
LEGAL ASPECTS OF
DOING BUSINESS
IN BRAZIL

- A BRIEF SUMMARY -

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a d v o g a d o s



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BRAZIL: BUSINESS, REGULATORY AND LEGAL OVERVIEW

Political Structure

Brazil is a Federal Republic, comprised of the Federal District, 26 states, and over 5000 municipalities. The Federal Capital is Brasília, which is located in the Federal District.

The Brazilian legal system is based on codes and legislation enacted by the appropriate legislative power at the federal, state and municipal levels.

The basic law of the country is the Brazilian Constitution, which establishes (i) the system of government; (ii) the attribution of powers to the Legislative, Executive and Judiciary branches of government; and (iii) the legislative competence of the federal, state and municipal administrations.

Judicial Structure

The Brazilian Judiciary is organized by the Brazilian Federal Constitution, which divides the judicial structure into federal and state courts. In general terms, the Brazilian courts have jurisdiction over any litigation somehow connected with the Brazilian territory. The federal courts have exclusive jurisdiction over any lawsuit where the federal government or any of its agencies or quasi-governmental bodies is a party of or has interest in, as well as over cases involving foreign states or international agencies. All labor and electoral courts are also under federal jurisdiction. Nonetheless, the bulk of all private commercial litigation is entertained before the state courts.

Regardless if the lawsuit is filed either before a federal or a state court, parties have a constitutional right to appeal to an Appellate Court. In the state system every State has its own State Court of Appeals. The Federal Appellate System, on the other hand, is comprised by 5 (five) Circuit Court of Appeals.

In a higher layer the judicial structure has 2 (two) superior Courts, which are called "Superior Tribunal de Justiça" (Superior Court of Justice) and "Supremo Tribunal Federal" (Brazilian Supreme Court), both located in Brasília, Capital of Brazil. Broadly speaking, the former has jurisdiction over any case decided by State or Federal Court of Appeals, if the decision rendered by any of these Courts violates any Federal Law. The latter has jurisdiction over Constitutional issues and can also revisit decisions rendered by any Court if the Brazilian Constitution happens to be violated.

Brazil is a civil law jurisdiction and decisions are based on the application of statutory laws. Where there is no specific statutory provision, the courts may decide on the basis of analogy and general uses and practices, or by applying general principles of law. In general, precedents are not binding but tend to be respected by Lower Courts.

All rules of civil procedure are federal and applicable throughout the country, which permits attorneys to practice all over the country. It emphasizes oral testimonies and concentrates much of the evidence-gathering function on Judge's hands. Brazil grants more powers for judges to control the proceedings and to obtain evidence than one normally finds in civil law countries. Hence, discovery is not allowed and attorneys, for instance, cannot privately collect depositions and make requests for admission and questions addressed to the opposing party. In addition, Brazilian system permits an enormous multiplicity of appeals, particularly interlocutory appeals that can delay proceedings for lengthy periods. Finally, all decision are made by Judges and Jury trials are only permitted in crimes committed against someone else's life, such as cases of murder in 1st degree and abortion.

Arbitration

In Brazil, enforcement of domestic arbitration decisions has been provided for by specific legislation since 1996. However, only in 2001 the Brazilian Supreme Court upheld the constitutionality of the Brazilian statute validating contractual arbitration provisions, thus removing lingering doubts in that regard. Arbitration, however, is only permitted with regard to negotiable rights, which comprise most of commercial transactions.

Foreign arbitration awards are also enforceable in Brazil. However, despite the fact that Brazil has ratified the NY Convention on Enforcement of Foreign Arbitral Awards, the foreign arbitration awards must still be ratified by the Brazilian Supreme Court in order to be enforced in Brazil.

II

FOREIGN INVESTMENT

General Rules

Foreign investment has been welcome in Brazil for a long time and constitutes an important source of capital for development of the Brazilian economy. The basic law regulating the matter was enacted in 1962 (Law No. 4131) and was amended in 1964 (Law No. 4390). The stability of the Brazilian foreign investment legislation is a clear indication of the country's desire to attract overseas investors.

Foreign investment is not subject to government approvals or authorizations, and there are no requirements regarding minimum investment or local participation in capital (except in very limited cases such as in financial institutions, insurance companies and other entities subject to the regulating authority of the Central Bank of Brazil). Foreign participation, however, is limited or forbidden in the few areas of activities explained later in this chapter.

The Central Bank of Brazil is the agency responsible for: (i) managing the day-to-day control over foreign capital flow in and out of Brazil (risk capital and loans under any form); (ii) setting forth the administrative rules and regulations for registering investments; (iii) monitoring foreign currency remittances; and (iv) allowing repatriation of funds. It has no jurisdiction over the quality of the investment and cannot restrict the remittances of funds resulting from the risk capital or loan, which are based on a registration with the Central Bank, through its Electronic System of Registration. In the event of a serious balance of payment deficit, the Central Bank may limit profit remittances and prohibit remittances as capital repatriation for a limited period of time. This limitation, however, has never been applied even during Brazil's most difficult balance of payments problems.

Foreign investments in currency must be officially channeled through financial institutions duly authorized to deal in foreign exchange (commercial banks). Foreign currency must be converted into Brazilian currency and vice-versa through the execution of an exchange contract with a commercial bank. Foreign investments may also be made through the contribution of assets and equipment intended for the local production of goods or services.

Foreign Exchange Market

There used to be two official exchange rate markets in Brazil (the commercial and floating rate markets), both of which were regulated and monitored by the Central Bank. The choice of one market or another was mandatory and depended on the nature of the remittance of funds to be made.

In March, 2005 the Central Bank unified both markets extinguishing the differences between them, and enacting more flexible exchange rules. As a consequence, currently remittances of funds in and out of Brazil must flow through one single exchange market regardless of the nature of the payments.

Foreign Investment Registration

Foreign investments in currency or in assets and equipment must be registered with the Central Bank of Brazil. Such registration grants the foreign investor the right to remit dividends and interest and to repatriate the investment.

As of August, 2000, foreign investments in capital must be registered with the Electronic System of Registration of the online data system of the Central Bank of Brazil (*i.e.*, the SISBACEN Data System). As to foreign loans, they also became subject to registration in the Electronic System of Registration of the Central Bank of Brazil, as of February, 2001.

