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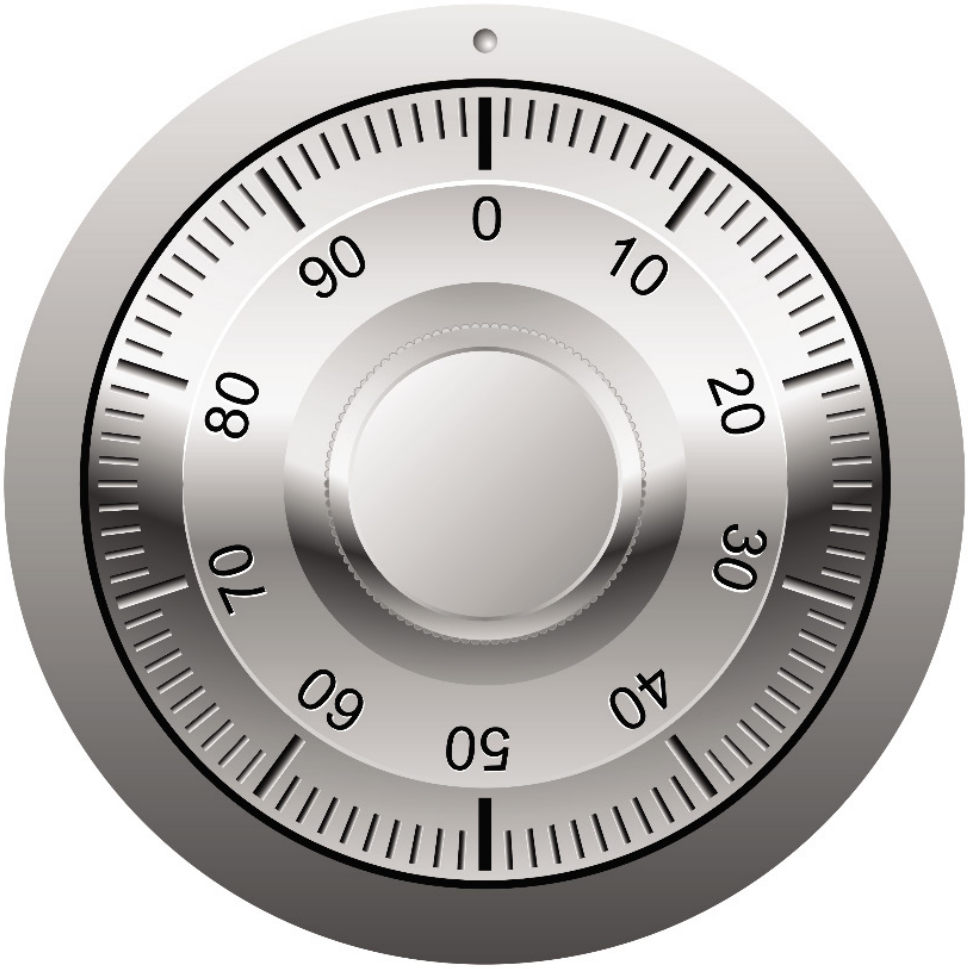

Upstream Guide

Corporate Tax

Deloitte Brazil

Contents

Corporate income tax (IRPJ) and social contribution on profits (CSLL)

Brazilian income tax rules apply uniformly to all Brazilian legal entities, irrespective of the form of association

The taxable income is determined pursuant to the law in effect on the date of the tax-triggering event. There are three taxation regimes: taxable income ("lucro real"), deemed income ("lucro presumido") and arbitrated income ("lucro arbitrado").

Brazilian Oil and Gas companies are subject to the general income tax regimes. Brazilian tax law does not provide for ring-fencing, field based taxes, and specific tax rates. Profits and losses from oil and gas activities can generally be offset against profits and losses from any other business activity of the oil and gas company.

IRPJ (Corporate Income Tax) and CSLL (Social Contribution on Net Profit) are levied on corporate entities´net income. IRPJ rate is 25%, 15% of which are levied on the overall annual adjusted profit, whereas a surtax of 10% is levied on the amount exceeding BRL 240,000.00. CSLL is levied at 9% over adjusted net profit.

Their overall combined rate amounts to 34%. For the purposes of this guide, the term corporate income tax will refer collectively to both taxes.

Taxation methods

Taxable income method ("lucro real")

Under the taxable income method, the taxable income corresponds to the statutory pre-tax net income adjusted by non-deductible (add-backs) and non-taxable items (exclusions), temporary or permanently. Pre-tax net income is to be determined pursuant to the precepts of local commercial law (BR GAAP, now mostly aligned with IFRS). This method is mandatory for any entity matching certain conditions listed by the ruling legislation, amongst which:

- Total revenues in the previous calendar year exceeding BRL 78,000,000.00 or proportional to the number of months during which the entity was operating in a given fiscal year, if shorter than twelve (12) months;
- Financial institutions, insurance companies and other similar financial entities;
- Companies that have income, profit or capital gains from foreign sources;
- Companies that are granted with tax incentives involving exemption from or reduction of income tax.

The taxable income method allows the taxpayer to calculate the income tax on a quarterly basis or on an annual basis. Taxpayers must elect either one of the procedures in January of each calendar year and are not allowed to change from one procedure to another throughout the course of any given year.

If the annual basis is selected, the taxpayer will be required to make monthly advance payments. The taxpayer is then entitled to offset the end of fiscal year tax payable with monthly advance payments.

Taxpayers must make monthly payments using one of the two methods:

- Gross revenues method ("receita bruta e acréscimos"), which is calculated through the application of percentages - pre-determined in the legislation - over revenues earned in a given month; or
- Suspension and reduction method ("suspensão e redução"), which derives from the entity's profit accrued according to the Brazilian GAAP, calculated on a year-to-date basis and adjusted by the add-backs and exclusions provided in the tax law.

The taxable income method is the most prevalent in the Oil and Gas sector, inasmuch as it allows for the offsetting of NOLs derived from exploration costs against income earned in future taxable periods, as well as deduction of costs incurred in one field against income from another.

The taxable income method also allows taxpayers to capitalize development costs and amortize them during the hydrocarbons production phase.

Deemed income method ("lucro presumido")

Corporate entities that are not obliged to adopt the taxable income method are entitled to elect the deemed income method, a simplified tax system for determining the tax base of income tax and social contribution. By this methodology:

- The election is definitive for the entire calendar year and it is formalized through the payment of the first installment or lump-sum payment of the tax due corresponding to the accrual period of each calendar year;
- IRPJ and CSLL are due quarterly;

- Taxable income is based upon a percentage of gross revenues accrued in each quarter.

Gross revenues are understood as the result of the sales of goods or products, from the price of the services rendered and for the income earned on transactions for third parties, with the following exclusions applying:

- Sales cancellations and returns of merchandise;
- Unconditional discounts granted;
- Federal Tax on Industrialized Goods (IPI) and Reverse Charge State Value-Added Tax on Circulation of Goods and Services (ICMS-ST) levied on sales.

The ratios applicable to the gross revenues derived from a company's activity are as follows:

revenue triggering activity	percentages applicable to gross revenues
Resale of petroleum, alcohol and natural gas-derived fuel for consumption	1.6%
Sale of goods or products (except those cited above)	8%
Services performed exclusively by companies with annual gross revenues lower than BRL120,000.00	16%
Services in general, except those with specific percentages	32%

The figures obtained, based on the table above, must be increased by capital gains and other gains accrued during the quarter, such as:

- Capital gains (profits) accrued on the sale of permanent assets (investments and fixed assets);
- Earnings from investments in fixed income instruments and equities;
- Interest on capital invested that has been paid or credited by another corporate entity in which the company is a shareholder or stockholder;
- Revenues from rental agreements when the lease of the asset is not part of the activities engaged in the company's stated corporate purpose;
- Financial discounts obtained;
- Assets monetary variations;
- Profits, earnings and capital gains obtained outside Brazil;

In the case of a company engaged in diversified activities, the relevant percentages contained in the table above have to be applied to the gross revenues from each activity.

