

BRAZIL TAX SYSTEM

BASIC OVER VIEW TO FOREIGN INVESTORS



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This is an overview guidance of Brazil Tax System aiming to give an initial approach to foreign investors.

1) GENERAL FEATURES

1.1. The Brazilian Federal Constitution, promulgated on October 5, 1988, confers powers to the Union, the States, and Municipalities to levy taxation.

1.2. Taxation in Brazil may take the form of taxes, fees, betterment fees, other contributions, and compulsory loans. Taxes may be levied by the three levels of government, according to their specific competence, as provided for in the Constitution.

1.3. Fees collected at the three levels of government are used to fund the Government cash, linked or not to a specific destination or to fund specific services.

1.4. Betterment fees, which are still not very much used, could be used as for example to collect from owners of real estate for improvements to their assets resulting from public civil construction projects.

1.5. The following contributions can only be collected by the federal administration: (a) social contributions (payroll charges); (b) contributions to intervene in the economic domain, (c) contributions in the interest of professional or economic categories and (d) contributions to finance social security.

1.6. Compulsory loans can only be instituted by the federal administration to defray urgent public investment of relevant national interest or cover extraordinary expenses resulting from public calamity or war abroad.

1.7. Unless otherwise expressly provided for in the Constitution, some fundamental constitutional rules must be complied with for establishing and collecting taxes, among which the following ones deserve special mention:

- The principle of legality (according to which, except by special cases, taxation may only be levied or increased by law passed by the National Congress);
- The rule of equality (according to which taxpayers in equivalent situations must receive identical tax treatment);
- The principle of non-retroactivity (according to which taxation cannot be levied based on facts that occurred prior to entering into force of the law that created a new tax or which increased rates or the calculation basis of an existing one);
- The principle of precedence (according to which taxes cannot be collected in the same fiscal year in which the law that created them or increased their rates was published, nor prior to ninety days of said publication. Contributions, on the other hand, can be collected in the same fiscal year, but must comply with the ninety-day deadline);
- The principle of non-confiscation (according to which taxes cannot be confiscatory).

2) FEDERAL TAXES

Brazilian residents are subject to taxation on a universal basis, that is, all their income is subject to taxation in Brazil, regardless of its source (whether in Brazil or abroad). Exception by indemnization payment.

2.1. Personal Income Tax (Imposto de Renda Pessoa Física - IRPF)

Income earned by resident individuals from domestic legal entities is generally subject to withholding income tax at a progressive rate ranging from 0% to 27.5%, depending on the amount of income received.

When the source payment origin is not obliged to pay the income tax the one who is receiving the amount is obliged to submit to taxation according to the current legislation. The amounts paid usually are configured as advances but by the end of fiscal period there is a reconciliation of the amount advanced and the amount due.

Capital gains obtained by resident individuals on the transfer or disposal of any rights and assets are generally subject to income taxation in Brazil until 15% rate, regardless of whether such right or asset is located in Brazil or abroad. Gains obtained by non-resident individuals are only subject to taxation in Brazil if derived from the transfer of rights or assets located in Brazil. If a non-resident individual acquires residency status, gains derived from rights and assets he or she acquired as a non-resident are only subject to taxation in Brazil if such rights and assets are located in Brazil, that is, gains obtained by resident individuals on the sale of rights or assets located abroad that were acquired while such individual was a non-resident are exempt from taxation in Brazil.

2.2. Corporate Income Tax (Imposto de Renda Pessoa Jurídica - IRPJ)

Brazilian legal entities are subjected to three methods to verify the calculation basis of the Corporate Income Tax, namely, real profit, presumed profit and arbitrated profit.

The choice of the real profit or presumed profit method is discretionary, but the real profit method is mandatory for legal entities (i) whose total annual revenues in the preceding year exceed R\$48,000,000.00; (ii) which earn income or gains obtained abroad through foreign branches and/or representative offices (income derived from exports of services or goods are not deemed to have been obtained abroad); (iii) which are financial or similar institutions; (iv) which are engaged in factoring activities; or (v) which are entitled to specific tax benefits and exemptions.

Real Profit Regime

In the real profit method, the tax is calculated on an annual through monthly basis on profits before taxes, duly adjusted in accordance with the provisions of the applicable tax law. Any tax losses incurred in the tax period may be carried forward and offset against taxable income earned in subsequent periods, up to a limit of 30% of the taxable profit in each subsequent period.

