.

# Forms of Business Entities

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Special financial arrangements have been initiated by the government to assure that trading companies will have sufficient funds to meet their working capital requirements.

Since their authorization in 1972, trading companies have developed steadily, although somewhat slowly, and now occupy a definite position in Brazil's economic structure for international commerce. Expected to provide strong leadership in the export market, they have not yet been able to do so and, consequently, have been responsible for only a limited amount of all exports.

Three reasons have been given for the trading companies' slow development:

1. Relative instability of internal/external markets together with lack of a stronger position of trading companies in their relations with manufacturers.

2. Lack of a fully established exporting 'mentality' on the part of medium and small size companies.

3. The presence of COBEC (*Companhia Brasileira de Entrepósitos e Comércio*), a huge government-dominated trading company with commercial offices in most parts of the world.

Proposals for the solution of these difficulties are being discussed at ministry level, and complementary legislation strengthening the trading companies' position is expected to be passed in the next few months.

## INSURANCE OBTAINED ABROAD

Insurance may be obtained from foreign insurance companies only for those risks that cannot be covered in Brazil. In such cases, permission of the relevant authorities is required before obtaining insurance from a company not based in Brazil.



# Accounting and Auditing

- LEGAL REQUIREMENTS
- ACCOUNTING PRINCIPLES
- AUDITING STANDARDS
- FINANCIAL STATEMENT PRESENTATION

To understand the Brazilian accounting profession, several distinctions should be made. The first concerns accountants and auditors. Both have met the professional requirements but the majority of accountants are employed in private industry or, if in professional practice, are engaged in write-up work, the tax area or in advising small or medium-sized companies. Only an accountant in professional practice who specializes in auditing, in the strict sense of the word, is considered an auditor.

Another distinction concerns the term *contabilista*, which includes both the *técnico de contabilidade* and the *contador*. Both types of *contabilistas* are officially recognized, but the *técnico* is a high school graduate while the *contador* is a university graduate. The great majority of *contabilistas* are *técnicos* whose technical ability is not of the same high standard as that of the *contadores*. However, both *técnicos* and *contadores* are usually referred to as *contador*, with the result that the accounting profession has not developed as strong an official and public position as in other countries.

Decree-Law 9,295 of 1946 requires that all companies have their accounting performed or supervised by a *contabilista*. Larger companies usually employ a *contabilista* to head the accounting function and other *contabilistas* for the junior positions. Smaller companies usually engage a *contabilista* who services a number of companies. In all cases, the financial statements required to be submitted to the tax authorities must contain the signatures of the owner or directors as well as that of the *contabilista*, who may be either a *técnico* or a *contador*. Any *contabilista* may sign the financial statements if he is registered at the *Conselho Regional de Contabilidade* – the official regional body that regulates the accounting profession. These regional bodies exist in each state and are subordinate to a central body connected with the Ministry of Labor (*Conselho Federal de Contabilidade*) that regulates the accounting profession, including specialized branches such as auditing.

In accordance with the income tax, company and other laws that regulate corporations, a *contabilista* is jointly responsible with company management for the propriety of a company's accounting and financial statements. However, in practice this responsibility is not meaningful except in cases of serious fraud. Where tax penalties are imposed, the company pays the fine, and not the manager or co-responsible *contabilista*. Although the *contabilista* is legally responsible for the financial statements he signs, it is recognized that he is usually an employee of the company and that his independence is limited.

# Accounting and Auditing

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Brazilian law distinguishes between a *técnico* and a *contador* in what is referred to as *perícia contábil* (an examination by an independent accountant that includes auditing). Only the *contador*, who is a university graduate, can practice independent auditing or give expert testimony in a lawsuit. Hence, a *técnico* can be employed by an auditing firm, but only a *contador* can sign the auditor's opinion. This matter is controlled by the *Conselhos*, which have instituted a general register of auditors. The *Conselhos* do not control the quality of auditing; they merely enforce the requirement that the *contabilista* who signs the financial statements and the *contador* who signs the accountant's report (*parecer de auditoria*) are properly registered.

**Professional Accounting Organizations.** Three principal professional organizations formerly existed in São Paulo, Rio de Janeiro and Rio Grande do Sul. The *Instituto dos Contadores Públicos do Brasil*, founded in São Paulo in 1957, had been the most active in establishing professional standards although no organization was officially recognized by either the *Conselho Federal de Contabilidade* or the Central Bank, which has authority to regulate the money market. In December 1971, the three organizations merged into a nationwide body under the name *Instituto dos Auditores Independentes do Brasil* (IAIB). One of its first accomplishments was to prepare and obtain approval of the *Normas de Auditoria* (auditing standards) and to obtain recognition that only accountants who are university graduates can practice as auditors.

## LEGAL REQUIREMENTS

All publicly-held companies (*sociedades anônimas de capital aberto*) and mutual funds must have their financial statements audited by an independent auditor who is registered at both the *Conselho Regional* and the Central Bank. A company is considered publicly held if at least 20% of its common stock (equaling 20% of the voting rights) is distributed among  $x$  shareholders holding  $x$  amount of shares each — the numbers depending on a company's capital and location. Companies in the states of São Paulo and Guanabara, whose capital is one million cruzeiros or more, are publicly held if at least 20% of their common shares are owned by at least 500 shareholders, each owning at least 100 shares. Since public sale of shares is an important means of obtaining long-term funds at low cost, the number of publicly-held companies is increasing.

There is no requirement that financial statements of privately-owned corporations or other institutions be audited by independent accountants. Banks generally do not require audited statements when

granting loans. However, all corporations are required to publish their annual financial statements, which must be signed by a registered *contabilista* who need not be independent or a registered auditor.

**Required Journals and Ledgers.** In general terms, all individuals and firms engaged in commercial activities are required to maintain proper books of account and to prepare annual financial statements which must be signed by the responsible official and inscribed in an official journal.

Some books must be registered with the Department of Commerce and others with the State Treasury. Most account books have to be signed by an officer and the chief accountant before they are registered. The books must be in Portuguese and the amounts must be in cruzeiros.

Both tax and commercial laws specify a long list of required journals and ledgers. The following is an abbreviated indication of the books all companies must keep:

General Journal	<i>Diário Geral</i>
Trade Bill Register	<i>Registro de Duplicatas</i>
Purchase Register	<i>Registro de Compras</i>
Inventory Register	<i>Registro de Inventário</i>

Nine books are prescribed for the Tax on Manufactured Products and for the Tax on Circulation of Merchandise, but each entity uses only those books necessary for its own activities.

Corporations must also keep books for registration of stock and founder's shares and for meetings of stockholders, directors and the statutory audit committee. Companies that render services are required to keep a book for recording job contracts and another for recording each invoice issued. Other books must also be kept, depending on the type of company and its activities.

## ACCOUNTING PRINCIPLES

Brazilian accounting has been much influenced in recent years by North American accounting principles, although it is still mostly influenced by Brazilian tax and company laws.

For audits of publicly-held companies, the Central Bank has defined generally accepted auditing standards and certain basic accounting principles. The principles apply to specific areas; other areas are not yet identified nor have guidelines been established by the profession and/or government. The Brazilian accounting profession, having been reorganized only recently, has much to accomplish in the difficult task of defining and establishing generally accepted accounting principles. This deficiency is apparent in the alternative principles presently incorpo-



# Accounting and Auditing

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rated in many of the financial statements of Brazilian companies.