Taxpayers are allowed to deduct from the IRPJ due the withholding income tax (IRRF) credits collected during the quarterly tax period.

The deemed income margin for CSLL is twelve per cent (12%) of the cited gross revenues for the quarter for most activities, except for service provision, for which the deemed income margin is 32%.

It is not usual for companies that operate in the upstream oil and gas industry in Brazil to adopt the deemed income calculation method, since it restricts the deduction, for IRPJ and CSLL purposes, of costs and expenses incurred in exploration and development phases, as explained earlier in this guide.

Arbitrated income method ("lucro arbitrado")

Arbitrated income is used by the taxpayer or determined by Federal Revenue when deficiency related to compliance of the requirements to Brazilian federal and local bookkeeping is detected.

Under Brazilian Income Tax Regulations, the IRPJ and CSLL due by the corporate entity will be arbitrated in the following cases:

- A company is subject to taxation based on taxable income method, but does not keep appropriate bookkeeping records as provided in commercial and tax laws or fails to prepare and publish the financial statements required by the tax legislation;
- The bookkeeping records that the company is required to maintain reveal obvious attempts of fraud or contain such an extent of flaws, errors or deficiencies that they are rendered useless in terms of:
  - Identifying the effective financial turnover or account transactions, including in the company's bank account, or
  - Determining the taxable income;

A corporate entity, amongst others:

- Fails to present to the Tax Authorities the commercial and tax bookkeeping records and documents (if it is subject to the Taxable Income method) or Cash Book (if it has elected taxation based on Deemed income method and does not maintain commercial bookkeeping records);
- Has incorrectly elected deemed income method, when it was obliged to adopt the taxable income method;
- Does not keep its General Ledger in an orderly manner and according to recommended accounting rules.

The arbitrated income method is not very frequently a taxpayer's option (especially in the case of companies engaged in oil and gas exploration and production activities) and its adoption by taxpayers that have conditions to assess their IRPJ and CSLL using the taxable income method may be subject to questioning by tax authorities.

Nevertheless, this should serve to encourage rapt attention to those aspects involving the maintenance of an orderly and up-to-date set of commercial and tax bookkeeping records, as the income tax due based on this method is likely to be higher than the tax due based on the other methods abovementioned.

Tax implications derived from the IFRS convergence

Between calendar years 2010 and 2015 (2014 as an option), a Transitional Tax Regime - "RTT", (introduced by Law 11,941/09 and repealed by Law 12,973/14)

had been implemented to neutralize the tax implications derived from the changes introduced to Brazilian Corporate Law with regards to its convergence with the IFRS rules.

Fiscal neutrality enabled by the RTT meant that no adverse tax consequences were to be triggered from the adoption of the new accounting criteria in connection with the recognition of revenues, costs and expenses computed on the assessment of net profits.

The RTT was repealed as of 1 January 2015, but an early adoption election could have been made by the taxpayers, whereby the new provisions were effective as of 1 January 2014. According to the new tax rules, companies must now calculate the taxable income based on the new accounting rules determined under the new Brazilian GAAP, which are mostly aligned with the IFRS rules.

1. Corporate income tax (IRPJ)

Relevant aspects applicable to companies in the Oil and Gas industry

As previously mentioned, the vast majority of companies operating in the oil and natural gas exploration and production industry adopt the Taxable Income method. Therefore, the comments that follow will focus mainly on the aspects applicable to this Corporate Income Tax calculation method.

Under Brazilian income tax regulations, Taxable Income – the income tax base – is defined as the net income for the accrual period adjusted by the add-backs, exclusions or offsets prescribed or authorized by the tax legislation.

Net income for the period corresponds to the sum of operating income, non-operating income and profit sharing, and is to be determined pursuant to the precepts established by the Brazilian commercial law. Net income accrued by the taxpayer according to the Brazilian GAAP is subject to certain adjustments to reach the taxable income. Such adjustments relate to add-backs to and exclusions from taxable income as set forth in the tax law.

Simplified computation of the taxable income as per the Taxable Income method is demonstrated below:

Description	Income
Net income before income taxes	100
(+) Add-backs	30
(-) Exclusions	(-10)
Taxable Income	**120**
(*) Corporate income tax (15% + 10%)	30
Social contribution on profit (9%)	10.8
Total	**40.8**

(*) For simplification purposes, no consideration was given to the portion of income exempt from the surtax, as it is probably not relevant to most businesses.

Examples of costs and expenses that are not deductible for Income Tax purposes and must be added-back to the tax base:

- Partners, shareholders and administrators meals;
- Employees non-compulsory contributions, except those related to insurance and health coverage plans and supplementary benefits similar to those provided by social security, instituted in favor of all employees and officers of the corporate entity;
- Donations and gift expenses, except those specific mentioned on the tax legislation;
- Losses incurred on transactions carried out on the equity and swap markets that exceed the gains accrued on the same transactions.

Additionally, there are certain types of income, profits, revenues and other amounts not included in arriving at the net income which, according to tax legislation, are to be computed in determining taxable income.

2. Revenues, costs and expenses – Accrual periods

Brazilian Corporate Law determines that:

- When determining the net profit of a given tax year, revenues and income earned or accrued during the period must be recorded, regardless of its cash realization; and
- Costs, expenses, charges and losses - either paid or incurred - corresponding to such revenues must also be timely recorded.

The Brazilian income tax legislation also adopts accrual as the default method for earnings recognition, with few exceptions. Such exceptions are applicable to certain specific situations, most commonly in connection with the recognition of exchange variations or income derived from revenues earned from public or quasi-public entities (such as Petrobras). In such circumstances, Tax Authorities allow taxpayers to use the cash basis for tax purposes, but not for accounting purposes.

Revenues derived from service provision must be recognized and taxed accordingly when such services are performed. When it comes to sale of goods, revenues must be recognized and taxed when such goods exchange hands, that is, when the goods are delivered to the final consumer.

As a general rule, IRPJ taxation is to adhere to the accounting principle of matching costs and revenues. Moreover, in allocating costs and recognizing revenues, the corporate entity is also to strictly observe the correct tax year for making the related entries.

Failure to observe the accrual basis for accounting purposes can only constitute grounds for assessing taxes and related fines and penalties if it results in:

- Tax payment postponement to an accrual period subsequent to the one in which it would be due; or
- Undue reduction in taxable income in any accrual period.

3. Expenditures incurred in company's pre-operating phase or costs incurred by an operating company with projects in the pre-operating phase

Companies engaged in oil and natural gas exploration and production activities typically face an initial exploration phase in

the course of their business. As a result, they incur in a considerable volume of expenses in this phase and, consequently, are typically surrounded by a high risk factor, a main trait of this industry.

The convergence of Brazilian accounting practices with the international accounting rules (IFRS) brought forth several changes applicable to companies in the pre-operating phase. According to the IFRS, companies need to register the pre-operating expenses in the year's Profit & Loss (P&L) accounts.

As previously mentioned, from 2010 to 2015 (2014 in some cases), RTT neutralized the impact of the new accounting methods introduced by Law 11,638/07 on the computation of Brazilian federal taxes.

Law 12,973/14, which repealed the RTT as of 1 January 2015 (or from 1 January 2014 in case of early adoption), regulated the adjustments concerning pre-operational and pre-industrial expenses for taxable income calculation purposes, which can be summarized as follows:

- Pre-operating costs, including the ones incurred during the initial phase of operation, when the company partially used their equipment or their installations as well as the costs of industrial activities expansions are not deductible for income tax purposes and must be added-back into the tax base;
- The expenses aforementioned would be considered deductible for income tax purposes on a linear basis during a period of five years from the beginning of the operation or from the year in which corresponding benefits were generated.

Tax loss carryforwards

Tax losses can be carried forward to future tax years with no time limit, thus no statute of limitations applies. Nonetheless, such tax losses cannot reduce taxable income by more than thirty percent (30%) in any given fiscal year.

