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BRAZIL'S PROFIT REMITTANCE LAW: RECONCILING GOALS IN FOREIGN INVESTMENTS

JAN HOFFMAN FRENCH*

Promoting foreign investment is a goal of many developing nations. Along with the benefits of that investment, however, foreign participation in development creates problems such as balance of payments deficits caused by the repatriation of profits earned by the foreign investor. Brazil's profit remittance law is one effort to reconcile these problems. By providing for the registration of foreign investment and using a system of reinvestment incentives, the Profit Remittance Law seeks to promote foreign investment while avoiding the loss of capital which results when profits are remitted abroad. The author of this article describes and explains the Profit Remittance Law and considers its impact on foreign investment in Brazil. The author then assesses the effectiveness of the law in achieving its goals of encouraging investment and retaining the byproducts of such investment in Brazil.

Foreign investment can have an enormous impact on the economy of a developing country. A national decision to encourage such investment involves careful consideration of often competing policies and goals. In enacting investment legislation, the government of a developing country must weigh the advantages of foreign investment in encouraging better use of the nation's assets for national development and local accumulation of capital, against the increased burden on the balance of payments due to eventual profit and interest remittances.

The Profit Remittance Law¹ is the Brazilian attempt to balance

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1. Law No. 4131 of Sept. 3, 1962, [1962] 5 Coleção das Leis [Coleção] 117, amended by Law No. 4390 of Aug. 29, 1964, [1964] 5 Coleção 97 [hereinafter cited as Profit Remittance Law].

these concerns.² The Law provides for the registration of all private foreign investment³ if the foreign investor intends to repatriate or

2. For some general views on the Profit Remittance Law in relation to the political history of Brazil, see P. FLYNN, *BRAZIL: A POLITICAL ANALYSIS* 153-54 (1978); T. SKIDMORE, *POLITICS IN BRAZIL, 1930-1964* (1967); P. PARKER, *BRAZIL AND THE QUIET INTERVENTION, 1964* (1979).

Brazil's present law was predated by 1946 legislation which placed annual ceilings of 8 percent on profit remittances and 20 percent on capital repatriations. Decree Law No. 9025 of Feb. 27, 1946, [1946] 1 Coleção 506. These limits, as well as a 1952 attempt to restrict remittances were, however, never actually applied. Decree No. 30,363 of Jan. 3, 1952, [1952] 2 Coleção 5. In 1962, Law No. 4131, the present law prior to amendment, was placed on the books, but was not enforced until President Goulart signed the enabling decree in January 1964. Decree No. 53,451 of Jan. 20, 1964, [1964] 2 Coleção 41. Following an abrupt change in government, Law No. 4131 was amended and finally put into force in February 1965. Decree No. 55,762 of Feb. 17, 1965, [1965] 2 Coleção 397 [hereinafter cited as Regulations to the Profit Remittance Law].

The 1962 pre-amendment law and its 1964 enabling decree imposed a 10 percent limit on profit remittances and a 20 percent limit on capital repatriations. Decree No. 53,451 of Jan. 20, 1964, arts. 31-34, [1964] 2 Coleção 41. The foreign capital base on which these limits were calculated included only initial investments and not reinvestments. *Id.* arts. 13, 31. Prior to the 1964 amendment, reinvestments were registered only in Brazilian currency. *Id.* art. 14.

As amended in 1964, and as still applied, the law no longer places caps on remittances or repatriations. Law No. 4390 of Aug. 29, 1964, [1964] 5 Coleção 97, art. 2, § 1 [hereinafter cited as Amendments to the Profit Remittance Law]. It instead requires payment of a progressive tax supplementary to the standard withholding tax. *See* Profit Remittance Law, *supra* note 1, art. 43.

The 1964 amendment also revised the registered foreign capital base to include reinvested profits. *Id.* arts. 3, 4. Reinvestments are registered in both foreign and national currencies and are considered foreign capital. *Id.* art. 4. This increases the investment base on which subsequent remittances are calculated, thus permitting larger payments of foreign currency further down the road.