In view of accounting principles emanating from Brazilian law and practice (monetary correction, recording of stock dividends at par value, etc.), Brazilian statutory financial statements must perforce vary from those prepared on the basis of accounting principles utilized in other countries. On the other hand, Brazil's need to cope with its former soaring rate of inflation has led to the creation of some financial practices and accounting principles that have aroused interest in other countries, also plagued by inflation, albeit on a lesser scale. This section will describe some of the problems caused by inflation and their effect on financial statements.

**Frequent Adjustments of Exchange Rates.** Brazil makes frequent changes in exchange rates to stimulate exports, avoid speculative imports and discourage a black market in foreign currencies. Every one or two months, but on variable dates and without prior notice, foreign currencies are adjusted to the reduced purchasing power of the cruzeiro. For example, the rate for the US dollar is raised in proportion to Brazilian inflation, but after deducting US inflation. Other foreign currencies are also adjusted in this manner.

Brazilian accounting practice in relation to currency revaluations is to adjust the cruzeiro equivalent of foreign loans only when financial statements are prepared and not for each adjustment of exchange rates. The charge, whether it arises from financing for the acquisition of fixed assets or for working capital, is recorded, at the company's discretion, either as a financial expense or as an amount to be offset by reserves. (Prior to 1974, only the charge arising from the financing for working capital was deductible; that from financing for the acquisition of fixed assets had to be offset by the results of the monetary correction of fixed assets.) Exchange differences are deductible immediately after they occur. The same treatment is given to bonds in national currency, subject to restatement in terms of current values.

**Loans Subject to Monetary Correction.** Only foreign currency obtained from an approved loan can officially be exchanged for cruzeiros. The interest rate on internal cruzeiro loans cannot exceed 12% per year. However, banks are allowed to charge a small commission plus monetary correction as compensation for inflation, which increases actual loan cost to between 24% and 30% per year. Monetary correction is added to the unpaid principal thus increasing the unpaid balance owed by the borrower.

Both the interest and the commission charged by banks on ordinary loans are usually recorded as interest expense, without further specifica-

tion. Income tax legislation provides that the monetary correction incorporated in the agreement for long-term loans be handled in the same way as described under *Frequent Adjustments of Exchange Rates*. Up to 1976, financial agreements incorporating monetary correction were not permitted between private persons or beyond those expressly provided in the law and official regulations. However, this question is still being discussed by the Judiciary, and there are already decisions that permit the stipulation of monetary correction between individuals.

As a rule, working capital is calculated in the following manner:

- A. Stockholders' equity
  - Plus
    - Nontaxable provisions (understood by the internal revenue department as free reserves)
  - Minus
    - Deductible provisions forming part of stockholders' equity; for example, allowance for doubtful accounts
    - Amount of capital to be paid in
    - Loss carryforwards
- B. Property, plant and equipment
  - Plus
    - Financial investments of a fixed nature such as participation in other companies
  - Minus
    - Depreciation

If *A* is greater than *B*, the difference will be the actual or positive balance of working capital. If *A* is less than *B*, there will be a deficiency or negative balance of working capital. The positive balance should be debited to the profit and loss account and credited to a specific reserve account. The negative balance should be debited to any reserve account or, in the absence thereof, to deferred charges and credited to the profit and loss account.

**Revaluation of Fixed Assets.** See Chapter 7.

**Reserve for Maintenance of Working Capital.** In addition to monetary correction and revaluation of fixed assets, to eliminate the effect of inflation on book earnings, entities may deduct the annual decrease in purchasing power of working capital. The amount of the decrease is obtained by applying an official index to the company's beginning-of-the-year working capital, limited to the actual profit for tax purposes determined in the year. The amount deducted must be maintained in a 'Reserve for Maintenance of Working Capital' and can be transferred to capital at any time. Contrary to its previous pro-

# Accounting and Auditing

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cedure, the Central Bank is no longer registering the increase of capital obtained through this reserve as capital in foreign currency.

**Receiving Shares of Other Companies.** The receipt of free shares (stock dividends) of other companies, whether they result from inflation, revaluation of fixed assets or monetary correction, is recorded in the receiving company's investment account at par value, with an obligatory credit to the capital stock reserve account.

In addition to stock dividends arising from monetary correction, tax legislation induces profitable companies to capitalize portions of retained earnings by issuing additional shares as stock dividends. Such stock dividends in the hands of the investor company are also added to investment cost at par or market value, whichever is lower, with a corresponding credit to capital stock reserve.

**Long-Term Receivables – Real Estate.** Up to April 1975, monetary correction had been confined to cases expressly stipulated in the law, that is, government bonds (ORTN), the *Banco Nacional de Habitação (BNH)* system and certain long-term operations of the banking and savings system. However, the government also recognizes the effect of inflation in the case of the sale of real estate by a legal entity. Both income tax law and generally accepted accounting principles provide that gain on the sale of real estate held over a long term (usually more than one year) be taken into income in proportion to the payments received. Companies that sell land on the installment basis and also those that build and sell on long-term credit terms must segregate payments received as follows:

1. The portion representing return of invested capital (cost).
2. The portion representing interest.
3. The portion representing monetary correction – if the sale was in accordance with the BNH system. If the sale was not made in accordance with said system, there is no monetary correction.
4. The portion representing profit.

Thus, companies with long-term real estate receivables can monetarily correct for each transaction the land cost and the construction cost, based on the government's coefficients.

**Accounting for Income Tax.** Until a few years ago, most companies recorded income tax as an expense of the year in which payment was made. It is now becoming common to adopt the practice followed by Brazilian subsidiaries of foreign companies of segregating in the current year's financial statements the portion of income tax that will be paid

in the following year, and this practice is obligatory for publicly-held companies. Such companies show the provision for income tax as a deduction in the income statement and a liability in the balance sheet. A few Brazilian companies still classify income tax as one of the reserves grouped under stockholders' equity, but this practice is disappearing.

There are two equally used practices for determining the income tax accrual:

1. Most foreign subsidiaries and some national companies accrue 100% of the income tax payable. They view the tax-money investment incentives (see Chapter 2) granted by the government as an option that occurs after the determination of income tax.

2. Most national companies and some foreign subsidiaries view the tax-money incentives as a *fait accompli* and record as tax expense only the actual tax payable (74%). Some provide for losses on the investment of the remaining 26% and others do not.

**Accounting for Tax Money Investment Incentives.** Companies that opt to invest 26% of their income tax liability, instead of paying it to the government, usually first classify the funds under 'Investments' as a 'Deposit.' Subsequently, when the company selects its investment, the deposits are transferred to a specific investment account. At this point, there are some variations in practice. Since the investments are usually in remote areas of the economy, in pioneer projects of uncertain profitability and uncertain realization, and are not transferable for at least five years, many companies provide for possible losses on the investment, especially when the investment is in a venture over which they have no control. This practice is commonly followed by foreign subsidiaries, but is seldom followed by national companies — perhaps because it is not recognized by the income tax authorities and also as it might imply a lack of confidence in the government's development program. A provision for possible losses may cover a portion of or the entire investment.

Many companies record 100% of the tax payable as an account payable. When the tax is paid, they debit accounts payable for the 74% of the tax paid to the government and debit receivables for the 26% deposited as an investment. The 26% balance in accounts payable is then transferred to a provision for possible loss on the investment. Such treatment appears to be unduly conservative.

**Liability for Severance Compensation.** Severance must be paid to employees dismissed without just cause. Current costs of this liability are funded through a payroll tax. As a rule, foreign-owned companies

# Accounting and Auditing

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compute yearly the severance that may be due to employees with vested rights in case of dismissal without just cause. These vested rights stem mainly from the law prior to 1967, at which time the Fund for Guarantee of Time of Service (see Chapter 3) came into being.