If the legal entity opts for payment based on yearly profits, said profits will be calculated from the profit and-loss statement drawn up in December, covering the results for the entire calendar year, but the tax must be pre-paid monthly. The monthly pre-payment

may be reduced or suspended if the taxpayer submits accounting evidence that the pre-paid value to that month exceeds the tax value calculated on the basis of real profit.

Entities that opt for the real profit method are subject to Corporate Income Tax at a rate of 15%, plus a 10% additional rate on income exceeding the amount set by Fiscal Authorities.

Presumed Profit Regime

Under the presumed profit regime, the tax is calculated same rates applied under the real profit method (mentioned above) over a profit margin calculated through the application of a percentage of the gross revenue of the legal entity, without any adjustment or deduction.

Arbitrated Profit Regime

The arbitrated profit basis is only applied in exceptional cases, such as when the tax authority detects signs of fraud or for some reason (such as fire and robbery of tax related records or documents) the company cannot submit its income tax returns to the tax authority. According to this method, profits are arbitrated considering all information about sales, bank operations, etc., and information from other sources that can provide an estimate of the company's profits.

2.3. Simplified Taxation Regime (SIMPLES)

Under the simplified and unified taxation regime known as SIMPLES, the amount of all taxes is determined by applying a single rate to the entity's gross revenue. This rate varies according to the gross revenue and the nature of the entity's business activity. Because of its simplicity, the simple taxation regime is seen as sort of a tax incentive. For this reason, legal entities must comply with several strict requirements to qualify for it, mainly the following ones: (i) their annual gross revenue must be less than the amount fixed by the Federal Government; (ii) they cannot be incorporated as a corporation (limited liability companies can benefit from the regime); (iii) only natural persons can hold their quotas (no legal entities can be quotaholders); (iv) none of their quotaholders can be domiciled abroad; (v) none of their quotaholders can hold quotas of another entity; (vi) they cannot operate some specific activities.

2.4. Tax on Industrialized Products (Imposto sobre Produtos Industrializados - IPI)

The tax on industrialized goods (Imposto sobre Produtos Industrializados – IPI) is levied on industrialized goods including imports and exports and it is a noncumulative tax, meaning that the amount of tax due may be offset by credits arising from the purchase of raw materials, intermediary products, and packaging materials. However, no credits are granted for goods that become fixed assets. Rates are assessed on the value of manufactured goods as they are commercialized from domestic plants, and they vary according to the nature of goods. The rate is defined by the Chief of Executive, depending upon the decision to foment the goods commercialization, which may be raised or lowered by the tax authority. Export goods are exempted from IPI.

2.5. Import Tax (Imposto de Importação - II)

The Import Tax is levied on imports of goods into the Brazilian territory. Its rates vary according to the nature of the goods and their classification under the Mercosur Common Nomenclature (NMC - The Import Tax is not a recoverable tax).

2.6. Tax on Financial Transactions (Imposto sobre Operações Financeiras - IOF)

The IOF is a tax on credit, foreign exchange and insurance transactions and on transactions with securities. It can be waived under certain circumstances according to monetary and foreign exchange objectives and to fiscal policies.

2.7. Rural Property Tax (Imposto Territorial Rural - ITR)

The ITR is an annual tax levied on ownership of rural real estate property. ITR rates depend on the region and on the property's productivity.

2.8. Tax on Large Fortunes (Imposto sobre Grandes Fortunas –IGF)

The IGF has not been instituted yet. There are great uncertainties among tax specialists around the standard that should be adopted to define the concept of large fortunes.

3) STATE AND FEDERAL DISTRICT TAXES

3.1. Value-added Tax (Imposto sobre Circulação de Mercadoria e Serviços - ICMS)

The ICMS is the main state-level tax and it is due on operations involving circulation of goods (including manufacturing, marketing, and imports) and by the Constitution obligation such as on interstate and inter-municipal transportation, communications services and utilities. There are some exceptions, but according to the ordinary rule it is non-cumulative, and thus tax due may be offset by credits arising from the purchase of raw materials, intermediary products, and packaging materials. Tax credits for goods destined to become fixed assets can be accepted, subject to certain restrictions. The ICMS is not levied on exports.