The amount registered with the Central Bank of Brazil as foreign investment includes the sum of (i) the original investment (whether in cash or in kind); (ii) subsequent additional investments (including the capitalization of credits); and (iii) eventual profit reinvestments. This aggregate amount constitutes the basis for repatriation of capital and computation of any eventual capital gain tax, as explained below.

Profit Remittance

Since January 1996, profits paid by a Brazilian company to a foreign investor are not subject to any withholding tax. The foreign currency to be remitted has to be purchased at the exchange market directly from any commercial bank, upon presentation of the corporate act declaring the dividends, the pertinent financial statements, proof of the tax payment and the registration in the Electronic System of Registration of the Central Bank of Brazil, in the Foreign Direct Investment mode. No further approval or consent of the Central Bank is necessary and there is no limitation on the amounts to be remitted if the original investment has been registered with the Central Bank as described above.

Repatriation of Capital

Foreign capital invested in Brazil may be repatriated at any time and there is no minimum period of investment.

Repatriation of the investment within the amount stated in the Foreign Direct Investment mode of the Electronic System of Registration of the Central Bank of Brazil may be made free of any tax or authorization. In principle, any excess over the registered amount will be treated as a capital gain, subject to a 15% withholding tax (such rate is increased to 25% in case of investors residing in tax heavens) and prior (and discretionary) approval of the Central Bank.

In accordance with an unwritten rule of the Central Bank of Brazil, whenever the total or partial repatriation of capital is sought upon the sale of an investment, the book value of the foreign investment (based on the financial statements of the company which received the investment) will be compared against the amount registered in foreign currency. If the book value is lower than the registered foreign investment, the remittance abroad of any amount exceeding the book value may be understood by the Central Bank as a capital gain, and, as such, subject to 15% tax.

Other Forms of Funding Brazilian Subsidiaries

The Brazilian foreign debt challenges, combined with other circumstances, forced the market to find various ways to fund Brazilian companies through note/bond issues and commercial papers placed outside Brazil under private and public placements. In recent years, the Central Bank has authorized a great volume of issues of bonds, fixed rate notes, floating rate notes, commercial papers and fixed or floating rate certificates of deposit, to be traded abroad. Nonetheless, foreign loans with maturity of less than ninety days

are currently subject to a 5% financial transactions tax ("IOF"). Interest paid to foreigners is subject to a 15% withholding tax (such rate is increased to 25% in case of creditors residing in tax heavens). Another source of funding has been the issue of ADRs - American Depositary Receipts and IDRs - International Depositary Receipts.

Restrictions on Foreign Ownership of Companies

Foreign capital may be freely invested in Brazil, and it enjoys the same treatment granted to Brazilian capital, with the few exceptions noted below. There is a strong trend in the Brazilian Congress towards lifting restrictions on foreign investments. Thus, most of the following restrictions are expected to be removed from the 1988 Constitution. Restrictions on mining, telecommunications, oil, coastal, health services and river shipping have already been removed:

- (i) **Property of Rural Land:** purchase of rural land by non-residents requires prior approval for properties with more than 25,000 acres;
- (ii) **Press and Broadcasting:** management by non-residents is forbidden and ownership is restricted to 30% of the total capital of the company; and
- (iii) **Banking and Insurance:** opening of new foreign banks and insurance companies, or of new branches by foreign banks already operating in Brazil is frozen until a new law regulating financial activities is enacted (such prohibition may be circumvented by a presidential decree authorizing the investment).

III

FORMS OF BUSINESS ORGANIZATIONS

There are two main types of companies that are used for most business operations in Brazil: the corporation ("*sociedade anônima*") and the limited liability company ("*sociedade limitada*"), commonly referred to as a "*limitada*".

A *limitada*, which resembles a U.S. Limited Liability Company (LLC), is a company in which the characteristics of each of the partners are given considerable weight and mutual trust. A *limitada* requires at least two partners but all partners have limited liability. All amendments to the company's articles of association require the approval of seventy-five percent (75%) of the capital. It is important to note, however, that the *limitada* is taxed in Brazil on its earnings, whereas an LLC usually is not taxed in the U.S.

A *sociedade anônima*, similar to a U.S. corporation, is a company in which decisions are generally taken by majority vote and in which the management is separate from the shareholders. It is a corporate form usually utilized for ventures capable of gathering concentrations of financial resources from a large number of investors.

A *limitada* offers a number of practical advantages, and this corporate form is recommended if the investor desires simplicity and flexibility in the corporate structure, reduced maintenance costs and the inapplicability of several legal formalities, which are mandatory in the case of a *sociedade anônima*. As a general statement, the *limitada* is usually appropriate in the case of wholly owned subsidiaries, and the *sociedade anônima* form may be preferable for ventures having a larger number or different groups of shareholders. In the event, however, that the company has future plans to issue debentures or other securities, become a publicly held company or admit other groups of investors, then the adoption of the *sociedade anônima* form is mandatory.

Although seldom adopted, there are other types of companies available in Brazil. It is also important to note that some types of Brazilian companies may be structured to qualify as "partnerships" for U.S. tax purposes, thus allowing a greater flexibility in structuring foreign subsidiaries of United States companies.

IV

MERGERS, ACQUISITIONS AND JOINT VENTURES

Structure of Acquisitions

The most traditional structure is the direct acquisition of existing Brazilian companies. The organization of a Brazilian holding company is also a common structure. The holding company then receives the direct investment of the foreign entity and is used as the vehicle for the acquisition and, if necessary, for arranging the funding for it.

As a general rule, the acquisition of Brazilian companies is accomplished under the same mechanisms used internationally. Buyer and seller execute an agreement setting forth terms and conditions of the acquisition, including the usual representations and warranties relating to the business being acquired. The accuracy of these representations and warranties and the general situation of the business are determined prior to the closing through due diligence reviews performed by accountants, lawyers and experts appointed by the buyer.

Letters of intent are also commonly used.

Joint Ventures

Foreign investors may enter into joint ventures with Brazilian parties or with other foreigners. Such joint ventures are usually structured in the form of a *limitada* or a *sociedade anônima*. The rights and obligations of the joint ventures in such companies are regulated by joint venture agreements, articles of association, by-laws, shareholders' agreements, and the applicable corporate law.