Brazilian-owned companies have not adopted this practice. This may be due to the widespread usage of Brazilian owned companies either to dismiss employees who did not opt for FGTS or to make separate agreements with non-opting employees so that all employees are basically under the scope of FGTS. These separate agreements provide for the voluntary payment by the company of a portion of the indemnity to which the employee is entitled if he is dismissed. The employee is then legally dismissed, indemnified under the agreement, and reemployed under the FGTS system.

## AUDITING STANDARDS

Although auditing has only recently received official backing, it has been practiced in Brazil for many decades. It stemmed from the need of owners of private companies to protect their interests with good accounting and from the presence of foreign subsidiaries that required auditing. Also, the presence in Brazil of offices of the international accounting firms influences and sets standards for the national accounting firms.

The auditing standards that were officially approved in 1972 are fundamentally modeled on SAP-33, but in an abbreviated form. The standard opinion contained in the official standards is the same opinion as that used in the United States.

## FINANCIAL STATEMENT PRESENTATION

In approving the obligatory accounting principles for publicly-held companies, the Central Bank also instituted requirements for the format and content of the income statement and balance sheet. The financial statements reproduced on the following pages in Portuguese, and translated into English, are in accord with these requirements.

Companies are beginning to use explanatory notes in their financial statements. Financial statements in Brazil are generally prepared with income tax regulations in mind and may not include provisions for contingencies and other adjustments not recognized for income tax purposes.

**FINANCIAL STATEMENTS**

# Accounting and Auditing

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## DEMONSTRAÇÃO DO RESULTADO ECONÔMICO EXERCÍCIO ENCERRADO EM 31 DE DEZEMBRO DE 19 . . .

### RENDA OPERACIONAL BRUTA

Venda dos produtos . . . . . Cr\$  
Prestação de serviços . . . . . Cr\$

Menos: Imposto faturado . . . . . Cr\$

RENDA OPERACIONAL LÍQUIDA . . . . . Cr\$

CUSTO DAS MERCADORIAS . . . . . Cr\$

LUCRO BRUTO . . . . . Cr\$

Despesas com vendas . . . . . Cr\$  
Gastos gerais . . . . . Cr\$  
Depreciações e amortizações . . . . . Cr\$

LUCRO OPERACIONAL . . . . . Cr\$

Rendas não operacionais . . . . . Cr\$  
Despesas não operacionais . . . . . Cr\$

LUCRO LÍQUIDO ANTES DO IMPOSTO DE RENDA . . . . . Cr\$

Imposto de renda pago no exercício . . . . . Cr\$

LUCRO LÍQUIDO . . . . . Cr\$

SALDO DE LUCROS SUSPENSOS . . . . . Cr\$

Mais:  
Reversão de provisões e reservas . . . . . Cr\$

Menos:  
Provisões . . . . . Cr\$  
Provisão para imposto de renda . . . . . Cr\$

Resultados a distribuir:  
Dividendos . . . . . Cr\$

Reservas:  
Reserva legal . . . . . Cr\$  
Reserva para manutenção do capital de giro . . . . . Cr\$  
Outras . . . . . Cr\$ Cr\$

SALDO ATUAL DE LUCROS SUSPENSOS . . . . . Cr\$

STATEMENT OF EARNINGS AND RETAINED EARNINGS  
YEAR ENDED DECEMBER 31, 19 . . .

REVENUES

Sales .....	Cr\$
Services rendered .....	Cr\$
	<u>Cr\$</u>
Less: Excise tax .....	<u>Cr\$</u>
<b>NET OPERATING REVENUES</b> .....	<b>Cr\$</b>
<b>COST OF SALES</b> .....	<b><u>Cr\$</u></b>
<b>GROSS PROFIT</b> .....	<b>Cr\$</b>
Selling expenses .....	Cr\$
General and administrative expenses .....	Cr\$
Depreciation and amortization .....	<u>Cr\$</u>
<b>OPERATING EARNINGS</b> .....	<b>Cr\$</b>
Non-operating income .....	Cr\$
Non-operating expenses .....	<u>Cr\$</u>
<b>EARNINGS BEFORE INCOME TAXES</b> .....	<b>Cr\$</b>
Income tax paid during the year .....	<u>Cr\$</u>
<b>NET EARNINGS</b> .....	<b>Cr\$</b>
<b>BALANCE OF RETAINED EARNINGS at the beginning of the year</b>	<b>Cr\$</b>
Add:	
Reversal of reserves no longer required .....	Cr\$
Less:	
Provisions .....	Cr\$
Provision for income tax .....	Cr\$
Proposed distribution:	
Dividends .....	Cr\$
Reserves:	
Legal .....	Cr\$
Maintenance of working capital .....	Cr\$
Other .....	<u>Cr\$</u>
	<u>Cr\$</u>
<b>BALANCE OF RETAINED EARNINGS at the end of the year</b>	<b><u>Cr\$</u></b>



# Accounting and Auditing

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## BALANÇO PATRIMONIAL (RESUMIDO)

31 DE DEZEMBRO DE 19 . . .

### ATIVO

#### DISPONÍVEL

Bens numerários . . . . .	Cr\$	
Depósitos bancários à vista . . . . .	Cr\$	
Títulos vinculados ao mercado aberto . . . . .	<u>Cr\$</u>	Cr\$

#### REALIZÁVEL A CURTO PRAZO

Estoques . . . . .	Cr\$	
Contas a receber de clientes menos valores descontados e provisão para devedores duvidosos . . . . .	Cr\$	,
Empresas subsidiárias ou coligadas . . . . .	Cr\$	
Valores e bens (títulos e valores mobiliários e bens não destinados ao uso) . . . . .	<u>Cr\$</u>	<u>Cr\$</u>

TOTAL ATIVO CIRCULANTE . . . . . Cr\$

#### REALIZÁVEL A LONGO PRAZO

Contas a receber de clientes . . . . .	Cr\$	
Empresas subsidiárias ou coligadas . . . . .	Cr\$	
Bens não destinados ao uso . . . . .	<u>Cr\$</u>	Cr\$

#### IMOBILIZADO

Imobilizações técnicas . . . . .  
Terrenos, edifícios, equipamentos, móveis,  
utensílios e veículos (valor de custo e  
correção monetária) . . . . . Cr\$

Valor corrigido . . . . . Cr\$

Menos: Provisão para depreciação . . . . . Cr\$ Cr\$

#### Imobilizações financeiras

Participações em empresas subsidiárias ou  
coligadas . . . . . Cr\$

Aplicações por incentivos fiscais . . . . . Cr\$ Cr\$ Cr\$

ATIVO REAL . . . . . Cr\$

#### RESULTADO PENDENTE

Despesas diferidas . . . . . Cr\$

SUB-TOTAL . . . . . Cr\$

CONTAS DE COMPENSAÇÃO . . . . . Cr\$

TOTAL . . . . . Cr\$

BALANCE SHEET (SUMMARY)  
AS OF DECEMBER 31, 19 . . .