4. Depreciation methods

In Brazil, depreciation is typically recorded using the straight-line method, which considers the useful life of the asset, based on an estimate of how long an item can be expected to be used in business or produce income.

The Federal Tax Authorities have issued ordinances stipulating the maximum depreciation rates of tangible assets, which are acceptable for tax purposes without the need of further documentation by the taxpayer. In the event the taxpayer employs assets in conditions that result in a more expedited depreciation of such assets, the taxpayer is required to rely on a specialist appraisal report supporting the asset's shorter life term.

While as a general rule, depreciation for book and tax purposes is consistent, the tax law allows for different depreciation rates for tax purposes in accordance with the table issued by the Federal Tax Authorities:
The Brazilian tax legislation does not

Product	Useful life (in years)	Yearly depreciation rate (%)
Vehicles	5	20
Machinery and equipment	10	10
Computers	5	20
Buildings	25	4
Vessels used to support research, exploration, drilling, production and storage of oil and natural gas	20	5
Vessels used in research activities and acquisition of geological and geophysical and geodesic data related to exploration of oil and natural gas	20	5
Equipment for acquisition of geological and geophysical and geodesic data related to the research of oil and natural gas	10	10
Floating crane used in offshore rig facilities	20	5
Tugs for vessels and support equipment used in research, exploration, drilling, production and storage of oil and natural gas	20	5
Fixed exploration, drilling or production units (machinery)	10	10
Floating, production, storage, offloading units	20	5
Floating or semi-submersible exploration, drilling or production units (platforms)	20	5

provide for specific depreciation rates for pipelines, Christmas trees, risers and auxiliary equipment used in the oil and gas exploration and production activities.

The straight-line depreciation method is based on the assumption that the assets usefulness declines evenly over time. Both increased activity or the actual use of the assets have no bearing on the amount of depreciation each year since it concerns the same every period. Thus, since this method takes into account the useful service life of the asset, it may not be the most adequate method for certain assets employed in the Oil and Gas industry, given that production fluctuates over time according to the production curve.

Tax authorities have established a specific rule for the mining industry regarding the depreciation of fixed assets, whereby depreciation for assets with useful life longer than the concession period of the mine would be based on the units of production ("UOP") method. Tax authorities have not yet issued any specific regulation with respect to its applicability in the Oil and Gas Industry.

Since the UOP method is a specific rule valid for the mining industry, the Brazilian tax authorities could question its adoption for Oil and Gas activities, regardless of the maximum depreciation rates established by tax authorities.

5. Deduction of E&P expenses

Law No. 13,586 provides specific rules for the deduction of expenses incurred during the exploration, development and production phases for oil and gas.

Expenditures incurred in the exploration and production activities of oil and natural gas can be fully deducted for purposes of calculating Corporate Income Tax.

Expenses in connection with the development phase may be deducted in proportion to the depletion of the related asset. Taxpayers may also consider an accelerated depletion of assets by applying the rate determined by the unit-of-production method multiplied by 2.5.

Normative Instruction No. 1,778 formalizes and clarifies the provisions established by Law No. 13,586 related to the activities that may generate deductible expenses at the exploration and development phases.

6. Deductibility of accruals

As a general rule, tax deductibility is limited to the following accruals:

- Vacation allowance (employees' holiday payment);
- Christmas bonus (automatic annual bonus paid to employees)..

Other accruals, including those applicable to the Brazilian oil and natural gas industry, such as the provision for well abandonment and field restoration, are considered non-deductible for purposes of calculating corporate income taxes.

7. Deductibility of operating expenses

Income tax Legislation in Brazil establishes certain criteria for considering expenses incurred by a company as operating, and, therefore, deductible for tax purposes.

Operating expenses are deemed as the ones necessary for the company's activities and maintenance of its source of production. Thus, deductible expenses are those considered as usual or normal in the transactions carried out by a given company in the course of its business.

8. Impairment

Impairment of assets was introduced by the convergence of Brazilian accounting practices with the international accounting standards (IFRS).

In accordance to the IFRS, entities have to review the carrying amount of their tangible and intangible assets to determine whether there is any indication that those assets should reflect impairment loss provision. If such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss.

Intangible assets with indefinite useful lives such as goodwill must be tested for impairment annually, whenever there is no indication that the asset may be impaired.

An impairment loss is recognized immediately in a given entity's profit or loss. Where an impairment loss for tangible assets subsequently needs reversal, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognized for the asset in prior years (historical carrying amount – cost). A reversal of an impairment loss is recognized immediately in the P&L. For intangible assets with indefinite useful lives such as goodwill, impairment losses, when recorded, are not reversed (even if the revised recoverable amount shows that the impairment loss is no longer required).

In accordance with Article 32 of Law 12,973/14, impairment registered in accounting books is to be considered deductible for tax purposes if the corresponding assets were not reversed when they are disposed of or written off.

9. Consortium – Tax aspects

General concepts

A consortium, as defined by the Brazilian commercial legislation, is an unincorporated entity set up by two or more partners to carry on a trade, business, financial transaction or venture and share the profits derived therefrom.

A consortium agreement does not imply in partners' joint liability, thus each individual partner is only responsible for their own obligations, according to the provisions of the underlying agreement. However, according to Law 12,402/2011, whenever the consortium parties decide that the consortium (and not the individual parties) will be responsible for hiring individuals or entering into agreements with legal entities, the consortium will be liable for the tax payment and filing obligations associated to such transactions, and, in such case, the parties to the consortium are jointly liable.

Some of the consortium's requirements are: i) definition of its objectives and duration; ii) definition of liabilities and responsibilities of each consortium partner; iii) rules of income receipt and income distribution; iv) each partner's contribution for common expenses, if applicable.

Tax aspects
Based on Normative Instruction (NI) 1,199/11, each party to the consortium shall be responsible for recognizing its own revenues, costs and expenses as a result of the consortium activities, proportionally to their share in the joint venture, which is determined by the underlying consortium agreement filed before the local Board of Trade, and apply the proportional method for calculation and collection of taxes on net income (IRPJ and CSLL), as well as taxes on revenues (PIS and COFINS).

The operator of the consortium is responsible for managing the joint venture, including accounting and tax bookkeeping and safeguarding any supporting documents. The operator must keep the consortium's accounting records either through separate records or through segregating the accounting figures for the consortium in its own financial statements. Such records must correspond to the sum of all revenues, costs and expenses shared by the parties, based on which each consortium party shall be able to demonstrate its own share in the joint venture's income and costs and collect taxes accordingly.

As a general rule, the parties in the consortium shall be responsible for issuing the invoices corresponding to their share in the consortium yields. Whenever authorized by the laws concerning ICMS and ISS, the consortium may issue the invoice on the total amount of its revenues.

A consortium that engages legal entities or individuals with or without employment relationship shall withhold taxes and fulfill the corresponding tax filing obligations, being each partner of the consortium jointly liable.

Corporate income taxes (IRPJ and CSLL)
As previously described, the cost incurred by virtue of activities undertaken under a consortium agreement (e.g., vessels charter and acquisition of goods) should be recognized by its parties in their financial statements, according to their interests in the arrangement.

Due to the fact that a consortium is an unincorporated entity, it is not deemed as a taxpayer for corporate income taxes purposes and, as a consequence, compliance with tax payments and corresponding reporting obligations will rely on the consortium partners.

Each party is required to include the net income resulting from the consortium's main and accessory activities in its taxable income, according to its share in the consortium.

Withholding taxes
Withholding, payment and fulfillment of the related filing obligations pursuant to such taxes shall be carried out by each party proportionally to its share in the joint venture.

If a consortium engages a legal entity or individuals with or without employment relationship, the responsibility for withholding such taxes and the fulfillment of the related tax filing obligations is assigned to:

- The consortium parties, using the National Register of Legal Entities (CNPJ) specific to each entity, if the consortium is in charge only of the engaging (and not the payment) of legal entities or individuals;
- The consortium, by using its own National Register of Legal Entities (CNPJ), whenever it is responsible for both the engaging and payment of individuals or legal entities.