V

LABOR ASPECTS

One of the most significant characteristics of the Brazilian labor system is that the laws, to a much greater extent than in the U.S., regulate the details of labor-management relations. Further, the concept of collective bargaining is also very strong in Brazil.

Most of employees' rights are compiled in what is known as the Consolidation of Labor Laws-CLT ("*Consolidação das Leis do Trabalho*"). The basic labor rights granted to employees in Brazil are the following:

- (i) Legal limit of regular working hours: The Brazilian Legislation provides that the working hours limit in Brazil is 44 hours per week or eight hours per day (item XIII, article 7 of the Brazilian Federal Constitution), unless provided otherwise through a convention or an agreement entered into with the relevant labor union;
- (ii) Vacation: Upon completion of each twelve months of work, employees are entitled to a paid vacation of up to thirty calendar days, added by an additional payment equivalent to 1/3 of that amount;

- (iii) Minimum Wage: Employees in Brazil are entitled to a mandatory minimum wages, which is annually adjusted by the Brazilian Government.
- (iv) 13th salary: Employees in Brazil are entitled to an annual gratification, called 13th salary ("13^o salário"), usually paid at the end of the year, on the basis of 1/12 of December remuneration for each month worked in that given year. The employer may pay in advance 50% of the 13th salary amount, whenever the employee enjoys his/her vacation between February and November of the same year;
- (v) Profit/Results participation: Employees in Brazil are entitled to Participation in the profits/results of the company, implemented by a specific program negotiated between employers and employees, as ruled by Federal Law 10.101/00;
- (vi) Overtime pay: Employees in Brazil are entitled to overtime pay of at least 50% of the hourly rate;
- (vii) Maternity leave: Employees in Brazil are entitled to paid maternity leave of 120 days (reimbursed to the employer through Social Security);
- (viii) Paternity leave: Employees in Brazil are entitled to paternity leave of five days;
- (ix) Prior notice period: In cases of dismissal without cause, the employer must grant the employee a prior notice period of dismissal of at least thirty days, which may be worked by the employee or indemnified by the employer; and
- (x) Weekly remunerated rest: Employees in Brazil are entitled to a 24-hours rest for each week of work, preferably on Sundays. There are, of course, certain economic activities which are authorized to work on Sundays, depending on their specific activities. Such authorization is granted by the Labor Ministry.

In addition to the above, Companies are also subject to the following social contributions or charges:

- (i) **Social Security** ("*Instituto Nacional de Seguridade Social*" - "INSS"): 20% to 28.8 % of the payroll must be paid by the company to the INSS; additionally, employees have 8% to 11% of their monthly remuneration deducted from their salaries and collected by the company to the INSS, observed the limits provided by law.

Payment of certain labor-intensive services (e.g., outsourcing, construction) is subject to an 11% withholding tax applied on the total value of the invoice. The withheld amount may be offset against the social security tax to be paid by the provider of the services.

- (ii) **Employment Security Fund** ("*Fundo de Garantia por Tempo de Serviço*" - "FGTS"): every month, an amount equivalent to 8.5% of the employee's monthly remuneration must be deposited by the employer in the employees' Employment Security Fund account at the Federal Savings Bank ("*Caixa Econômica Federal*"). From these 8.5%, 8% is destined to the employee and 0.5% to the government. If an employee is dismissed without cause, the employee is entitled to withdraw the deposits made in the FGTS account during his/her employment relationship with the company. Further, the employer will have to pay a fine corresponding to 50% of the total amount deposited in the employee's Fund account. From these 50%, 40% is destined to the employee and 10% to the government. The Fund is also received by the employee upon his/her retirement.

VI

VISAS AND INDIVIDUAL INCOME TAXATION

Currently, Brazilian authorities maintain a strict immigration policy in defense of Brazilian workers and the Brazilian economy. The Ministry of Labor must give its prior approval to labor contracts with foreigners, and subsequently the Ministry of Foreign Affairs issues visas through Brazilian Consulates. The Ministry of Justice and the National Immigration Council are also sometimes involved.

Permanent Visas

Permanent visas are usually granted to foreigners transferred to Brazil from foreign companies to work in their subsidiaries or affiliates as officers or directors.

The Brazilian company in which the foreigner will occupy a position as a director or an officer must prove that:

- (i) the foreign affiliated company has invested at least US\$ 200,000 paid into the capital stock of the Brazilian company, for each foreign citizen indicated to occupy a position as director or officers in the company; or
- (ii) the foreign affiliated company has invested at least US\$ 50,000 paid into the capital stock of the Brazilian company, or through technology transfer, or through the transfer of other goods estimated in, at least, US\$ 50,000, for each foreign citizen indicated to occupy a position as director or officer in the company. In this case, the Brazilian company must also generate ten new jobs within the two subsequent years as of the foreign director or officer hiring date in Brazil.

Foreigners who are married to Brazilian citizens or have Brazilian children or have a job in Brazil may also apply for permanent residence visa.

Temporary Visas

Temporary visas may be granted for a maximum period of two years to foreigners who will perform scientific or technical functions in Brazil pursuant to an employment contract. For that, the foreigner must prove his/her previous professional experience related to the activities to be developed in Brazil. Such visas are renewable once for an additional two-year period, by authorization of the Ministry of Justice. Thereafter, the bearer of the temporary visa may apply for transformation of his/her visa into a permanent visa, provided all legal conditions are met.

Individual Income Taxation

A foreigner, commencing with his/her arrival in Brazil, in case of a permanent visa, or after the twelfth month of residence, in case of a temporary visa, is considered to be a taxpayer, and is subject to the same income tax laws applicable to other residents of Brazil.

As a taxpayer in Brazil, his/her worldwide income will be subject to Brazilian income taxation. A tax credit may be granted for income taxes paid to other countries, provided that certain conditions are met.

