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Some aspects of foreign investment taxation in Brazil

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According to a study published by the United Nations Conference on Trade and Development (UNCTAD), 2007 was an outstanding year for worldwide foreign direct investments (FDI), which reached a historic mark of US$ 1.5 trillion.

In this intense capital flow between nations, the option to invest in a particular country is subject to analysis of various factors, among which the fiscal aspect is certainly one of the most important.

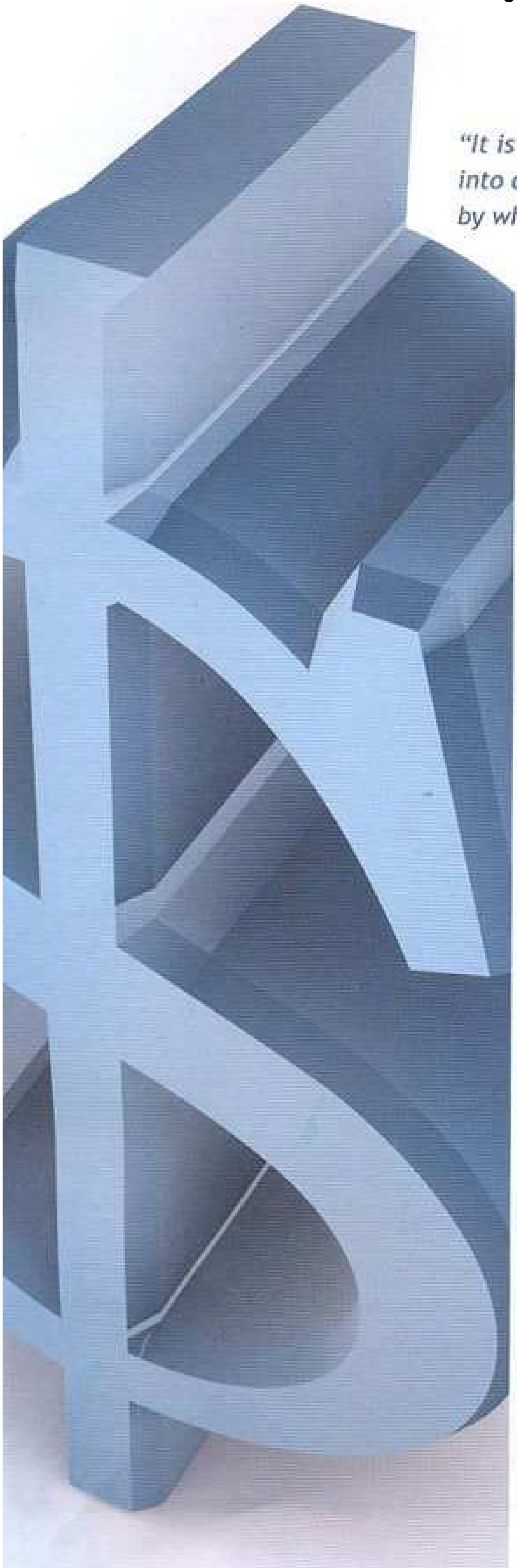
As a developing country, Brazil tries to exercise, to the extent possible, its right to tax income every time the paying source is located in Brazil, or in certain cases, the relevant asset is situated in the country (production source). That is why as a general rule there is withholding tax on remittances abroad, such as on payment of services, interest and capital gains.

Regarding the last one, the sale of stock in a Brazilian company by a non-resident is subject to income withholding tax at a rate of 15%, even if both the seller and buyer are domiciled abroad. If the seller is located in a blacklisted low-tax jurisdiction[1], then the income withholding tax is raised to 25%.

In this context, however, it is important to consider that Brazil has entered into double tax conventions with some countries, by which the tax burden from income withholding tax can be legitimately reduced. These countries are: Argentina, Austria, Belgium, Canada, Chile, China, Czech Republic, Denmark, Ecuador, Finland, France, Holland, Hungary, India, Israel, Italy, Japan, Luxembourg, Mexico, Norway, Philippines, Portugal, Slovakia, South Africa, South Korea, Spain, Sweden and Ukraine. It has also executed reciprocity agreements with Germany, Great Britain and the United States, and an agreement for the exchange of information with the latter.

These arrangements between countries constitute a relevant factor for attracting foreign investments, as they ensure: (i) greater stability and security regarding the applicable tax rules, including maximum income tax rates; (ii) the right not to have the same income taxed in both Contracting States; and (iii) nondiscriminatory tax treatment in comparison with that attributed to national investors.

Additionally, regarding the taxation imposed on the sale of shares held in a Brazilian company, when involving investments made by non residents in the Brazilian financial or capital market, according to National Monetary Council (CMN) Resolution 2,689/2000, any capital gains are tax-exempt.



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Setting up an equity investment fund (FIP), venture capital fund (FIEE) and fund of equity investment fund (FICFIP) can also bring significant tax benefits for foreign investors, since: (i) all net earnings and gains obtained from the sale, liquidation, redemption, assignment or roll-over of bonds, financial investments and securities held by investment funds; and (ii) dividends or interest on shareholders' equity received by investment funds are exempt from income tax.

More important for foreign investors, the income tax rate is reduced to zero on investors' earnings from FIPs, FIEEs and FICFIPs, when paid to a beneficiary that is resident abroad, in a jurisdiction not blacklisted, and as long as some regulatory requirements are fulfilled.

In order to compensate the loss of revenue due to the extinction of CPMF[2], foreign exchange operations in Brazil to internalize and also repatriate funds are now subject to the assessment of the Tax on Financial Operations (IOF), at rates ranging from 0.38% to 5.38%.

Nevertheless, the Brazilian government has granted specific IOF tax reductions to zero to foreign investors in transactions, such as currency exchange operations to settle accounts for the inflow of capital for stock acquisition by foreign investors in public offerings registered with the CVM, or for stock subscription, in either case if the issuing company's shares are listed for stock exchange trading.

Based on these considerations, along with Brazil's good economic fundamentals and excellent potential for growth, there is no doubt that the tax advantages provided for in the pertinent legislation or resulting from the application of double tax conventions and reciprocity agreements, will play an important role in continuing to attract foreign investments in the coming years.

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1. Jurisdictions that tax the income at a maximum rate inferior to 20%.
2. CPMF was a tax levied any time money was withdrawn from a bank account, physically or by other means.