If the operator is responsible for engaging and paying the legal entities or individuals on behalf of the consortium, it shall also pay the relevant withholding taxes and comply with the related filing obligations using its own CNPJ. In this case, the filing obligations related to the consortium activities shall be submitted together with the operator's own filing obligations.

Tax filing obligation
Normative Instruction 1,110/2010 defined that the consortiums that carry out operations on their own name, including hiring legal entities or individuals with or without employment relationship, must submit the Monthly Statement of Debits and Federal Tax Credits ("DCTF Mensal"), as long as they have debits to declare.

Moreover, the consortium must submit the "DCTF Mensal" related to December of each calendar year, even if they do not have debits to declare, in which case they shall indicate the months that they had no debts to report.

Additional comments on Income Tax aspects

In this section we comment on other aspects related to income taxation in Brazil (most of them also applying to determination of taxable income for CSLL purposes), which we believe are necessary for an enhanced understanding of the Brazilian tax environmentv

1. Income tax return/Other related tax filing obligations

In order to align the Brazilian tax law to the new accounting standards adopted in Brazil, the Income Tax Return was subject to several changes throughout the years.

In 2007, tax authorities (comprising federal, state and municipal governments) implemented the Public Digital Bookkeeping System (SPED) to standardize and unify the reception, validation, storage and authentication of books and documents, therein comprising commercial and tax accounting, through a single computerized flow.

In general terms, SPED comprises three main sub-projects: Electronic Tax Invoice (NF-e), Digital Accounting Bookkeeping System (ECD) and Digital Tax Bookkeeping (EFD). They were primarily created to unify the main tax reporting obligations of legal entities in a single system, thus allowing a more efficient control in the intersection of such obligations.

Furthermore, the Brazilian Federal Tax Authorities (RFB) established the so-called e-Lalur, through which they intended to eliminate the redundancy between the information contained in accounting bookkeeping, in taxable income book (LALUR) and corporate income tax return (DIPJ), in order to facilitate the filling of tax obligations. Subsequently, e-Lalur started to be called EFD-IRPJ.

Finally, Law 12.973/14 established the Fiscal Accounting Bookkeeping (ECF), which substituted the EFD-IRPJ.

This project has as main objectives: simplify compliance with main and accessory obligations (payment and reporting of taxes, respectively); enhance the quality of information submitted to RFB; increase revenue, by decreasing the defaults, the incidence of errors, tax evasion and fraud.

In summary, a new and more comprehensive income tax return (ECF) substituted the old one (DIPJ). ECF became mandatory as of calendar year 2014, and should be transmitted annually through the Public Digital Bookkeeping System (SPED) until the last business day of July of the year following the calendar year to which it relates.

So, as from calendar year 2014, companies are no longer obligated to file LALUR and DIPJ, since those filing obligations were substituted by ECF.

2. Foreign tax treaties and foreign tax credit

As of January 1, 1996, the Brazilian corporate income tax (IRPJ) is assessed on worldwide income. Prior to that, foreign source income was not considered in the tax base. Foreign source income started to be subject to Social Contribution on Profits (CSLL) from October 1999 onwards.

A credit for the income tax paid abroad is allowed, limited to the total Brazilian tax liability (income tax and social contribution on profits) assessed on the foreign income.

Please find below a chart containing the countries Brazil has signed tax treaties with, as well as the corresponding withholding income tax rates on interests and royalties withholding income tax rates on interests and royalties.

Withholding Income Tax Rates under Brazil's Double-Tax Treaties (1)

Country of destination	Interest (3) (%)	Royalties (4) (%)
Non-treaty rates (2)	15	15
Argentina	15	15
Austria	15	15/10
Belgium	15/10	15/10
Canada	15/10	15
China	15	15
Czech Republic	15/10	15
Denmark	15	15
Ecuador	15	15
Finland	15	15/10
France	15/10	15/10
Hungary	15/10	15
India	15	15
Italy	15	15
Israel	15	15/10
Japan	12.5	15/12.5
Luxembourg	15/10	15
Mexico	15	15
Netherlands	15/10	15
Norway	15	15
Philippines	15/10	15
Portugal	15	15
Slovakia	15/10	15
South Africa	15	15/10
South Korea	15/10	15/10
Spain	15/10	15/10
Sweden	15	15
Ukraine	15	15

(1) Taxation of dividends was abolished in 1996.
(2) These rates apply if they are lower than the rate specified in the treaty.
(3) Lower rates apply to bank loans with a minimum term of seven years.
(4) Lower rates apply to copyright royalties.

3. Federal income tax incentives

The Brazilian federal government grants tax incentives in order to allocate part of the collection of income tax to areas and activities requiring federal support for development. There are many types of tax incentives; they have specific purposes and each one has their associated activity. In this sense, we will present the main income tax incentives companies engaged in the oil and gas industry might be entitled to.

Such tax incentives are restricted to companies that elect the Taxable Income method to assess IRPJ and CSLL. Entities that are benefiting from such tax incentives must report annually certain information related to those tax incentives in their corporate income tax return.

4. Research and development

The eligibility for Brazilian R&D benefits is broad and is not limited to particular industries. Activities undertaken to achieve technological innovation qualify for R&D tax incentives. These activities include designing new products or processes, as well as the aggregation of new functionalities or characteristics to an existing product or process, resulting in incremental improvements in quality or productivity. Additionally, software development qualifies as an R&D activity as long as it is undertaken to achieve scientific or technical goals.

R&D expenditures include wages, salaries, and certain payments to third parties (e.g. laboratory tests, etc.), directly attributable to qualified R&D activities.

The program allows taxpayer to take advantage of the following incentives for corporate income tax purposes:

- Super deduction: Deduction of 160% of the total R&D expenditures.
- Enhanced super deduction: If the entity increases the amount of researchers exclusively dedicated to research projects by up to 5% in a given year, super deduction increases to 170%; and if headcount increases more than 5% in a given year, the super deduction increases to 180% of the qualified expenses. Employees who relocated internally to work exclusively in research projects may

also be considered in the increase of the number of researchers.

- Enhanced super deduction for patents: An extra 20% deduction is allowed for the qualifying costs incurred in developing a patent, so long as it is registered. Since super deduction is delayed until the patent is effectively registered, few taxpayers take advantage of this provision.

Unused deductions may not be carried forward or carried back.

The following additional research incentives are also available:

- Depreciation: 100% depreciation is allowed in the year of acquisition for new machinery, equipment, and instruments exclusively dedicated to research and development.
- Amortization: 100% amortization for intangibles used in research and development in the year when incurred.
- IPI reduction (federal excise tax): Equipment, machinery, and tools dedicated to R&D receive a 50% reduction of the IPI due. This incentive must be claimed at the time the research related equipment, machinery, or tools are acquired.

5. Regional tax incentives

SUDAM and SUDENE

Industrial undertakings set up in the regions under the jurisdiction of SUDAM and SUDENE (Amazon and Northeast Region development authorities, respectively) may be eligible for certain regional tax incentives, including a reduction of income tax.

These benefits are extended to corporate entities that have projects approved for installation, expansion, modernization or diversification in certain priority sectors of the nation's economy as defined by the Federal Government, which includes oil & gas production projects.

The covered areas are the northern region of Brazil, basically the Amazon Basin (SUDAM) and the Northeast (SUDENE), the latter including part of the northern region of the State of Minas Gerais and certain municipalities of the State of Espírito Santo (both the latter technically classified in the Southeast geographically speaking) and which meet the legal requirements.

Income tax reduction

For projects approved up to 2018, a 75% reduction of income tax might be granted if all conditions imposed by the applicable legislation are met.

IRPJ incentive should be determined based on a calculation method called Operating Profit ("Lucro da Exploração"), which is to be calculated on an annual basis considering the net income for the accrual period before deduction of the provision for income tax, and exclusion of certain amounts provided in the applicable law.