VII

TAXES RELATING TO BUSINESS OPERATIONS

Taxation in Brazil is a vast and complex field, comprising numerous federal, state and municipal taxes. The main taxes are:

- (i) **Federal Taxes:** Corporate Income Tax, Import Duties, Export Tax, Tax on Manufactured Products ("*Imposto sobre Produtos Industrializados*" - "IPI"), Tax on Financial Transactions ("*Imposto sobre Operações Financeiras*" - "IOF"), Social Contribution on Profits ("*Contribuição Social sobre o Lucro*"), Contribution to the Social Integration Plan ("*Contribuição ao Programa de Integração Social*" - "PIS"), Contribution for Financing of the Social Security ("*Contribuição para Financiamento da Seguridade Social*" - "COFINS"), Provisional Contribution on Financial Movements ("*Contribuição Provisória sobre Movimentações Financeiras*" - "CPMF"), and Contribution for Intervention in the Economic Domain ("*Contribuição de Intervenção no Domínio Econômico*" - "CIDE");
- (ii) **State Tax:** Tax on the Circulation of Goods and Services ("*Imposto sobre a Circulação de Mercadorias e Serviços*" - "ICMS"), Tax on Vehicles Property ("*Imposto sobre a Propriedade de Veículos Automotores*" - "IPVA") and Tax on Donation and on Inheritances ("*Imposto sobre Heranças e Doações*"); and
- (iii) **Municipal Taxes:** Service Tax ("*Imposto sobre Serviços*" - "ISS"), Real Estate Transfer Tax ("*Imposto sobre Transmissão Inter Vivos*") and Real Estate Property Tax ("*Imposto sobre a Propriedade Territorial Urbana*" - "IPTU").

Federal Taxes

Corporate Income Tax – There are three methods for the calculation of the Corporate Income Tax, namely: (i) real profit basis; (ii) presumed profit basis; and (iii) arbitrated profit basis.

Until December 1999, companies with foreign capital were required to calculate the Income Tax with basis on the real profit. Such determination was revoked, as of January, 1999, Currently, the rules are the same for both Brazilian and foreign capital companies.

Companies with total gross revenues above approximately US\$ 20,000,000 per year and others named by law must calculate real profits based either on quarterly or annual balance sheets. They are not allowed to calculate this tax based on presumed profits (a method for the calculation of profits based on a percentage of gross revenues).

If the option is made for taxation based on a quarterly balance sheet, payment of taxes will be definitive, and all rules for calculating annual profits will apply to such quarterly profit (rates, additions, provisions, offset of losses, etc.). The income tax, in this case, may be paid in three equal and successive monthly installments or in a single quota in the month subsequent to the quarter.

If the company opts for payment based on yearly profits (the most common and generally adopted system), 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 has accounting evidence that the pre-paid value until that month exceeds the tax value calculated with basis on the real profit.

The tax assessed each month has to be paid until the last business day of the following month.

Contribution for Financing of the Social Security ("*Contribuição para Financiamento da Seguridade Social*" - "COFINS") – Since 1998, this tax was levied on gross revenues from the sale of goods, provision of services, or results of transactions on third parties' account at a 3% rate. As of

February, 1999, the taxable basis was widened to include all gross revenues (including financial income, exchange variation income etc). However, for the determination of COFINS basis, gross revenues do not include canceled sales or services and unconditional discounts, among other values stipulated by law.

As of February, 2004, the rate of the COFINS applicable to most companies that calculate its Corporate Income Tax according to the real profit basis was increased from 3% to 7.6%. Moreover, such contribution became a non-cumulative tax, allowing the taxpayer to discount 7.6% of specific costs and expenses determined by the law (inputs utilized to the manufacturing of goods, electrical energy used in the premises of the legal entity and others).

Some economic sectors, companies that calculate its Corporate Income Tax based on presumed profits, and specific types of revenues are still subject to the cumulative system of the COFINS, at the rate of 3%.

Social Contribution on Profits ("*Contribuição Social sobre o Lucro*") - As of January, 2003, this tax is due at the rate of a 9% on adjusted net profits, calculated monthly or annually (pursuant to an option for income tax made by the taxpayer) and is not deductible from income tax.

Tax on Financial Transactions ("*Imposto sobre Operações Financeiras*" - "IOF") - IOF is a tax levied on general financial transactions (i.e., those involving exchange, securities, credit, gold and/or insurance). IOF tax rates vary according to the nature of the taxable transaction. The tax rate applicable to the remittance⁸ of cash for the purpose of investment abroad is currently 0%.

Contribution to Social Integration Plan ("*Contribuição para o Programa de Integração Social*" - "PIS") - Since 1998, this tax was levied on gross revenues from the sale of goods, provision of services, or results of transactions on third parties' account at a 1.65% rate.. As of February, 1999, the taxable basis was widened to include all gross revenues (including financial income, exchange variation income, etc). However, for the determination of the contribution tax basis, gross revenues do not include canceled sales or services and unconditional discounts, among other values stipulated by law.

As of December, 2002, the rate of the PIS contribution applicable to most companies that calculate its Corporate Income Tax according to the real profit basis was increased from 0.65% to 1.65%. Moreover, such contribution became a non-cumulative tax, allowing the taxpayer to discount 1.65% of specific costs and expenses determined by the law (inputs used to the manufacturing of goods, electrical energy used in the premises of the legal entity and others) .

Some economic sectors, companies that calculate its Corporate Income Tax based on presumed profits, and specific types of revenues are still subject to the cumulative system of the PIS contribution, at the rate of 0.65%.

⁸ Will the Fund be "remitting" cash for investment purposes? What does this mean? This information is not necessary in this case.

Provisional Contribution on Financial Transactions (“*Contribuição Provisória sobre Movimentações Financeiras*” – “CPMF”) - This is a contribution levied, as a general rule, on the transfers of financial assets within the organized Brazilian financial system (financial institutions). The amount due as CPMF is debited in the account of the holder of the financial asset and paid directly by the financial institution to the government.

The CPMF is, in principle, a contribution with a temporary life, that will be charged at the rate of 0.38% up to December 31, 2007.

Contributions for Intervention in the Economic Domain - CIDE (“*Contribuições de Intervenção no Domínio Econômico*” – “CIDE”) – Based on the Brazilian Federal Constitution, the government has created several contributions for intervention in the economic domain (CIDEs), namely:

- CIDE for the Universal Telecommunications Service Fund (FUST);
- CIDE on remittances abroad of royalties and payment of services;
- CIDE levied on the importation and marketing of petrol, oil products, natural gas and its byproducts, ethylic alcohol and ethylic alcohol fuel;
- CIDE for the Development of the Cinematographic Industry; and
- CIDE to the Telecommunications Technological Development Fund – FUNTTEL.