ASSETS

CASH

Cash on hand . . . . .	Cr\$	
Cash in banks . . . . .	Cr\$	
Marketable securities . . . . .	<u>Cr\$</u>	Cr\$

SHORT-TERM REALIZABLE ASSETS

Inventories . . . . .	Cr\$	
Trade notes and accounts receivable less trade accounts and notes discounted with recourse and allowance for doubtful accounts . . . . .	Cr\$	
Accounts receivable from subsidiary or related companies	Cr\$	
Negotiable instruments . . . . .	<u>Cr\$</u>	<u>Cr\$</u>

TOTAL CURRENT ASSETS . . . . . Cr\$

LONG-TERM REALIZABLE ASSETS

Trade notes and accounts receivable . . . . .	Cr\$	
Amounts due from subsidiary or related companies . . . . .	Cr\$	
Negotiable instruments . . . . .	<u>Cr\$</u>	Cr\$

FIXED ASSETS

Property, plant and equipment (at cost plus monetary  
correction) . . . . . Cr\$

Less: Accumulated depreciation . . . . . Cr\$ Cr\$

Investments

Subsidiary or related companies . . . . . Cr\$

Tax-incentive investments . . . . . Cr\$ Cr\$ Cr\$

REAL ASSETS . . . . . Cr\$

DEFERRED CHARGES

Prepaid and deferred expenses . . . . . Cr\$

SUB-TOTAL . . . . . Cr\$

MEMORANDUM ACCOUNTS . . . . . Cr\$

TOTAL . . . . . Cr\$

# Accounting and Auditing

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## PASSIVO

### EXIGÍVEL A CURTO PRAZO

Fornecedores .....	Cr\$		
Empresas subsidiárias ou coligadas .....	Cr\$		
Diretores e acionistas .....	Cr\$		
Instituições financeiras .....	Cr\$		
Provisões (inclusive para pagamento de imposto de renda) .....	Cr\$		
Outras exigibilidades .....	<u>Cr\$</u>	Cr\$	

### EXIGÍVEL A LONGO PRAZO

Fornecedores .....	Cr\$		
Empresas subsidiárias ou coligadas .....	Cr\$		
Diretores e acionistas .....	Cr\$		
Instituições financeiras .....	Cr\$		
Debêntures .....	Cr\$		
Outras exigibilidades .....	<u>Cr\$</u>	<u>Cr\$</u>	Cr\$

### NÃO EXIGÍVEL

Capital subscrito .....	Cr\$		
Menos: capital a realizar .....	<u>Cr\$</u>		
Capital excedente .....	Cr\$		
Correção monetária do ativo imobilizado .....	Cr\$		
Reservas legais			
Reserva legal .....	Cr\$		
Reserva para manutenção de capital de giro ...	<u>Cr\$</u>	Cr\$	
Reservas estatutárias .....	Cr\$		
Reservas livres .....	Cr\$		
Lucros suspensos .....	<u>Cr\$</u>	Cr\$	

### PENDENTE

Receitas diferidas .....	<u>Cr\$</u>
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SUB-TOTAL .....	Cr\$
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CONTAS DE COMPENSAÇÃO .....	<u>Cr\$</u>
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TOTAL .....	<u>Cr\$</u>
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**LIABILITIES AND STOCKHOLDERS' INVESTMENT**

**SHORT-TERM LIABILITIES**

Trade notes and accounts payable .....	Cr\$	
Accounts payable to subsidiary or related companies .....	Cr\$	
Directors and stockholders .....	Cr\$	
Loans .....	Cr\$	
Accruals (including income tax) .....	Cr\$	
Other liabilities .....	<u>Cr\$</u>	Cr\$

**LONG-TERM LIABILITIES**

Trade notes and accounts payable .....	Cr\$		
Amounts due to subsidiary or related companies ..	Cr\$		
Directors and stockholders .....	Cr\$		
Loans .....	Cr\$		
Debentures .....	Cr\$		
Other liabilities .....	<u>Cr\$</u>	<u>Cr\$</u>	Cr\$

**STOCKHOLDERS' INVESTMENT**

Subscribed capital stock .....	Cr\$		
Less: capital to be paid-in .....	<u>Cr\$</u>		
Additional paid-in capital .....	Cr\$		
Monetary correction of fixed assets .....	Cr\$		
Reserves			
Legal .....	Cr\$		
Maintenance of working capital .....	<u>Cr\$</u>	Cr\$	
Bylaw reserves .....	Cr\$		
Free reserves .....	Cr\$		
Retained earnings .....	<u>Cr\$</u>		Cr\$

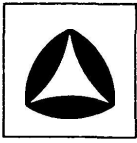
**DEFERRED INCOME**

Unearned income .....		<u>Cr\$</u>	
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SUB-TOTAL .....		Cr\$	
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MEMORANDUM ACCOUNTS .....		<u>Cr\$</u>	
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TOTAL .....		<u>Cr\$</u>	
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# Taxation in Brazil

- CORPORATE TAXATION
- TAXABLE INCOME
- DEDUCTIONS
- TAX PAYMENTS
- TAX INCENTIVES

- REVALUATION (MONETARY CORRECTION) OF FIXED ASSETS
- OTHER TAXES
- WITHHOLDING TAXES
- INDIVIDUAL INCOME TAX
- MISCELLANEOUS TAXES

The income tax law is based on Decree 76,186 of September 1975, which originated with Law 4,506. This law has been periodically modified. By constitutional provision, only the federal government can impose an income tax.

**Effects of Inflation.** To compensate for the effects of inflation, the amounts expressed in cruzeiros in income tax legislation are corrected annually by an official index. This applies, for example, to amounts deductible for a taxpayer's dependents, to the minimum exemption, to fines, etc.

## CORPORATE TAXATION

All legal entities (including sole proprietorships, branches of foreign corporations and other noncorporate as well as corporate entities) are subject to corporate income tax. This chapter will discuss the essentials of the Brazilian income tax law as it applies to the corporation (S.A.), which is used by most medium and large companies, and to the limited liability company (Ltda.), which is mainly used by smaller businesses. The taxation of general partnerships is covered briefly as few are in existence; professional partnerships which enjoy favored tax treatment are also discussed briefly.

**Corporate Income Tax Rate.** The normal income tax rate for corporations is 30%. An additional tax of 5% is levied on any portion of taxable income distributed during the base year (see *Tax on Distributed Profits*). This 5% additional tax is not imposed when profits are distributed to other legal entities.

**Filing of Tax Returns.** Annual tax returns must be filed as follows:

Fiscal Year Ending	Month of Following Year Tax Return is Due
January - September	January
October	February
November	March
December:	
Corporations	May
Other entities	April

# Taxation in Brazil

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As indicated, an entity whose fiscal year ends in January is not taxed on its base year profit until the following January, but it may have to make advance tax payments (see *Tax Payments*).

## TAXABLE INCOME

Taxable income is defined in the Regulations as gross receipts less allowable deductions. In practical terms, taxable income is the book profit, subject to the adjustments discussed in the following pages.

**Income from Foreign Sources.** Brazilian entities that obtain income from sources both within and without Brazil are subject to taxation only on income derived from within Brazil. If the Brazilian-source income cannot be determined separately, tax regulations provide that it be estimated on the basis of 20% of worldwide gross receipts.

Although not expressed in the law, the prevailing view is that corporate income derived solely from foreign sources is not taxed in Brazil. However, this matter is still open to dispute, and each case must be viewed on its own merits.

When tax-exempt foreign income of a Brazilian entity is distributed to shareholders, it is taxed in the same manner as the distribution of Brazilian income. Income resulting from monetary correction of any kind is subject to taxation.

**Capital Gains.** Although an individual's capital gains are not taxable and capital losses are not deductible, the capital gain or loss of business entities arising from buying or selling shares of other companies is treated as ordinary gain or loss. No distinction is made in calculating such income or loss nor in the applicable tax rate, with one exception: When a company incurs a loss on the sales of shares not listed on a stock exchange and without informing the tax authorities, only 10% of such loss is deductible. A gain in the same circumstances is fully taxable.