Companies with projects approved by the SUDAM/SUDENE are allowed to calculate the income deduction based on two methodologies: (i) proportion between all activities carried out by the company and the ones covered by the tax reduction; (ii) calculation of the tax benefit based exclusively on the activity covered by the related SUDAM/SUDENE incentive grant.

There is a formal interpretation of the SUDENE (northeast) regulatory authorities providing that this tax incentive is applicable to the oil and natural gas industry, including production that takes place in offshore areas.

Income tax reduction for reinvestment

Up to 2018, corporate entities located in the activity area of SUDAM/SUDENE could deposit for reinvestment in Banco da Amazonia S.A. or Banco do Nordeste do Brasil S.A. (BNB) 30% of their income tax calculated on the operating profit, as long as they invested 50% of their own resources.

However, the release of resources is subject to approval by SUDAM/SUDENE, for the related technical and economic modernization projects.

This 30% rate will be levied upon tax due reduced by 75% as per theincome tax reduction incentive above-mentioned.

6. Other tax incentives

In addition to the SUDAM/SUDENE tax benefits, there are other tax incentives available to reduce income tax burden, as briefly described below.

Workers' Meal Program (PAT)

The Workers' Meal Program aims to promote the improvement of employees´nutritional conditions, reduce work accidents and increase productivity. It consists on a direct deduction of expenses incurred with employees´meals.

Specific rules set forth by the Ministry of Labor and Employment (Ministério do Trabalho e Emprego) need to be observed, including previous registration in the program.

Entities under PAT are allowed to use the costs incurred with the employees' meals as deductible expense for IRPJ and CSLL purposes. In addition, they may use part of such costs directly to reduce its income tax due.

The benefit will consist of the lowest amount amongst:

- The result of the corporate income tax rate applied to meal expenses effectively incurred in a given tax year;
- Application of 4% over IRPJ payable at a 15% rate. For calculating the benefit, the surtax (10%) is not considered.

For labor purposes, meals granted under the Workers' Meals Program shall not constitute compensation in-kind. On the other hand, if a company has not been registered in the aforementioned program, expenses incurred with meals granted to employees may be considered as fringe benefit and taxed accordingly (as compensation) for Tax, Labor and Social Security purposes.

Cultural activities

Cultural activities eligible for income tax incentives are currently segregated in two: "Lei Rouanet" incentive and incentive for specific activities, as defined in Law 9874/99. Both allow for a deduction up to 4% on income tax due (15%):

- Incentive for specific activities: such activities are described in Law 9784/99. This incentive may be totally deducted from the due income tax (15%). However, the corresponding expense should be added-back for income tax purposes.
- "Lei Rouanet" incentive: comprises other activities not defined in Law 9874/99. 40% of donations and 30% of sponsorships expenditures may be directly deducted from income tax due. It is important to note that such expenses will be considered deductible for IRPJ and CSLL purposes.

The global limit of audiovisual (described below) and cultural incentive is 4% of the due income tax (15%).

Children's and Adolescents' Rights Fund (Fundo dos Direitos da Criança e do Adolescente)
Corporate entities are allowed to deduct donations effected to Children's and Adolescents' Rights Fund from the income tax due in each accrual period. The maximum deduction allowed is 1% on income tax due for each base period.

Amounts regarding donations are nondeductible as operational expenses in determining taxable income for income tax and social contribution on net profits purposes.

Audiovisual incentive
The audiovisual incentive is segregated in three parts:

- Up to the 2019 tax year, corporate entities may deduct amounts related to sponsorship project previously approved by the National Agency of Cinema ("ANCINE"). The maximum individual deduction allowed is 4% on the income tax due. Also, the deduction can not exceed 4% on the income tax due, considering all the other incentives related to audiovisual and cultural activities. Amounts regarding to sponsorships are not deductible in determining taxable income.
- Up to the 2019 tax year, corporate entities subject to taxable income may deduct amounts spent in acquisition of quotas from National Cinematographic Industry Financing Fund ("FUNCINE"). The maximum deduction allowed is 3% on the income tax due. The amount of the investment made based in FUNCINE quotas acquisition can not be deducted from taxable income. The eventual losses presented on disposal quotas will not be considered deductible.
- Up to the 2019 tax year, corporate entities may deduct amounts related to investments in projects previously approved by the National Agency of Cinema ("ANCINE") on income tax due. The maximum individual deduction allowed is 3% on the income tax due. Also, the deduction cannot exceed 4% of the income tax due, considering all other incentives related to audiovisual and cultural activities. Amounts regarding to investments in audiovisual activities are deductible in determining taxable income.

Sports Incentive
Entities may deduct from the due income tax the amounts spent with sponsorship or donation, in direct support of the sports, sport activities for athletes with a disability and projects previously approved by the Ministry of Sports. The maximum deduction allowed is 1% of the income tax due in each fiscal year (15% rate).

The value of donations and sponsorship is not deductible as operating expenses for purposes of determining the taxable income.

Currently, the tax law does not stipulate a global limitation applicable to this incentive when used concurrently with other income tax incentives. Companies will not be able to use the expenses related to sports activities whenever such expenses are incurred for the benefit of an individual or an entity related to the company.

7. Foreign exchange variation effects

Cash/Accrual basis accounting
Decree 8,451 provided new rules with respect to how companies account for exchange-rate variations used in the calculation of various taxes (IRPJ, CSLL, PIS and COFINS). Taxpayers will be able to elect to be taxed on foreign exchange rate variations on a cash or an accrual basis to the extent that, in a particular calendar month, the variation (positive or negative) exceeds 10%.

The 10% variation will be determined based on the US dollar rates on the first and last day of the calendar month, and the change in the cash or accrual basis taxation may be effected in the month following the month in which the 10% variation was exceeded. A change can be made any time the monthly 10% threshold is exceeded, and will be valid for the entire calendar year; however, if the 10% variation occurred from January through May 2015, the change of regime must be made in June 2015.

8. Technical assistance and royalty agreements

Technical assistance
Technical assistance consists of services concerning the transfer of specialized knowledge or technology, whereby the technology holder shares his knowledge to third parties upon payment of a fee.

The Brazilian Patent Office (INPI) considers as technical assistance contracts the ones that stipulate the conditions for obtaining technique, planning methodologies and programming, as well as researches, studies and projects destined to the execution and performance of specialized services.

INPI accepts the register of services related to entities main activity, as well as services performed in connection with equipment and/or machines located abroad, whenever such service is accompanied by a Brazilian technician and/or when it generates any kind of documents, such as a report.

Royalty agreements
The legislation in force define technology transfer agreements as those that have the specific purpose of acquiring knowledge and techniques, which will be applied to the production of consumer goods, materials, supplies in general and services.

Therefore, a technology transfer agreement is one where a business or an individual commits to transferring to another contracting party the knowledge concerning special manufacturing processes, secret formulas, original

techniques or practices, for a given time period, freely or by paying a stipulated amount (royalties).

The technology transfer contracts must especially cover:

- Supplying engineering technical data for the process or for a given product, including the methodology of the technological development used in obtaining it. This data is represented by a set of formulas and technical information, documents and industrial models, instructions on operations and other analogous elements that allow the manufacture of the product;
- Supplying data and information for updating the process or the product;
- Providing technical assistance by technicians from the supplier and training technical personnel of the acquirer.

Registration requirements before the Brazilian Patent Office (INPI)

The technical assistance agreement or the royalty agreement for the use of industrial property between the parties must be registered before the INPI, as stipulated by Regulatory Act 135/97. The INPI is the public agency responsible for all matters concerning industrial and intellectual property in Brazil.

INPI must analyze and approve both royalty agreements and technical assistance. For the latter, INPI usually requires an explanation of the man/hour cost detailed per type of technician, the term provided for the performance of services or the evidence that the services will be effectively performed.

Such registration validates the foregoing acts and contracts before third parties for purposes of remittance of the related payments abroad and tax deduction of the payments involved.