Import Duty - As a general rule, all imports are subject to the Import Duty, as well as the IPI and the ICMS, whether the imports are carried out with or without exchange coverage. Imports from other member countries of the Southern Common Market (“MERCOSUL”, as it is called in Brazil or “Mercosur”, as it is called in the Spanish-speaking countries) are free of Import Duty, as long as the imported item has a certificate of origin from one of the country members. The other members are Argentina, Uruguay, Paraguay and Venezuela. Chile, Ecuador, Peru and Bolivia are associate members and are part of the free-trade area, but they maintain their respective systems of customs duties. The Import Duty is calculated on the total CIF value of the import, as long as the price of the product is in conformity with the customs valuation rules of Chapter VII of the GATT of 1994. Import Duties are charged based on the tariff classification of the product in the TEC/SH (Foreign Common Tariff – Harmonized System). MERCOSUL has allowed its members to have an “exception list” of products that may have different import duty rates for limited period of time.

Brazil is a member of the World Trade Organization/GATT and follows the WTO standards for tax classification (Harmonized System), customs valuation, dumping, subsidy, *etc.*

Export Tax – Only a few products are subject to the export tax, such as (i) raw hides and skins of bovine (including buffalos), equine, sheep or lambs animals; (ii) cigarettes containing tobacco (when exported to the Caribbean, Central and South America); (iii) weapons and ammunition (when exported to South America exception made to Argentina, Chile and Ecuador and Central America, including the Caribbean Islands). The tax is calculated on the export price of the goods.

IPI - This tax is similar to an excise tax. It is levied on most manufactured products, whether made in Brazil or imported. Although the IPI is ultimately passed on to the final consumer, it is charged on each production step or phase of independent manufacturers.

The IPI is usually levied *ad valorem*. The rates are based on the type of product. The IPI is a value-added tax. A tax credit is allowed for the tax that has been paid in the purchase or importation of the raw material and components that are used in the manufacturing process of the product to be taxed. In the case of imported products, the IPI is calculated on the customs value, plus the import duty.

State Taxes

ICMS - ICMS is a value-added tax. It is levied on imported and domestic products at the time the goods leave the business premises. The ICMS due on each transaction is based on the price of products sold and a tax credit is granted for ICMS paid on the purchase or importation of the products, as it is for the IPI.

Currently, ordinary rates in the State of São Paulo are 12% on transportation services, 18% on products imported, sold or transferred within the State, and 25% on communication services. Other rates may also apply depending on the specific product, service or State in which the transaction occurs. Rates may also vary for interstate transactions: they are usually 12% but can be 7% depending on the State of destination; the rationale is the following: the more developed the State, the higher the rate.

The ICMS is also imposed on interstate and inter-municipal transportation services and communications services.

ITCMD – The Tax on Donation and on Inheritances is levied on the transfer of personal assets or rights resulting from legal or testamentary inheritance and donations. Rates vary from 1% to 8% of the fair market value of the transferred asset or right.

Municipal Taxes

ISS - The ISS is a municipal tax levied on all professional, commercial and industrial services, except those subject to federal taxation through the IPI, or those covered by the ICMS. Rates vary from 2% to 5%, according to the Municipality.

Real Estate Transfer Tax (Imposed on Transfers for Value) - This tax is assessed on property transfers at a progressive rate, which varies depending on the value of the property on all transfers for value, of any nature, except in the case of contribution to the capital of companies

Real Estate Property Tax. - The real estate property tax is a municipal tax levied annually at a 1% rate on the appraised value of real estate; rates vary in each Municipality.

It is important to mention that there is a tax reform underway, which may change several aspects of tax law in Brazil.

VIII

FOREIGN TRADE

Foreign trade is under the direct control and jurisdiction of the federal government. The agency in charge of this area is the Foreign Commerce Secretary ("*Secretaria de Comércio Exterior*"- "SECEX").

As mentioned above, Brazil is a signatory of the WTO and is a member of the Latin American Integration Association ("ALADI"). Brazil has also signed the Treaty of Asuncion that created MERCOSUL with Argentina, Paraguay, and Uruguay (presently includes Venezuela and Chile, Bolivia, Peru and Ecuador as associated members) which formalized the objective of integration of the economies of the signatory countries. The main goal of MERCOSUL is to stimulate trade and foreign investments among its members.

Imports

Import operations are carried out in Brazil by means of electronic registration of the operation with the Integrated System of Foreign Trade ("*Sistema Integrado de Comércio Exterior*" - "SISCOMEX"). The licensing for the import operations will either be automatic with the registration of the

operation with SISCOMEX (after arrival of the goods) or non-automatic (registration of the operation depends on licensing prior to the shipment of the goods abroad).

An extensive list of items is subject to the non-automatic licensing: (i) imports under drawback; (ii) imports subject to restrictions or tax benefits; (iii) items subject to similarity exam; (iv) used material; (v) imports made under a financial or operational licensing; and (vi) imports made without exchange coverage (capital investment, donation, *etc.*).

As a general rule, all imports are subject to Import Duty, IPI, and ICMS, PIS and COFINS whether carried out with or without exchange coverage. The Import Duty rate for machinery and equipment not produced locally may be reduced to 2% upon request of the importer to the competent authorities.

Exports

Any company organized in Brazil may carry out export operations upon registration as the exporting company with SECEX. Industrial companies, commercial exporting companies ("CECs"), and trading companies are among the types of companies eligible for registration. Registration of industrial companies and CECs is very simple, and no prior export experience is required. Registration of a trading company is complex, requiring the fulfillment of several conditions.

As mentioned earlier and as a general rule, exportation of goods is free of taxes, subject only to the necessary export registration with the SISCOMEX. The exportation of certain products, however, is prohibited (*e.g.*, native animals, native animals' skins and works of art older than 100 years, antique books, red and pard honey and military equipment to few specific countries). The export registration is the mechanism through which SECEX regulates all exports and ensures an acceptable sales price, collection of export taxes, compliance with export programs, *etc.* By and large, securing an export registration is a mere formality in most cases, and in some cases, it may be obtained after the actual exportation.

Commissions to foreign agents are permitted and may be deducted from the export invoices. Nevertheless, except for very specific cases and at SECEX's discretion, the payment of commissions to legal entities affiliated to the Brazilian exporter will not be permitted.