Ordinary companies are not allowed to buy or sell their own shares. However, this ban does not apply to a company introducing its shares on the stock market. On that occasion, the shares can be sold at a premium which will be nontaxable if credited to a reserve for the increase of capital. Authorized capital corporations (see Chapter 5) are not banned from buying and selling their own shares.

**Exclusions from Income.** The following income is not taxable:

- Cash dividends and distribution of profit to quotaholders by other Brazilian legal entities.

- Income from the export of manufactured products.
- Expenses resulting from monetary correction, regardless of their nature.

**Nondeductible Expenses.** The following are the principal expenses not deductible for tax purposes:

- Excess remuneration of directors. The current ceiling for the remuneration of each director or partner is Cr\$16,100 per month for a maximum of seven directors or partners. Remuneration in excess of this limit must be restored to taxable income. An overall ceiling of 30% of taxable income, calculated before any remuneration to directors or partners, is also in effect. In any case, even in the event of loss, a company may deduct the equivalent of Cr\$3,000 a month (in 1976) for each partner or director.
- Any remuneration to a corporate director who is a nonresident of Brazil.
- Provisions not allowed by law or in excess of the tax deductible limits. Examples are provisions for obsolete merchandise or severance compensation for employees who did not opt for FGTS or to provide benefits for those who did opt but retained certain benefits under the old system (see Chapter 3).

## DEDUCTIONS

In general terms, all expenses necessary for the activities of an enterprise and the maintenance of the producing source are deductible, provided they are usual or normal in the operation or activities of the business. Such deductible expenses include:

1. All taxes, duties and assessments, with the exception of income tax itself, fines for tax infractions and taxes paid after the fiscal year in which due.
2. An allowance for bad debts based on experience, but subject to a maximum of 3% of outstanding receivables.
3. Exchange losses arising from foreign loans to supply working capital, property, plant, or equipment. As of 1977 (based on 1976), the monetary correction that exceeds 20% will be deductible from the income tax due, instead of from operating profit.
4. Expenditures for scientific or technical research.
5. Royalties and other expenses for foreign scientific, technical and administrative assistance, with deductible amounts being subject to several restrictions. First, no deductions are allowed for payments to

# Taxation in Brazil

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foreign companies that exercise direct or indirect control of the paying company. Second, the amounts paid are subject to maximums set for each industry by the Minister of Finance. The maximum for royalties on patents is 5% of sales and the maximum for trademarks is 1%. In addition, all contracts of this nature must be registered as explained in Chapter 2. Limits on the number of years such deductions are allowed may be imposed, and the tax authorities may require definite evidence that all services paid for have been rendered. Disallowed royalty payments are treated as distributions of profit, and are taxed accordingly.

6. Annual decrease in purchasing power of working capital may be deducted by entities to eliminate the effect of inflation on book earnings. The amount of the decrease is obtained by applying an official index to the company's beginning-of-the-year working capital, but this deduction is limited to the profit for the year. The amount deducted must be maintained in a 'Reserve for Maintenance of Working Capital' (see *RMCG* in Chapter 6), and stock or quota dividends may be issued at any time by transfers from this reserve. It should be noted that these additional stock or quota dividends may not be registered at the Central Bank as foreign capital.

**Inventory Valuation.** Inventory is valued at cost or market, whichever is lower. 'Cost' is not clearly defined, but most companies use an average cost method and avoid FIFO and other methods that increase reported profits in a period of inflation. LIFO and other methods that decrease taxable income are sometimes used for internal management purposes but are not normally accepted for tax purposes.

**Depreciation.** Straight-line depreciation is the usual method allowed for tax purposes. The full cost of an asset is depreciable as salvage value is not taken into account. Upward asset revaluations (monetary corrections) due to inflation are also depreciable (see *Revaluation of Fixed Assets*). The following are typical annual rates of depreciation that have been accepted for tax purposes:

Asset	%
Buildings	2
Machinery:	
Used for one shift	10
Used for two shifts	15
Used around the clock	20
Automobile and other vehicles	20
Office equipment	10

Accelerated rates of depreciation may be used if permission is requested and granted prior to their use in the tax return. Permission is



obtainable on the basis of specific written approval from the *Instituto Nacional de Tecnologia*, which has permitted, for example, annual depreciation rates of 33.3% and 50% for vehicles. Such permission can also be obtained by companies for new or expanded operations on projects approved by a governmental body known as *Conselho de Desenvolvimento Industrial (CDI)*.

**Losses of Prior Years.** Losses, as computed for tax purposes, may not be carried back to prior years but may be carried forward and set off against the profits of the next three years, with limitations. The principal limitation is that only losses in excess of 'undistributed earnings' of prior years may be carried forward. 'Undistributed earnings' includes retained earnings, capital surplus and any kind of reserves, except reserve of monetary correction of fixed assets. When operating losses are anticipated in future years, it may be important to overcome this limitation by distributions of cash or shares to reduce retained earnings. If prior operations have resulted in a deficit, it is usually possible to obtain the full benefit of loss carryforwards for up to three years.

## TAX PAYMENTS

Income tax can be paid in up to 12 monthly installments, without interest. Similarly, any use of tax funds for an approved tax-incentive investment, in lieu of payment to the government, can be accomplished in installments. The first monthly installment is due in January of the year in which the tax return is scheduled for filing. Any installment due prior to the month in which the tax return is to be filed is based on the following formula:

$$\begin{aligned} & \text{Installment Due Month of January, 1976} \\ & \frac{1975 \text{ Income Tax} \times 1975 \text{ Gross Receipts}}{1974 \text{ Gross Receipts} \times 12} \end{aligned}$$

### Example:

A company's 1975 income tax was Cr\$50,000. Its gross income was Cr\$600,000 in 1975 and Cr\$500,000 in 1974. This company's first monthly installment would be Cr\$5,000.

When the tax return is filed, the tax already paid is credited and the balance of tax due is spread over the remaining months of the year. Rebates of up to 8% are offered for early filing and full payment of tax due, but most entities prefer to delay tax payments to the maximum extent.

# Taxation in Brazil

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## TAX INCENTIVES

As explained in Chapter 2, up to 26% of income tax otherwise payable to the government may be used for specific investments. If this tax incentive is fully utilized, the effective corporate tax rate is reduced from 30% to 22.2%, as the balance of 7.8% is used for investment purposes.

**Agricultural Activities.** The following tax incentives are available to companies formed between October 1, 1969 and December 31, 1979 engaging in agricultural or pastoral activities; beekeeping; breeding of silkworms, fish or small animals; and plant or animal extractive industries.

1. Complete income tax exemption in the first two years.
2. 50% reduction in the third year.
3. 25% reduction in the fourth year.
4. Normal taxation thereafter.

Companies formed prior to October 1, 1969 that engage in any of these activities may deduct up to 80% of their otherwise taxable income for investments designed to improve or expand their operations.

## REVALUATION (MONETARY CORRECTION) OF FIXED ASSETS

Inflation has caused asset accounting based on historical costs to lose its significance. Consequently, it has been compulsory since 1964 for all companies to make an annual revaluation of their fixed assets and related depreciation (also referred to as monetary correction) based on indices published each January by the government. This revaluation must be recorded within four months after the end of an entity's fiscal year. The index for assets acquired during the preceding year is always one (1). Consequently, assets purchased by a calendar year entity during 1976 would not be monetarily corrected until 1978.

Beginning in 1974, the system for evaluation of fixed assets underwent some important changes. The aim was for a better adjustment of the effects of inflation on the financial statements, and to ensure that the original value of property, plant and equipment, together with the monetary correction thereof, would always be depreciated at the same ratio. The following is a simplified illustration of monetary correction.