The request for registration of the agreement before the INPI should be made in a specific form, accompanied by:

- The original contract or instrument, duly legalized by the Brazilian Consulate in the foreign country and translated into Portuguese by a public sworn translator;
- Detailed equity structure of the parties, and;
- Other documents and/or information pertaining to the transaction as deemed necessary by the parties.

In addition, the agreements must be registered with the Central Bank of Brazil (BACEN), for the remittance of payments to overseas. For such registration, the required documents are a copy of the contract as described above, the original INPI registration document, and a statement of the capital structure of the Brazilian company.

Tax deduction of expenditures with royalties and technical assistance

- The registration of the related license agreement for the use of trademark, technical and scientific assistance services in the INPI;
- Observation of the maximum limit of 5% on net revenues from the sales of goods produced with licensed technology and/or benefiting form, the technical assistance provided. Such 5% limit applies to the royalty and technical assistance payments combined figures. This effective limit also varies according to the industry as set forth by the Ministry of Finance;
- Registration of the related agreement in the BACEN, if the beneficiary of the royalty or payment of technical assistance fee is domiciled abroad;
- The general rules for expenses deductibility also apply to royalty and technical assistance agreements. Expenses must be necessary, normal and usual for the company's activities and supported by proper documentation;
- Technical assistance agreements will be deductible during the first 5 years in which the company has been in operation or after the special production process is introduced. This period may be extended for an additional five years upon authorization of the National Monetary Council, or CMN.

9. Interest on net equity

A company may decide to pay interest on net equity (INE) to their shareholders / quota holders, at year-end or during the year on an interim basis.

The amount of payable INE is calculated based on the long term interest rate (TJLP), the local prime rate that is quarterly fixed by BACEN, applied to each shareholder's portion of net equity. Brazilian corporate law establishes that current earnings are not included as part of the net equity.

In contrast to dividends, which are exempt from withholding tax, INE is subject to withholding tax at the rate of 15% (or 25% if the remittances are made to tax havens), but, depending on the beneficiary tax jurisdiction, the tax paid in Brazil can be offset by the beneficiary. This is because INE is considered a financial expense for tax purposes, although it is effectively a return on equity.

INE is a deductible expense for both corporate income tax and social contribution tax (SCT) purposes. INE is deductible to the extent; it does not exceed fifty percent (50%) of either of the following amounts:

- Net income, as determined for accounting purposes, for the current period of interest payment before the provision for income tax and the deduction of the amount of interest; or
- Accumulated earnings from prior years.

10. Transfer pricing

Introduction of transfer pricing regulations and rulings

The basic purpose of Brazilian transfer pricing legislation is to avoid losing tax revenues on transactions between related companies, where profit could be sent to countries with more favorable tax structures. In this sense, certain methods are stipulated for testing prices of intercompany transactions involving goods, services and rights, besides financial transactions between related parties.

Brazil does not follow the international transfer pricing standards elaborated under the OECD guidelines. Most of the Brazilian transfer pricing methods are based on statutory margins provided to test inbound and outbound transactions, except for PIC and PVEx methods (based on the comparison of similar transactions

performed by unrelated parties) and for PCI and PECEx methods (for products deemed as commodities).

Brazilian entities must conduct an annual transfer pricing analysis (from January 1 to December 31) and the eventual adjustments are due on January 31 of the following year. Detailed information of results is required in the Brazilian income tax return.

The concept of related parties with respect to a Brazilian taxpayer is determined by Law No9.430/1996 and Normative Instruction No1,312/2012, and includes the following parties:

- Their head offices, when domiciled abroad;
- Their affiliates or branches, domiciled abroad;
- A controlling or associated individual or legal entity, headquartered abroad;
- An exclusive dealership of the legal entity domiciled in Brazil;
- An exclusive purchaser of the legal entity domiciled in Brazil.

The above list is not exhaustive, but only shows the most common related parties situations for Brazilian transfer pricing purposes.

Transfer pricing legislation does not determine the amounts that should be contained in the documents formalizing transactions between related companies. Its purpose is not to interfere in monetary policy. Rather, for corporate income taxes computation purposes, it establishes methods for calculating prices that define the maximum deductible amount of costs, expenses and charges and the minimum amounts of revenues related to goods, services and rights incurred by Brazilian companies in transactions subject to transfer pricing rules.

Introduction of transfer pricing models Calculations should be performed on a 'product by product' basis and prepared in local currency – Brazilian Reais (R$). Each method must be elected per product, and the method chosen can be changed only from one tax year to another or in case of tax assessment, if the Brazilian revenue disqualifies the method chosen.

Taxpayers may use the methods that yields the lowest taxable income. The method elected by the Brazilian company shall be consistently applied for each specific transaction subject to transfer pricing rules throughout the tax computation period. Different methods may be used by the taxpayer for different transactions. As an exception, commodity transactions are subject to specific transfer pricing methods (PCI and PECEX).

The Brazilian transfer pricing rules are also applicable to transactions carried out with any entities (related or not) located in a tax haven jurisdiction or deemed as "privileged tax regime".

The rules apply to inbound and outbound transactions as Importation or Exportation of goods, services or rights taken from foreign related parties and Interest on loan agreements with related parties (registered or not at Brazilian Central Bank - BACEN).

Although service transactions are also subject to transfer pricing rules, royalties and fees for technical, scientific, administrative or similar assistance are not, provided some conditions are met (e.g. registration of the agreement with the INPI - Intellectual Property Agency).

Methods applicable to inbound transactions

comparable uncontrolled prices (PIC). Brazilian equivalent to the CUP method, relying on the comparison of prices of identical or similar goods/services on the domestic or international market for purchase and sale operations on similar payment terms. The PIC method compares the amounts charged in related party transactions with the average prices of similar goods, services or rights within the Brazilian market, or in other countries, in purchase and sale transactions carried out between unrelated parties and under similar payment conditions.

Under this method, the price of imported goods, services and rights purchased from a related party shall be compared with the prices of similar goods, services and rights:

- Sold by the foreign related party to resident or nonresident unrelated parties;
- Purchased by the Brazilian entity from resident or nonresident unrelated parties; and
- In purchase and sale transactions carried out between other resident or nonresident unrelated parties.

The Brazilian transfer pricing regulations do not specifically provide a definition of similar services and rights. With respect to goods, it indicates that two or more goods shall be deemed to be similar when they, concurrently:

- Have the same nature and the same function;
- May substitute each other in their intended function; and
- Have equivalent specifications.

The value of goods, services or rights shall be adjusted to minimize the effects of differences in the related business conditions, physical nature and contents, in relation to which prices are to be compared.

Despite the fact this is the most intuitive method, its application depends upon the availability of documentation of comparable transactions between unrelated parties.

Resale price less profit (PRL)

The PRL method compares amounts charged in related party transactions with the average of the resale price charged for goods, services or rights minus unconditional discounts granted, taxes and contributions levied on the sales, commissions paid, and a profit margin that varies according to companies' operations, as demonstrated below:

- 40% for:
  - Pharmachemical and pharmaceutical products;
  - Tobacco-related products
  - Optics, photography, and cinematographic equipment and

instruments;
  - Medical and dentistry-related machinery and equipment;
  - Extraction of oil and natural gas;
  - Oil-related products.
- 30% for:
  - Chemical products;
  - Glass and glass related products;
  - Cellulose, paper, and paper products;
  - Metallurgy.
- 20% for:
  - All other sectors.

Production cost plus profit (CPL)
The CPL method compares amounts charged in related party transactions with the average of production cost of similar goods, services or rights in the country of origin, increased by the taxes and duties imposed on exports by referred country, and by a statutory margin of 20% computed on the identified cost.