Export Tax Incentives

The main export tax incentives are:

- (i) **Withholding Income Tax** - As a general rule, any payments made to non-resident foreigners are subject to a withholding tax. To stimulate exports, some payments are exempted from the tax.
- (ii) **IPI** - The IPI legislation presently provides for two kinds of incentives for exportation of industrialized products: exemption of IPI and non-reversal of booked IPI credits;
- (iii) **ICMS** - The export tax incentives in the ICMS area consist of an exemption of ICMS and non-reversal of ICMS booked credits corresponding to the tax paid for the acquisition of raw, intermediate and packaging materials used to manufacture the exported products;
- (iv) **IOF** - Export operations are not subject to IOF;
- (v) **COFINS** - Contribution for the Financing of Social Security. This contribution is levied on the monthly gross revenue of Brazilian companies at a 7.6% rate. Pursuant to the Constitutional Amendment nº 33/01, exports are exempted from this contribution;

- (vi) **PIS** – Social Integration Program - This contribution is levied on the monthly gross revenue of Brazilian companies at a 1.65% rate. Pursuant to the Constitutional Amendment nº 33/01, exports are exempted from this contribution;
- (vii) **Drawback** - The drawback special regime allows various tax benefits with respect to imports that are used in the manufacture or packaging of exported products. Goods imported under this regime have the Import Duty and IPI tax payments suspended and there are no taxes applied if the goods in which the imported material/components were used are duly exported. An exemption from ICMS is granted by the state legislation.

Export Financial Incentives

The main kinds of financing available for exportation are:

- (i) With funds from the Export Financing Program ("*Programa de Financiamento às Exportações*" – "PROEX") operated by the Bank of Brazil ("*Banco do Brasil*") as the financial agent of the federal government;
- (ii) With funds from banks authorized to operate with foreign exchange, from the National Bank for Economical and Social Development ("*Banco Nacional de Desenvolvimento Econômico*" - "BNDES"), from the Special Agency for Industrial Financing ("*Agência Especial de Financiamento Industrial*" - "FINAME"), and from financial institutions located abroad, including branches of Brazilian banks.
In these cases, the equalization of the interest rates (the difference between the maximum reference rate admitted by the Central Bank of Brazil and the interest rate of the financing for exportation of domestic services and assets) will be carried out with PROEX resources; and
- (iii) With the exporter's own resources or with resources from third parties, without the use of federal funds.

IX

INVESTMENT INCENTIVES

ADENE Area

Investment within the area of the Northeastern Brazil through the relevant agency ADENE ("*Agência de Desenvolvimento do Nordeste*") may be done through an investor's own project or through a third party's project.

Industrial and agricultural companies seeking to establish a business venture in the ADENE area must submit a proposal to ADENE, which, after approval, will entitle them to the following financial and tax incentives:

- (i) Financial support of the Northeast Investment Fund ("*Fundo de Desenvolvimento do Nordeste*");
- (ii) Income Tax reduction;
- (iii) Import Duties and IPI exemption or reduction in imports; and
- (iv) State and municipal incentives.

Legal entities are allowed to invest a portion of their corporate income tax in shares of the Northeast Investment Fund instead of making payments to the federal government. Said Fund will then invest in the subscription of shares of companies installed in the ADENE area. A legal entity or group of legal entities that individually or jointly control the voting capital of a company located in the ADENE area may allocate its income tax reduction as investment to such controlled company.

ADA Area

Investment in the area of the Amazon Development Agency - ADA (*"Agência de Desenvolvimento da Amazônia"*) is quite similar to that in the ADENE area. ADA is located in the Northern area of Brazil, primarily in the Amazon area, with the financial support of the Amazon Investment Fund (*"Fundo de Desenvolvimento do Amazônia"*).

Manaus Free Zone

It is possible for any company to establish an affiliated company in the Manaus Free Zone, which may benefit from an exemption of the Import Duty on the importation of goods for the internal consumption at the Free Zone and for any level of industrialization and on the storage of imported goods that are subsequently exported.

Depending on a prior approval of a specific project with SUFRAMA, it is also possible to import raw material and parts and components without the payment of the import duty and IPI, provided that said goods be used in the manufacture of the products indicated in the manufacturer's project in accordance with the basic productive process established by the competent tax authorities for said products. When the final product leaves the Manaus Free Zone to be traded into de country the import duty due for the importation of the raw material, parts and components shall be paid with an 88% reduction.

Tax Incentives for Technological Development

Programs for Industrial and Technological Development ("PDTI") provide the following tax incentives for the technological development of companies:

- (i) Reduction of the income taxes due, subject to the limitations established in the regulation;
- (ii) Exemption of IPI on the purchase of equipment, machines, devices, instruments and their accessories, spare parts and tools destined to research and technological development;
- (iii) Accelerated depreciation for income tax purposes, subject to conditions, for new equipment, devices, and instruments to be used in research and technological development;
- (iv) Accelerated amortization (on an annual basis) of expenses incurred for the acquisition of intangible assets, provided those assets were acquired for the exclusive purpose of industrial research and technological development and are booked in the accounting books in accordance with the regulation;
- (v) A credit for the income tax withheld at the source and reduction of the IOF due on amounts paid, remitted or credited to beneficiaries residing or domiciled abroad, as well as for royalties for technical or scientific assistance or for services; and
- (vi) Deduction of royalties for scientific or technical assistance, in the form and subject to the limitations provided for in the regulations.

According to the applicable regulations, the goal of PDTI is to enhance the technological capacity of companies to generate new products or processes or to improve characteristics through the execution of its own programs of research and development, or agreements with research and development institutions, managed by the company through a permanent structure of technological management.

X

ANTITRUST LAW

The Brazilian Antitrust Act, Law No. 8,884 (the “Act”) of 1994, is the main statute governing competition issues in Brazil. The governmental agency responsible for the administration of the Act is the Administrative Council for Economic Defense (“CADE”), a federal independent agency linked to the Ministry of Justice. CADE is assisted by two secretariats: the Secretariat of Economic Law (“SDE”), reporting to the Ministry of Justice, and the Secretariat of Economic Monitoring (“SEAE”), reporting to the Ministry of Finance. Together these three agencies constitute the Brazilian System of Competition Defense (“SBDC”).

The Act applies to all individuals and legal entities that carry out business within the Brazilian territory and also to those abroad, to the extent that their conducts may produce effects in the Brazilian market.