**Example:** An asset was acquired on January 1, 1973 for Cr\$100 and is being depreciated at 10% per year. No assets were acquired in 1974 or 1975.

For the tax year 1975, the following monetary correction is made:

	<b>Cr\$</b>
Cost of asset	100
Official index	<u>1.4</u>
Monetarily corrected cost	<u>140</u>
Original value	<u>100</u>
Accumulated depreciation of the original value	20 (20%)
Amount of monetary correction of fixed assets	40
Amount of monetary correction to be depreciated at the same ratio as the original value	8 (20%)

Amount of monetary correction of depreciation from month to month, chargeable to cost, in the first two years:

Year	Index for Year	One-Twelfth	Amount
1973	1.30 (x)	1/12.10	0.25
1974	1.40 (x)	1/12.10	<u>0.33</u>
			0.58

Amount of monetary correction of depreciation still to be recorded in order to maintain the ratio of depreciation to the original value ( $8 - 0.58 = 7.42$ ).

<b>Book Entries</b>	<b>Cr\$</b>
Reserve for monetary correction of fixed assets for increase of capital	32.58
Monetary correction of depreciation	<u>7.42</u>
Monetary correction of fixed assets	<u>40.00</u>
Depreciation of monetary correction	0.58

In future years, depreciation on the increase in asset cost is deductible for tax purposes, and the Cr\$40 is an additional deduction for depreciation in base year 1975.

The monetary correction for the 1976 base year will be:

	<b>Cr\$</b>
Cost of 1973 asset	100
Official index	<u>1.6</u>
Monetarily corrected cost	160
Less — previous correction	<u>140</u>
Net correction	<u>20</u>
Original value	100
Accumulated depreciation of original value	30 (30%)
Amount of monetary correction of fixed assets	60
Amount of monetary correction to be depreciated at the same ratio as the original value	18 (30%)

# Taxation in Brazil

Amount of depreciation of monetary correction recorded, consisting of:

- a. monetary correction of depreciation (chargeable to cost),
- b. monetary correction of depreciation (chargeable to reserve of monetary correction for increase of capital), and
- c. recorded depreciation of monetary correction of fixed assets (chargeable to cost).

a. Year	Index for Year	1/12 Depreciation of Original Value	1/12 Depreciation of Correction Value	Amount
1973	1.30 (x)	1/12.10	—	0.25
1974	1.40 (x)	1/12.10	—	0.33
1975	1.60 (x)	1/12.10	1/12.4	<u>0.70</u>
				1.28
<b>b. % of Depreciation</b>		<b>Correction Value</b>	<b>Depreciation Value</b>	
	10	40		4.00
<b>c. Correction of recorded depreciation</b>				<u>7.42</u>
Total (a + b + c)		1.28 + 4.00 + 7.42		12.70

Amount of monetary correction of depreciation still to be recorded in order to maintain the ratio of depreciation to the original value (18.00 – 12.70) 5.30

## Accounting

Reserve for monetary correction of fixed assets for increase of capital (32.58 + 14.70)	47.28
Monetary correction of depreciation (7.42 + 5.30)	<u>12.72</u>
Monetary correction of fixed assets	60.00
Depreciation of monetary correction	5.28

(x) Illustrative indices

Any revaluation of fixed assets beyond the aforementioned rules established for compulsory monetary correction, or at higher indices than the official ones, which usually occurs when companies are absorbed or merged, is taxable at the 30% rate.

**Treatment of Foreign Exchange Differences.** For tax purposes, both realized and unrealized exchange losses are deductible. Therefore, losses arising from unpaid loans in foreign currencies, based on the exchange rate in effect on the balance sheet date, are deductible. This applies to loans to acquire fixed assets or to supply working capital.

## OTHER TAXES

**Tax on Distributed Profits.** Except for companies with comparatively small capital, closely-held companies are subject to an additional tax of 5% on profits distributed during the year. Publicly-held companies are designated as open capital corporations and, as such, are exempt from

this tax. Only companies whose shares are regularly traded on the stock exchanges, and whose share ownership meets required conditions that vary with the size and location of the company, are classified as open capital corporations.

The 5% tax on distributed profits is calculated in the annual income tax return and serves to increase the portion of the tax (26%) that may be invested in tax incentive programs. This tax is not deductible in computing taxable income.

**Tax on Increases in Capital.** The tax on increases in capital stock has been discontinued.

**Tax on Branches of Foreign Companies.** Branches of foreign entities are subject to the regular income tax of 30%, the tax on distributed profits of 5% and, in addition, to withholding tax on distributed income of 25%, which is due within 120 days of the end of the fiscal year. Thus the total tax paid by a branch is 60%. However, if net foreign remittances exceed 12% of registered capital, the branch will incur the supplementary taxes noted in Chapter 2.

The 25% withholding tax is levied normally on all income paid or credited to residents of foreign countries. But, in the case of a branch, even profit held in a reserve account, and not paid or credited to its parent company, is subject to the 25% tax. Mainly for this reason, operation in Brazil as a branch of a foreign company is not usually advisable.

**Withholding Tax on Payments to Nonresidents.** All income earned in Brazil by foreign individuals or legal entities (profits, dividends, interest, royalties, fees for technical assistance, rent, allowances, etc.) is subject to a withholding tax of 25%. Although termed a withholding tax, and levied on gross income paid or credited, it is actually a final tax. In addition, whenever the average remittances of dividends or profits exceed 12% of registered capital over a three-year period, a graduated supplementary withholding tax is levied on that portion of the remittances in excess of 12% of registered capital.

**Tax on Excess Reserves of Corporations.** A 15% tax is levied on the excess of reserves (not including the legal reserve) and retained earnings over the registered capital stock. The tax is levied whenever the annual balance sheet indicates that the total of such accounts exceeds 200% of capital stock. The purpose of this tax is to encourage the distribution of either cash or stock dividends. If these reserves and retained earnings

# Taxation in Brazil

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are capitalized and distributed as a stock dividend, the full impact of the tax on excess reserves can be avoided. If cash dividends are distributed, the tax on excess reserves previously paid represents a credit against withholding taxes imposed on cash dividends. If the dividends are distributed to a legal entity, the company will have the right to request the refund of the 15% tax, since no withholding tax applies when the beneficiary of the dividends is a legal entity (see *Withholding Taxes*).

**Taxation of General Partnerships.** Partnerships are subject to the same income tax (30%) as other business entities, and partners' salaries are deductible only within the limits mentioned under *Deductions* on page 63. Partners' salaries are subject to withholding by the partnership, and the partners credit the amount withheld when filing their individual income tax returns.

Partnership after-tax earnings are credited to a retained earnings account. Any portion of after-tax earnings actually distributed to partners is taxed to the individual partner.

These rules apply to professional partnerships also.

## WITHHOLDING TAXES

Various payments are subject to withholding by the payor, who is liable for failure to make the proper withholding and may be subject to fines and interest as well as any underwithholding. The tax withheld at source will offset the amount due in the tax return after, in the case of individuals, being readjusted by an official index. The more important payments subject to withholding are discussed below.

**Income Earned by Employees.** All types of employee net income (salary, wages, overtime, per diem allowance, directors' fees, etc.) are subject to withholding by the employer at progressive rates, which are adjusted annually to compensate for inflation. The following monthly withholding table applies to successive increments of an employee's earnings during 1976. Maximum earnings are subject to withholding at each lower rate as indicated.