When determining the price under this method, the following items may be included as part of the cost:

- Acquisition cost of raw materials, feedstock and packaging materials used in the production of goods, services or rights;
- Cost of any other goods, services or rights applied to or consumed in production;
- Cost of manpower applied to production, including the cost of direct supervision, maintenance and custody of production facilities and the respective payroll taxes incurred, required, or provided by prevailing legislation in the country of origin;
- Rental, maintenance and repair costs, and depreciation, amortization or depletion charges relating to the goods, services or rights used in production; and,
- Amounts corresponding to reasonable levels of breakage and loss incurred in production, as provided by the tax legislation in the country of origin of the goods, services or rights.

A relevant issue in connection with the applicability of the Cost Plus method is the extremely stringent documentation requirements of the Brazilian Tax Authorities to support deductibility for tax purposes, which includes copies of all documents that supported the cost accounting entries, such as commercial invoices, apportionment spreadsheets, payroll reports, lease documents, fixed asset controls including depreciation rates. The taxpayer is also required to present the income tax return filed in the country in which the costs were incurred. All documents are legally required to be presented in a sworn translation version, notarized in the country of origin, recognized by the Brazilian embassy/ consulate in the country of origin, and registered in a Brazilian Notary Office (Cartório de Registro de Títulos e Documentos).

The CPL is not applicable if the foreign related party is not the original producer of goods exported to the Brazilian company, or the original provider of services.

Methods applicable to outbound transactions
Regarding outbound transactions, the legislation in force determines that revenue accrued in operations with related parties domiciled overseas are to be subject to arbitration when the average price of the goods/services/rights is less than ninety per cent (90%) of the average price charged on sale of the same items on the Brazilian market.

Moreover, the Brazilian Revenue Service (RFB) dismisses of the application of transfer pricing methods the taxpayer who fits in at least one of the following situations:

- If the export sales in one year is lower than 5% of the total net revenues in that same year, the materiality safe harbor or
- If the net income (pre-tax income, or the net income before taxes) on export transactions for related companies is, at least, equal to 10%, considering an annual average of the calendar year in which the transfer pricing rules are being applied and the two previous ones, the Profitability Safe Harbor. The 10% margin should be determined based on the financial data for the three most recent years (current year plus two preceding years). The profitability safe harbor does not apply to taxpayers entering into outbound intercompany transactions whose net revenue from related parties represents more than 20% of the total outbound transaction net revenue.

Safe harbor provisions do not apply to transactions conducted with entities domiciled in tax haven countries.

If the company does not meet one of the safe harbors requirements described above, calculations to justify one of the presented methods below will be needed:

- Export sales method (PVEX) - Defined as the arithmetic mean of sales prices practiced in transactions involving the exports of goods, services or rights to unrelated customers, during the same computation period of the income tax (IRPJ) and social contribution on profits (CSLL).
- Wholesale price in country of destination less profit method (PVA) - Defined as the arithmetic mean of the sales price of identical or similar goods, services or rights, practiced in the wholesale market of the country of destination, under similar payment conditions. Such arithmetic mean shall be net of the taxes included in the price, charged in said country, and of the 15% profit margin on the wholesale sales price.
- Retail price in country of destination less profit method (PVV) - Defined as the arithmetic mean of the sales price of identical or similar goods, services or rights, practiced in the retail market of the country of destination, under similar payment conditions. Such arithmetic mean shall be net of the taxes included in the price, charged in said country, and of the 30% profit margin on the retail sales price.
- Acquisition or production cost plus taxes and profit method (CAP) – Defined as the arithmetic mean of the acquisition or product costs of the goods, services or rights exported increased by taxes and contributions charged in Brazil and by a 15% profit margin computed on the aggregate of costs plus taxes and contributions.

Methods for commodities

Law 12,715/12 introduced two additional transfer-pricing methods to the existing Brazilian methods: the commodity exchange import price (PCI) and the commodity exchange export price (PECEX) for inbound and outbound transactions with commodities, respectively. The application of these methods are mandatory to intercompany transactions involving commodities, and the taxpayers are not able to apply any other legally provided methods or safe harbors.

Both PCI and PECEX methods are defined as the average commodity exchange price for certain commodities negotiated in internationally recognized commodities and future exchanges. Thus, the prices of imported and exported goods declared by the Brazilian taxpayer will be compared with listed prices of the same goods in these commodities and future exchanges, adjusted according to average market premium, on the date transaction.

In case there are no listed prices of the tested goods on internationally recognized commodities and future exchanges, the commodities prices can be compared to those obtained from reputable international sector institutions, or, for export transactions, from normative organizations or agencies and published in the Federal Official Gazette of Brazil (Diário Oficial da União – DOU).

Financial transactions

Until the publication of Law No12,766/2012, only the interest arising from loans not registered with the Brazilian Central Bank - BACEN were subject to the application of transfer pricing rules.

Currently, interest arising from new or renegotiated loans, independent of whether or not registered with the Brazilian Central Bank, are required to comply with the legislation.

The basic rule establishes that the limit of interest on financial transactions (a maximum limit, for transactions involving foreign exchange inflows, and a minimum limit, for transactions involving foreign exchange outflows) consists in a combination of rate plus spread. Different rates are applicable depending on the type of transaction, currency and interest rate defined in a contract.

Royalties and technical assistance

Brazilian transfer pricing rules do not apply to royalty and technical assistance agreements registered before the INPI agency and the Brazilian Central Bank, which are subject to specific deductibility rules.

Tax haven concept

The Brazilian Congress enacted Law 11727 on June 23, 2008, thereby broadening the concept of tax haven jurisdictions for purposes of the Brazilian transfer pricing rules. For transfer pricing purposes, the law is effective as from January 1, 2009.

As opposed to the previous law, this new statute does not focus on the "jurisdiction" concept to determine whether a transaction between related parties was carried out at arms' length. Rather, it focuses on the tax regime under which the operation was performed.

In practical terms, the Brazilian transfer pricing rules could be applicable to entities domiciled in jurisdictions other than those that were currently expressly blacklisted in the Brazilian legislation.

Under the provisions of the new statue, an operation carried out between a Brazilian entity and a foreign one could be regarded as subject to low tax regime and should thus be subject to Brazilian transfer pricing rules whenever any of the following conditions is met:

- The foreign company is subject to tax in its jurisdiction at a rate lower than 20%;
- The amounts paid out of Brazil are not subject to tax in the jurisdiction where the foreign entity is domiciled at regular rates and conditions; or
- This foreign jurisdiction does not provide public access to information regarding company's structure and ownership by non-residents.

In order to clarify whether an operation between a Brazilian party and a foreign one would be subject to the Brazilian transfer pricing rules or not, the Brazilian Federal Revenue Service issued the Regulatory Instructions RFB 1,037/2010 and 1,045/2010, which contain an updated list of low tax jurisdictions (blacklist) and privileged tax regimes (grey list).

The tax consequences of inclusion on the black list and grey list can be summarized as follows:

Description	Unrelated Party	Related Party	Black list	Gray list
Transfer pricing rules	No	Yes	Yes, even with unrelated parties	Yes, even with unrelated parties
Thin capitalization rules	No	2:1 debt-to-net equity ratio	0.3 debt-to-net equity ratio	0.3 debt-to-net equity ratio
Withholding tax on outbound payments	15%	15%	25%	15%
Nonresident capital gains	15%	15%	25%	15%

Brazilian withholding income tax (IRRF) on outbound remittances

Any payment, credit or remittance made by a company located in Brazil to an individual or legal entity residing or domiciled abroad is subject to withholding income tax

The most important operations and corresponding rates are:

Description	Rate %
Royalties	15
Services in general	15
Technical assistance services	15
Dividends	0
Interest on net equity	15
Interest on loans	15
Leasing of capital goods	15
Charter of vessels	0
Capital repatriation	0

Please note that according to the Brazilian tax authorities, payments/remittances made to tax haven jurisdictions are subject to a 25% withholding income tax rate.

Important considerations regarding specific transactions listed in the above chart follows below:

Royalties and technical assistance contracts

As of January 1, 2002, the Brazilian withholding tax rate applicable to royalties paid to foreign beneficiaries changed to 15%.