3.2. Inheritance and Gifts Tax (Imposto sobre Transmissão Causa Mortis e por Doação, de Quaisquer Bens e Direitos - ITCMD)

The ITCMD is a state-level tax levied on the assignment of real property, credits, shares, quotas, equity, securities and other assets of any nature, as well as of rights related thereto, by way of donation or inheritance.

3.3. Tax on the Ownership of Automotive Vehicles (Imposto sobre a Propriedade de Veículos Automotores - IPVA)

The IPVA is a tax assessed annually on the ownership of automotive vehicles and motorcycles.

4) MUNICIPAL TAXES

4.1. Service Tax (Imposto sobre Serviços - ISS)

The ISS is a municipal tax levied on the provision of services. The services to which the ISS applies are listed in a Complementary Law. ISS rates range from 2% to 5%. The ISS is usually levied by the municipality in which the company providing a service is established, but in some cases it is levied by the municipality in which the service is provided.

4.2. Property Transfer Tax (Imposto sobre Transmissão de Bens Imóveis - ITBI)

The ITBI is a municipal tax levied on transfers of ownership of Brazilian real property and rights related thereto. The basis for calculating it is the value of the transaction or the market value appraised by the Municipality, whichever is higher. Municipalities are allowed to appraise and update the real estate value through market research.

Usually, the ITBI is not levied on transfer of property resulting from a contribution to capital or corporate reorganization.

4.3. Urban Property Tax (Imposto Predial e Territorial Urbano - IPTU)

The IPTU is levied on an annual basis. The IPTU tax basis is the market value of the real urban property. If the real property does not fulfill the basic requirements of having a social purpose as set forth in the Municipality's program, the tax authorities may apply a higher rate.

5) CONTRIBUTIONS

5.1. Social Contribution on Net Profits (Contribuição Social Sobre o Lucro - CSSL)

The CSL is levied on profits before income tax ascertained in accordance with commercial law, adjusted as set forth in the law. CSL's rate for non-financial entities is currently is 9% (15% for financial entities). Entities which opt for the presumed method are subject to a presumed basis such as the income tax.

5.2. Contribution for Social Security Financing (COFINS) and Contribution to the Social Integration Program (PIS)

PIS and COFINS are contributions levied monthly on gross revenue earned by legal entities. There are two regimes for PIS and COFINS. In general, companies that chose the presumed profit method are subject to the cumulative regime of PIS and COFINS, while

those opting for the real profit method are subject to the non-cumulative PIS and COFINS regime, although there are some exceptions.

Under the cumulative regime, PIS and COFINS are applied at a combined rate of 3.65% on revenues from sales and services, while under the noncumulative regime, PIS and COFINS are applied at a combined rate of 9.25% on gross revenues, but there are also some exceptions.

The law regulating the noncumulative regime of PIS and COFINS is very detailed. For the purposes of this Overview document, it sufficient to mention that the following items can be used as credits against PIS and COFINS: (i) assets acquired for resale; (ii) assets and services used in rendering services or in production goods and products for sale, including fuel and lubricants; (iii) electricity used by facilities of legal entities; (iv) finance lease of buildings, machinery and equipments paid by legal entities; (v) machinery, equipment and other assets incorporated into fixed assets to be used in providing services or in production goods and products for sale; (vi) buildings and improvements on real estate owned by the taxpayer; (vii) returned goods and assets, provided that the correspondent sale revenue was taxed in previous months; (viii) storage and freight paid for sales, provided that such expenses were borne by the seller.

- PIS and COFINS are also levied on imports of goods and services at a combined rate of 9.25%, with few exceptions. The amount paid is usually recoverable as input tax credit if the taxpayer has opted for the non-cumulative regime.

5.3. Contributions on Corporate Payroll

In general, the payroll of Brazilian enterprises is ordinarily subjected to Social Security Contribution at a rate of 20% which are collected together over the following contributions on payroll such as: ; Contribution to the Social Service of Commerce (SESC) Contribution to the Brazilian Micro and Small Business Support Service (SEBRAE), Contribution , Contribution to the National Industrial Apprenticeship Service (SENAI), Payroll based Contribution to Education (SE), and Contribution for Work Accidents (SAT), which could reach a combined rate until 29%.