Monthly Wage Bracket		Withholding Percent
From Cr\$	1 to Cr\$3,000	None
3,001	3,400	5
3,401	4,400	8
4,401	6,000	10
6,001	8,300	12
8,301	11,200	16
Over	11,200	20

For withholding tax purposes, employee net income is gross income less employee contribution for social security (8%) and less an allowance for each dependent of Cr\$500.

**Self-Employment Income.** Company payments to self-employed persons are subject to withholding of 8% on monthly payments over Cr\$580.

Self-employment income includes remuneration for any services rendered and for copyrights. A 7% withholding rate applies only to self-employment income of salesmen, brokers and commercial representatives.

**Payments to Building Contractors.** Withholding is imposed only on payments by government entities to building contractors. The rate is 8% on payments to individuals and 1.5% on payments to companies.

**Freight and Cartage.** Payments made by companies to other companies and individuals for freight and cartage are subject to withholding of 3%.

**Payments to Nonresidents.** Income paid or credited to nonresidents (including interest, royalties, fees, copyrights, rent, dividends, profits) is subject to a single withholding rate of 25%. Brazil's international tax treaties (see next page) may affect this rate.

**Cash Dividends.** Dividend distributions by corporations are subject to withholding as outlined in the following table. *International tax treaties, however, may affect the rate of withholding.*

<b>Dividends on Nominative Shares of Closed Corporations:</b>	<b>Withholding Percent</b>
Paid to individuals	exempt
Paid to legal entities	exempt
Paid to nonresidents	25
<b>Dividends on Nominative Shares of Open Capital Corporations (Publicly-Held Companies):</b>	
Paid to individuals or legal entities	exempt
Paid to nonresidents	25
<b>Dividends on Bearer Shares of Closed Corporations:</b>	
Paid to disclosed shareholders	exempt
Paid to undisclosed shareholders	25
Paid to nonresidents	25
<b>Dividends on Bearer Shares of Open Capital Corporations:</b>	
Paid to disclosed shareholders	exempt
Paid to undisclosed shareholders	15
Paid to nonresidents	25

# Taxation in Brazil

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**Note:** Individuals who are holders of nominative shares or disclosed holders of bearer shares are ordinarily exempt from withholding, but can opt for withholding at the dividend source. In these cases, the withholding rates will be 25% on dividends paid by closed corporations and 15% on dividends paid by open capital corporations. In cases where individuals opt for withholding at the source, the tax withheld is a final tax and the dividend income is not reported in the tax return. However, individuals may credit the tax withheld at source when filing their income tax returns, provided they consider the dividends or profits as taxable income.

Distribution of Earnings to Quotaholders:	% Withholding
Paid to individuals	10
Paid to legal entities	exempt
Paid to nonresidents	25

**Interest Payments.** A wide variety of withholding taxes is imposed on payments of interest. The rate of withholding varies with the type of loan, the length of time of the loan, the amount, and other factors.

**International Tax Treaties.** International treaties to avoid double taxation and to reduce the tax on investment income have been concluded with Sweden, Japan, Norway, France, Portugal, Belgium, Denmark, Germany and Spain. A tax treaty has been ratified by the US but is being held in abeyance by Brazil.

## INDIVIDUAL INCOME TAX

All residents of Brazil are required to file an annual income tax return. A foreign person who is in Brazil for more than twelve months is considered a resident. A foreigner entering Brazil with the intention of becoming a permanent resident may be considered a resident from the date of arrival, depending on the circumstances of each case.

The tax return is normally due between January 1 and April 30 and is based on the income of the preceding calendar year. However, an individual leaving Brazil prior to the end of the year must file a tax return for the period between January 1 and the date he requests tax clearance for leaving the country.

Nonresidents and former residents who have been outside of Brazil for 12 months are not subject to tax at the tax rates that apply to residents, but at the withholding tax rate of 25%. A foreigner who enters and leaves Brazil in the same calendar year is not required to file an income tax return, but he will be subject to 25% withholding on any income received.



**Net Taxable Income.** Personal income is classified in eight schedules. The taxpayer, normally a husband and wife filing a joint return, includes in each schedule the gross income received in the preceding year and the allowable deductions from each type of income. The general principle is that all expenses incurred in earning income may be deducted. For example, from Schedule C, 'Compensation Received as an Employee,' the following deductions are allowed: Mandatory contributions for social security and for support of labor unions, dues to scientific or other groups related to taxpayer's work, subscriptions to trade journals and cost of technical books related to taxpayer's work, travel expenses where employee's work involves outside contacts or out-of-town travel (fares, meals and hotels).

The sum of the income reported in all schedules, less the allowable deductions, is 'gross personal income.' From gross personal income, other general deductions may be taken to arrive at 'net taxable income.' Amounts withheld during the taxable year are credited against the tax due. Any excess withholding is refunded, and any balance due must be paid, according to the wage brackets mentioned under *Income Earned by Employees*.

**Income Taxed Abroad.** Income received abroad by individuals residing in the country, whether or not it is transferred to Brazil, should be classified for income tax purposes in the schedules relating to the nature of such income. Hence, interest received abroad would be classified in Schedule B, salaries in Schedule C, and so on. The taxpayer may obtain a credit for any tax paid to a foreign country, provided reciprocal treatment is accorded. However, tax withheld abroad cannot be used to reduce the tax on income earned in Brazil. The applicable tax regulation provides that the foreign tax credit cannot exceed the difference between the tax computed without including the foreign income and the tax computed with its inclusion. In other words, the taxpayer must make two tax computations:

1. Including both Brazilian and foreign income and taking credit for the foreign tax.
2. Including only Brazilian income.

The computation that results in the higher tax must be used.

**Capital Gains and Losses.** Individual capital gains are not taxable and capital losses are not deductible, regardless of the holding period. An occasional sale by an individual of real estate is considered as falling within this rule; and all sales of shares, quotas and mutual funds are within the rule.

# Taxation in Brazil

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**Income from Agricultural Activities.** So many tax incentives are provided for individuals engaged in agricultural or pastoral activities that for practical purposes little taxable income can result. In any case, the net taxable income under Schedule G, the section under which agricultural income is reported, is limited to a maximum of 5% of gross income.

**General Deductions.** The following general deductions may be taken from gross personal income to arrive at net taxable income:

1. Cr\$5,900 for 1976, the amount is adjusted yearly, for each dependent (wife, child under 21 or to age 24 if attending college, unmarried or widowed daughter).
2. Payments to doctors, dentists, hospitals, and accident and medical insurance premiums.
3. Interest on personal debts, but limited to 6% of gross income, extraordinary losses not covered by insurance, and life insurance premiums.
4. Educational expenses of taxpayer and dependents, but limited to 20% of gross personal income.
5. Contributions to recognized philanthropic organizations.
6. Investments in forestation and reforestation.

Excluding deductions for dependents and the medical expenses referred to in item 2, general deductions from gross personal income cannot exceed 50% of gross personal income prior to such deductions.

Certain incentives are provided to stimulate interest in the stock market. These are of limited duration and others may emerge next year. In 1976, general deductions from income tax due are available for the following principal investments:

1. 3% of the investment during the year in Treasury Bonds.
2. 6% of investments in real estate bills, purchase of shares in publicly-held corporations, and deposits in savings accounts of the Habitation Financial System.
3. 4% of investments in bills of exchange and time deposits.
4. 12% of the amount subscribed for shares of publicly-held companies.
5. 20% of investments in shares of publicly-held companies engaged in tourism and of investments in reforestation, according to projects approved by the government.