However, a 10% contribution for intervening in the economic domain (CIDE) is paid by the Brazilian beneficiary of the technology. (Please see specific comments regarding CIDE in the specific section).

Service contracts

Services provided to foreign individuals or legal entities residing or domiciled abroad are subject to withholding income tax at a rate of 15%, regardless of the existence of transfer of technology. In that case, the corresponding remittance, payment or credit correspond to the triggering event.

If the service involves transfer of technology, it must be registered before the INPI (Brazilian Patent Office), which is the federal agency responsible for analyzing the service contract and determining if there is an actual transfer of technology.

In case the beneficiary company is located in treaty countries (such as Spain and France), the payment, remittance or credit may be considered under the business profit article of the treaty, thus, taxable only by the country where the beneficiary is located. In other words, in this case there would not be withholding income tax.

However, it is important to point out that the tax authorities issued an opinion (ruling) with the understanding that the referred exemption of withholding income tax would not be applicable in these cases, since, in their view, these payments would not fall under the business profit

clause but under the clause related to other income. In addition, they claim that such classification (other income) must be adopted even when this clause does not exist in the treaty.

In case of remittances to beneficiaries located in a treaty country, exclusively from a tax and legal standpoint, we believe that there are very strong arguments to claim that the payments made by a company to a non-resident party located in a country with which Brazil has a treaty are not subject to withholding income tax. Such understanding is based on the Business profit clause established by the treaties and on the fact that, according to our legislation, the provisions of international treaties must prevail over the internal legislation.

However, because Brazil has signed a protocol with some of treaty-countries, which defines that payments related to technical services and technical assistance shall be deemed as royalty such remittances must be subject to 15% withholding income tax.

Such protocol has been signed only with a few treaty-countries, which means that with respect to the remittances made to treaty-countries with which there was no Protocol, the authorities did not have any argument to claim for the withholding income tax.

Tax authorities' official understanding is that the business profit clause established in the treaties would not be applicable to remittances derived from the rendering of technical assistance or technical services that do not comprise transfer of technology or expertise. Instead, technical services would be classified as other income under the treaty. If the other income clause does not exist in the particular treaty, such payment/remittance must be treated as non-comprised by the corresponding treaty.

Dividends

Dividends are not subject to withholding income tax, regardless of the location of the beneficiary.

Leasing of capital goods

There is a 15% withholding income tax on remittances, related to leasing of capital goods, to non-resident companies (regardless of whether they are located in a treaty country or not).

Please note that payments for leasing of capital assets (financial leasing) have specific rules that might reduce the withholding Income tax. In fact, under the Brazilian Income Tax Code, the income tax withholding must levy only the amounts related to the interest portion of the payment/remittance. The amounts related to the payment for the amortization of the equipment can be exempt from the withholding income tax.

For payments/remittances derived from operational leasing, the withholding income tax must be calculated based on its total amount due.

Capital repatriation

Capital repatriation is not subject to withholding income tax up to the amount of foreign investment registered before the Brazilian Central Bank. The portion exceeding this amount is treated as capital gain, thus, subject to 15% withholding income tax. Please refer to further comments in the specific section of this guide (exchange control and foreign investment).

Withholding taxes on local payments for services

IRPJ, CSLL, PIS and COFINS

Brazilian income tax rulings also consider the incidence of withholding taxes on the acquisition of professional services, credit consulting, market consulting, credit management, selection and risks and management of accounts payable and receivable by a legal entity from another legal entity within Brazil.

The Brazilian Legislation provides for an extensive list of what must be considered professional services, amongst which:

- Lawyers;
- Technical analyses;
- Technical advisory and consulting;
- Audit;
- Consulting;
- Accounting;
- Engineering.

In this respect, a Brazilian legal entity acquiring professional services from another legal entity must withhold at source: income tax, social contribution on profit and taxes on revenue (PIS and COFINS), at the following rates.

Tax	Rate %
Income tax (IRPJ)	1,50%
Social contribution on profit (CSLL)	1,00%
Tax on revenue (PIS)	0,65%
Tax on revenue (COFINS)	3,00%
Total	**6,15%**

Thus, the contractor pays to the renderer 93.85% of the service's price, withholding and remitting to the Brazilian Federal Revenue Service the remaining 6.15%. On the other hand, the renderer would recognize a credit of 6.15% of the price of the service. Tax credits are offsettable against taxes payable, thus being treated as tax anticipations.

The withholding is not applicable to payments up to five thousand reais (R$5,000.00) per month. If there is more than one payment, the overall sum should be lower than such amount to avoid the withholding.

Withholding taxes – Public agencies

Federal public agencies, autarchies and foundations must withhold at source income tax (IRPJ), social contribution on profits (CSLL) and taxes on revenues (PIS and COFINS) when acquiring all kinds of goods or services from another legal entity.

In this regard, since January 2004, such provision was extended to the public companies and semi-state companies. Thus, since Petrobras is a semi-state company, all goods sold or services rendered to it are subject to this withholding procedure.

The table below provides a summary of withholding rates for some selected transactions:

Withholding Taxes					
Description	**Rates**				
	IRPJ	**CSLL**	**PIS**	**COFINS**	**Total**
Services rendered with the utilization of goods					
Transportation of goods	1,20%	1,00%	3,00%	0,65%	**5,85%**
Goods in general					
International transportation of goods, performed by Brazilian companies	1,20%	1,00%	0,00%	0,00%	**2,20%**
Telephone					
Labor force rental					
Vigilance					
Business intermediation	4,80%	1,00%	3,00%	0,65%	**9,45%**
Factoring					
Other services					

Other taxes

Other taxes are usually levied upon the operations of Brazilian companies, including those direct or indirectly applicable to the operations carried out by upstream companies. Even if not directly related to the profits accrued from operations, we deem it relevant to comment on the main aspects pertaining to such taxes and contributions, inasmuch as they may affect calculation of accounting for profit or loss and the tax burden of companies involved in upstream activities.

Tax on financial transactions (IOF)

IOF is a federal tax levied on credit, exchange and insurance operations and financial transactions. Its regulations are currently consolidated in Decree 6,306/07 (IOF regulations). Considered as an instrument of government economic policy, its rate may be changed at any time.

Under the IOF regulations, in the case of exchange operations, for instance, the applicable rate may reach as high as twenty-five per cent (25%). After the end of CPMF, the Brazilian government increased the IOF rates applicable to certain transactions, in an effort to partially compensate the tax collection losses.

Contribution for intervention in the economic domain (CIDE)

Technical and administrative assistance services and royalties

Law 10168 went into force on December 29, 2000, to encourage Brazilian technological development, instituting a program to stimulate interaction between universities and companies to support innovation. Hence, Brazilian technological development is stimulated through programs involving scientific research and technological cooperation between universities, research centers and the productive sector.

The raising of funds for the program in question takes place through collections of the contribution for intervention in the economic domain (CIDE), instituted by Article 2 of the said law. This levy is due by corporate entities that have license to use or acquire technological knowledge, companies signing contracts that entail transfer of technology, companies signing contracts providing technical and administrative assistance, with parties resident or domiciled overseas.

The contribution is levied at the rate of ten per cent (10%) on amounts paid, credited, turned over, employed or remitted each month to parties resident or domiciled abroad, by way of remuneration arising from the obligations indicated previously.

CIDE is not considered a withholding tax as the taxpayer is the person who remits the payment, while the taxpayers for withholding tax are the beneficiaries of the remittances.

Importation and Sale of Petroleum, Natural Gas and their Derivatives

Law 10336/01 provides for the levy of CIDE on the importation and sale of petroleum, natural gas and derivatives thereof, as well as fuel alcohol.

CIDE triggering events are transactions carried out by taxpayers involving the importation and sale on the Brazilian domestic market of gasoline, diesel and other fuels, pursuant to Article 3 of such Law. Further, under such legal provision, CIDE taxpayers include the individual or corporate producers, formulators and importers of liquid fuels.

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