Violations to the Economic Order

The Act provides general rules to identify violations to the economic order and includes a broad “rule of reason” according to which a conduct which distorts competition or free enterprise is not unlawful *per se*, but when it could, even potentially: (i) limit, restrain or in any way injure competition or free enterprise; (ii) control a relevant market of a certain product or service; (iii) increase profits on a discretionary basis; or (iv) constitute an abuse of a dominant position in a certain market. Therefore, conducts are analyzed on a case-by-case basis.

Examples of the most common conducts that may constitute a violation to the economic order, in case they may produce any of the effects mentioned in the item above, even if they are not achieved, are: (i) Price Fixing; (ii) Territorial and clients' base restrictions; (iii) Exclusivity Agreements; (iv) Refusal to deal; (v) tie-in arrangements; (vi) price discrimination, among others. Please note that the Act provides only an exemplification of the conducts that may constitute violations to the economic order.

The violations to the economic order must be investigated in an administrative proceeding and CADE is the responsible agency for the issuance of a final decision regarding the case.

The Act provides for several penalties which include: (i) fines from 1% to 30% of the gross revenue registered by the company in the previous year; (ii) fines that range from approximately US\$ 2,500 (R\$ 6,000) to US\$ 2,500,000 (R\$ 6,000,000), depending on the infraction; (iii) obligation to publish CADE’s decision in a well known newspaper; (iv) ineligibility for official financing or participation in bidding processes; (v) inscription of the violator on the Brazilian Consumer Protection List; (vi) recommendation to the proper public agencies to grant compulsory license for patents held by the violator; and (vii) the company's spin-off, transfer of corporate control, sale of assets, partial discontinuance of activities, or any other measure required for such purposes.

Economic Concentrations

The Act provides that all acts of concentration (regardless of the legal form this act may take (merger, acquisition, joint venture, etc)), whether or not against the economic order be submitted to the SBDC in the event that:

- (i) it results in the control of a market share in excess of twenty per cent (20%) of a given market to be considered either individually or combined; or
- (ii) any of the entities involved in the transaction or the respective "group of companies" to which they belong (including the resulting entity or combined transaction) had gross revenues in Brazil during the preceding fiscal year in excess of R\$ 400 million (approximately US\$138 million).

In this regard, it is important to point out that the current legislation does not clearly specify that the relevant amount is just related to Brazil and, in the past, CADE understood that the amount should be considered as the result of the worldwide operation of the companies. However, based on a judgment session held on January 19, 2005, regarding the analysis of ADC Telecommunications Inc.'s acquisition of Krone Digital Communications Inc., the CADE Board decided that transactions that do not involve applicants and/or economic groups with gross sales, in Brazil, in excess of R\$ 400,000,000, do not need to be submitted. CADE's Board has also decided to implement this new interpretation as a rule, therefore, an extract was issued regarding CADE's prevailing case law with respect to the interpretation of the turnover criteria set forth in the Act. Because of that, as of January of this year CADE has dismissed the judgment of any case that does not meet the "Brazilian gross sales threshold"; however this could still change.

The Act's criterion is objective and autonomous, if any of the conditions above are met, the transaction must be notified. The Act does not provide for a *de minimis* exemption like other legislations. The notice must be submitted to the SBDC within fifteen business days as of the "occurrence thereof". Currently, CADE's position is that the triggering event to notify is "the execution of the first binding document" in the transaction. CADE is very strict regarding this issue and repeatedly imposes fines for extemporaneous notifications.

Once the transaction is submitted, the SEAE analyzes the case and issues a report regarding the economic aspects of the transaction; secondly the SDE analyzes the legal aspects of the transaction also issuing a report. Upon such analysis, both non-binding reports are sent to CADE for its analysis and approval of the transaction.

CADE can basically render three different decisions regarding the transaction in question: (i) approve it with unconditional clearance; (ii) disapprove it; or (iii) approve it upon the satisfaction of certain conditions.

XI

INDUSTRIAL PROPERTY RIGHTS

General

Industrial property rights in Brazil cover trade and service marks, certification marks and collective marks, patents of invention and utility model patents, technology transfer, industrial designs, franchising, technical and scientific services, protection of unfair competition and other rights following the definition of "industrial property" introduced by the Paris Convention.

Industrial property is mainly regulated by the Brazilian Industrial Property Law (Law No. 9279 of 1996), the Paris Convention and its Stockholm Revision and by several norms issued by the National

Institute of Industrial Property ("*Instituto Nacional de Propriedade Industrial*" - "INPI"), and the Central Bank of Brazil. The Industrial Property Law No. 9279 of 1996, which entered into force on 15 May 1997, consolidated the various rules governing the subject and introduced changes to the current protection of industrial property rights in Brazil.

The INPI is the federal agency in charge of regulating and registering patents and trademarks, as well as of approving licensing agreements and any other agreements involving industrial property rights as mentioned above.

Trademarks

The protection of trademarks in Brazil is obtained by registering the trademark with the INPI. Law 9279, however, introduced an exception to this rule: for well-known trademarks, including service marks. Special protection is granted for well-known trademarks, regardless of whether or not they have been registered in Brazil. This provision is aimed at protecting from piracy holders of well-known trademarks that are registered outside of Brazil, but not in Brazil. It also reinforces the protection of Article 6 *bis* of the Paris Convention which has long granted protection for well-known trademarks regardless of their registration.

Registration of a trademark is valid for a period of ten years, and is renewable for successive ten-year periods. A trademark's registration may be cancelled if it is not used for five years from the date of its registration, or if its use is interrupted for more than five consecutive years.

Tradenames in Brazil are not governed by the Industrial Property Law, and, therefore, are not subject to registration with the INPI. Tradenames are regulated by the Paris Convention, which grants protection to the owner of a trade name in all signatory countries, without filing or registration obligation, as well as by specific regulations issued by the National Department of Commerce Registry ("*Departamento Nacional do Registro do Comércio*") which require the registration of trade names with the Commercial Registry. Registration at Commercial Registry grants protection at state level. If protection is required for the entire country, application for registration in each state will be required. The protection of tradenames in Brazil is now also regulated by the new Civil Code in force since January 11, 2003.

Trademark Licensing Agreements

Trademarks may be the subject of a licensing agreement if they are duly registered or in the process of registration with the INPI in the name of licensor.