6. 42% of the amount subscribed for shares issued by industrial or agricultural companies in the SUDENE or SUDAM areas. Note: The afore-mentioned investments must remain in the custody of a financial institution for two years, and the shares may not be sold during that period.

The reduction in tax payable as a result of investments is in inverse proportion to the amount of the taxpayer's gross income, as shown in the following table:

Gross Income US\$ (US\$1 = Cr\$10)		Limit of Deduction from Tax Due %
From	1 to 7,410	60
	7,411 9,950	55
	9,951 13,620	50
	13,621 17,890	45
	17,891 24,530	40
	24,531 39,210	35
	Over 39,210	30

**Direct Tax Incentive.** Individuals are eligible for one direct tax incentive that permits a portion of the tax otherwise payable to the government to be invested in a special mutual fund. The portion of an individual's tax that may be so invested varies from 10% to 24%, with the highest percentage being available to the taxpayers with the lowest gross income, and vice versa. This type of investment can be recouped at the end of the fifth or sixth year from the time of the deposit.

**Individual Income Tax Rates.** Tax rates range from 3% to 50% and are applied to successive portions of net taxable income. The tax payable on net taxable income of US\$20,000 would be US\$4,700, based on an exchange rate of Cr\$10. The maximum rate of 50% applies to taxable income over Cr\$500,000 (US\$50,000). The tax table is automatically adjusted each year to compensate for inflation.

**Payment of Tax.** Personal income tax is payable in eight successive monthly installments, without interest. The first installment is due when the official bill is received (theoretically in May, but sometimes some months later).

**MISCELLANEOUS TAXES**

**Tax on Circulation of Merchandise (ICM).** The ICM is the states' chief source of revenue. Basically, it is an added value tax that must be included in the sales price, but has to be shown separately on other documents.

# Taxation in Brazil

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Each successive seller collects ICM tax on merchandise that is physically transferred out of his place of business, and subtracts the ICM paid on his purchases of merchandise or raw materials. The effect is that each company pays ICM only on the value added. The current tax rates are 11% on interstate movements of merchandise and 14% on intrastate movements.

Exports are exempt from this tax and the exporter retains the use of the credit arising from his tax payment when acquiring the goods or raw materials. A manufacturer who exports his goods obtains in addition a tax credit equal to the ICM that would have been charged on the exported goods but limited to 13% of the FOB price in cruzeiros of each product exported.

Some state governments, including São Paulo, offer an incentive to companies that purchase certain types of Brazil-made machinery. The incentive consists of an exemption from ICM tax on such machinery.

**Tax on Manufactured Products (IPI).** IPI are basically excise taxes imposed by the federal government on most products, whether produced in Brazil or imported. The excise taxes on non-luxury products range from 3% to 20%, depending on the importance of the goods to the economy, with an average excise tax rate of about 10%.

IPI is imposed at each stage of manufacturing, and works as follows. IPI paid by manufacturers on raw materials and supplies is debited to a special account. When the manufactured product is sold, the IPI charged to the purchaser is credited to this account. A credit balance in the account at the end of the month is paid to the government; a debit balance is carried over into the next month.

As an incentive, this tax has been suspended on exported products, and the exporter retains the use of his tax paid when purchasing the goods or raw materials. In addition, the exporter obtains a tax credit equal to the IPI that would have been charged on the exported goods, but the credit cannot exceed 15% of the CIF price of the product in cruzeiros.

**Municipal Tax on Services.** Legal entities whose income is derived from services rendered are subject to a tax on gross income that varies with the municipality but is usually in the range of 2% to 5%. Activities classified as services are set forth in municipal legislation. The following activities are normally considered to be services: consulting, advertising, engineering, building, transportation, hospitals, public entertainment, tourism, leasing of property, hotels, photographic and movie studios, etc. Auditing is classified as a professional service, and audit firms are taxed on the basis of the number of professional staff.

**Tax on Credit and Insurance Premiums.** This federal tax is a successor to the stamp tax. The tax is imposed on borrowers (principal plus interest) at rates ranging from 0.2% to 1% and on payers of insurance premiums at rates ranging from 1% to 2%.

**Other Taxes.** Various other minor taxes are imposed.

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<b>Puerto Rico</b> San Juan		

## EUROPE

<b>Austria</b> Vienna	<b>Greenland</b> Godthaab	Rotterdam Terneuzen Tilburg Zwolle
<b>Belgium</b> Brussels	<b>Ireland</b> Belfast Cork Dublin Limerick	<b>Norway</b> Moss Oslo Sandefjord
<b>Channel Island</b> Jersey	<b>Italy</b> Milan	<b>Spain</b> Barcelona Madrid
<b>Denmark</b> Ballerup Copenhagen Esbjerg Kolding Odense	<b>Netherlands</b> Alkmaar Almelo Amersfoort Amsterdam Arnhem Beverwijk Breda Eindhoven Enschede Gouda Groningen Haarlem The Hague Heerlen Hilversum Leeuwarden Middelburg Nijmegen Rijswijk	<b>Sweden</b> Stockholm
<b>France</b> Paris		<b>Switzerland</b> Geneva Zurich
<b>Germany</b> Berlin Bielefeld Bremen Dusseldorf Frankfurt/Main Hamburg Hannover Munich Nurnberg Stuttgart		<b>United Kingdom</b> Birmingham Bristol Edinburgh Glasgow Leeds Leicester Liverpool London Manchester
<b>Greece</b> Athens		

## CENTRAL AMERICA & CARIBBEAN

<b>Cayman Islands</b> Grand Cayman	<b>Nicaragua</b> Managua
<b>Guatemala</b> Guatemala City	<b>Panama</b> Panama City
<b>Jamaica</b> Kingston Montego Bay	<b>Trinidad &amp; Tobago</b> Port of Spain
<b>Netherlands Antilles</b> Curacao	

## ASIA/PACIFIC

<b>Australia</b> Adelaide Brisbane Canberra Melbourne Newcastle Perth Surfers Paradise Sydney Wollongong	Sendai Takamatsu Tokyo
<b>Guam</b> Agana	<b>Malaysia</b> Johor Baru Kota Kinabalu Kuala Lumpur Kuala Trengganu Kuantan Kuching Penang
<b>Hong Kong</b> Hong Kong	<b>New Zealand</b> Auckland Christchurch Wanganui Wellington
<b>Indonesia</b> Bandung Jakarta Medan Surabaya	<b>Okinawa</b> Naha
<b>Japan</b> Fukuoka Hiroshima Kobe Kyoto Nagoya Osaka	<b>Philippines</b> Bacolod Cebu City Davao Manila
	<b>Singapore</b> Singapore

## SOUTH AMERICA

<b>Argentina</b> Buenos Aires	<b>Colombia</b> Bogota Cali
<b>Brazil</b> Belo Horizonte Porto Alegre Rio de Janeiro Salvador Sao Paulo	<b>Peru</b> Lima
<b>Chile</b> Santiago	<b>Venezuela</b> Caracas Maracaibo

## AFRICA & MIDDLE EAST

<b>Cyprus</b> Larnaca Limassol Nicosia	Salisbury Umtali
<b>Iran</b> Tehran	<b>Saudi Arabia</b> Jeddah
<b>Kenya</b> Nairobi	<b>South Africa</b> Cape Town Durban Johannesburg Pietermaritzburg Port Elizabeth
<b>Kuwait</b> Kuwait	<b>Turkey</b> Istanbul Izmir
<b>Lebanon</b> Beirut	<b>United Arab Emirates</b> Sharjah
<b>Mauritius</b> Port Louis	
<b>Rhodesia</b> Bulawayo	