Patents

Patent protection is obtained by registering the patent with the INPI. The registration is valid for a period of twenty years, if related to inventions, or fifteen years, if related to utility models, both as of the filing date of the patent. The patent holder must use the patent within three years from the grant date in order to avoid the loss of the patent rights.

Patent Licensing Agreements

Patents may be the subject of a licensing agreement if they are duly registered with the INPI or in the process of registration in the name of licensor.

Technology Transfer

Technology in Brazil is defined as know-how not protected by a patent. The basic concept of the Brazilian rules with regard to the use of technology by a Brazilian party has been, since 1975 due to the former (and revoked) INPI Normative Act 15, that technology is subject to a "transfer" to a Brazilian party

rather than to a "license". In other words, technology may be "sold" but not "licensed". In consideration of the "sale", the supplier may be entitled to certain fees during the term of the agreement, but the recipient should be free to use the technology after the expiration of the agreement.

Technology Transfer Agreements

The INPI has traditionally approved technology transfer agreements for a five-year period. The payment of fees as well as the deduction thereof for tax purposes is restricted to the five-year period of the agreement (see Article 354, § 1º of the Income Tax Regulation instituted by Decree N° 3,000/99) Such term may be extended for an additional period of five years upon INPI's approval and authorization from the National Monetary Council.

Franchising

Franchising is defined as a system by which a franchisor grants to a franchisee the right to use a trademark or patent, along with the right to the exclusive or semi-exclusive distribution of products or services and, possibly, also the right to use the technology of implementation or management of related business or operational system developed or retained by the franchisor.

Law No. 8955, enacted in 1994, known as the Franchising Law, regulates the terms of a franchising agreement in a generic way, clarifying the relationship between franchisor and franchisee. This legislation created what is called the "Franchise Offer Circular". This document discloses, to the potential franchisee, a more-detailed description of the franchise in which franchisee intends to engage, as well as information about the franchisor, both of which are crucial elements for the franchisee to consider whether or not to engage in the business investment.

A franchisee may cancel the franchising agreement even after it is signed if the Franchise Offer Circular procedure is not observed.

Franchising Agreements

Franchising agreements executed between a local franchisee and a foreign franchisor must be registered with the INPI to receive the benefits described below, if they contain trademark licenses, technical assistance, and/or other forms of technology transfer that would be necessary for the attainment of the objectives of the agreement.

Registration

As a general rule, agreements relating to industrial property rights must be approved by and registered with the INPI for the following purposes:

- (i) Remittance of royalties abroad, in which case the agreement must also be registered with the Central Bank;
- (ii) Deductibility of payments as operational expense for Brazilian income tax purposes; and
- (iii) Enforcement of the obligations *vis-à-vis* third parties.

IRF

Royalties or fees remitted abroad as payment under agreements regarding industrial property rights are subject to a withholding income tax. If the agreement registered with the INPI so provides, the Brazilian law allows the amount of royalties remitted abroad to be "grossed up", resulting in a higher effective income tax rate.

The agreement must establish which party shall bear the IRF. The Brazilian party will always be responsible for withholding the IRF at source on behalf of the party that will receive the payments.

Contribution for Intervention in the Economic Domain

As of January 2001, technology transfer payments to non-residents of Brazil are subject to a new tax ("CIDE"). For the purpose of this tax, technology transfer includes patent and trademark licenses, transfer of technology, know-how and technical assistance. While the income tax withheld at source is a burden of the beneficiary of the royalty payment, the new tax is an obligation of the Brazilian payer.

The new tax rate is 10%. However, for payment of royalties there is a provisory measure that provides a special credit to offset future payments of the new tax after the first payment is made, at progressively reduced levels as from 2001 until 2013.

XII

ENVIRONMENTAL CONTROL

Historically, Brazilian regulations aimed at environmental protection were elaborated in order to address the different spheres of economic activities in the country. Consequently, we had regulations regarding the use and exploitation of core natural resources such as Forests (Brazilian Forestry Code - Law 4771/65); Minerals (Mining Code – Law Decree 227/67); Fisheries (Law Decree 221/67); Hunting in general (Hunting Code - Law 5197 / 67), Water Usage (Water Code - Decree 24643/34) and National Policy for the use of water resource. Several states have adopted legislation to further regulate the use of water resource. imposing payment compensation for such use.

The development of environmental concerns worldwide and the enactment of numerous international agreements resulted in a growing consciousness in Brazil bringing about the adoption of a National Policy Law for the Environment (Law 6938/81), which was furthermore crowned with the approval in the Brazilian Federal Constitution of 1988 itself of a whole chapter addressing environmental issues. One might be able to state that the environmental protection as it is mirrored in legislation countrywide was ultimately consummated with the enactment of the National Environmental Criminal Law (Law 9605/98).

At present, regulations regarding environmental protection in the country abound. They range from nuclear-damage penalties to coastal-management rules or from the creation of conservation units to the requirement to implement environmental-education systems in schools, among others. Besides, both the states and the municipalities all over the country are empowered to implement their own regulations regarding environmental protection and the use of the natural resources at the regional and local levels respectively.

With regard to industrial activities, applicable regulations generally require obtaining environmental permits *prior* to the commencement of a company's activity. Likewise, the competent authorities may decide on the need for a company to present an Environmental Impact Assessment before its activity can be implemented. As to pollution control systems, they are implemented to a greater extent in largely industrialized centers like the states of São Paulo and Rio de Janeiro. Both the lack of environmental permits and the act of polluting might be deemed criminal acts.

Two more national rules are worth mentioning: strict liability and joint liability. The general provisions concerning environmental liability in Brazil provide for strict liability, *i.e.*, the sanctions are imposed regardless of guilt (negligence). Joint liability will be mostly acknowledged in circumstances of outsourcing the transportation and final disposal of waste/residues.

Recent federal regulations establish liability of the manufacturers of batteries and tires for the final disposal after the end of the life cycle of the respective products. There are indications that such type of liability will be imposed on a regulatory level on other industries and activities as well.

Finally, it should be mentioned that Brazil is a party to numerous multilateral environmental agreements such as the Climate Change Convention, the Biodiversity Convention, the Basel Convention on the Movement of Hazardous Waste, the Montreal Protocol, and UNCLOS, among many others. Rules reflecting such agreements are being enacted at the national level so as to comply with relevant international obligations.

Attention

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