More stringent rules regarding royalty remittances, especially between Brazilian subsidiaries and foreign parent corporations, and registration of licensing and technical assistance contracts are other features of the amended law. Profit Remittance Law, *supra* note 1, art. 14; Regulations to the Profit Remittance Law, *supra*, art. 20. These provisions represent an attempt to obtain needed technology without the government paying excessive prices for it, while at the same time ensuring that these companies do not avoid tax liability.

3. Central Bank of Brazil figures reveal that registered foreign investments quadrupled between 1972 and 1978. In 1978, registered foreign investment in Brazil reached US \$13.74 billion. Araújo, *Foreign Investment and Transfer of Technology Laws and Regulations in Brazil*, in PRACTISING LAW INSTITUTE, *LEGAL ASPECTS OF DOING BUSINESS IN LATIN AMERICA* 39 (1980). Central Bank figures showed US \$19.2 billion in registered foreign investment by the end of 1981, an increase of 10 percent over the previous year. O Estado de São Paulo, Mar. 28, 1982, at 43, col. 2. An additional US \$5.5 billion in foreign capital had been reinvested in the country. O Estado de São Paulo, Feb. 17, 1982, at 25,

reinvest the capital, or to remit the profits, dividends, interest, royalties, or technical assistance fees derived from the investment.⁴

O Estado de São Paulo, Mar. 28, 1982, at 43, col. 2. An additional \$5.5 billion in foreign capital had been reinvested in the country. O Estado de São Paulo, Feb. 17, 1982, at 25, col. 5.

4. When registration of foreign capital entering Brazil is accepted by the Central Bank, the bank issues a certificate of registration which serves as evidence of the investment and must be presented for all subsequent remittances, reinvestments, and repatriations. Regulations to the Profit Remittance Law, *supra* note 2, art. 7. Foreign capital can be registered in any currency entered in Brazil, regardless of the country of origin. For example, a U.S. company can remit dollars, yen or Swiss francs as equity contribution to a Brazilian firm. The initial capital will be registered in each of the currencies. The reinvestments, however, will be made only in dollars, since reinvested profits are registered simultaneously in *cruzeiros* and the currency of the country to which the profits could have been remitted. Profit Remittance Law, *supra* note 1, art. 4. However, incoming capital in the form of goods must be registered in the currency of its country of origin. *Id.*

The foreign currency figure appearing on the certificate is the "registered foreign capital base." Profit remittances are taxed at a fixed rate until a point is reached at which a supplementary tax is levied, calculated as a percentage of the registered foreign capital base. A 25 percent nonresident withholding tax is withheld from all payments actually remitted or simply credited or attributed to nonresidents. This 25 percent is calculated as a percentage of the remittance itself. After the 25 percent is deducted, the 12 percent of registered foreign capital is calculated for supplementary tax purposes. *See* A. ANDRADE, GUIDELINES ON BRAZIL'S FOREIGN INVESTMENT LAW 75 (1980) [hereinafter cited as ANDRADE GUIDELINES]. *See also* Hornbostel, *Brazil: Withholding Taxes on Foreigners' Income*, 6 LAW & POL'Y INT'L BUS. 987, 992-93 (1974). Repatriation of the entire registered foreign currency amount including both the original investment and later reinvestments is permitted without the imposition of taxes. *See infra* notes 59-87 and accompanying text. Therefore, the higher the registered foreign capital base, the higher will be the permitted remittances and repatriations in the future.

For this reason, foreign investors are always interested in having their reinvested profits registered in foreign currency. The Central Bank, however, follows its own internal, generally unpublished, norms for deciding the amount of the reinvestment it will register in foreign currency. Interview with Attila de Souza Lëao Andrade Jr., Escritório de Advocacia, São Paulo, Brazil (Feb. 12, 1982) [hereinafter cited as Andrade Interview].

The Central Bank will register in foreign currency only those profits actually derived from the operating business of the Brazilian company receiving the investment. Thus, profits representing passive income such as that derived from real estate and investments in stock will probably not be eligible for registration in foreign currency. ANDRADE GUIDELINES, *supra*, at 61. In addition, the capitalization of reserves due to monetary correction of a company's fixed assets and working capital reserves can be registered only in *cruzeiros*, therefore keeping down the registered foreign capital base. Remarks of José Roberto Opice, Attorney, Barros, Machado & Meyer, Seminar for Newly-Arrived Businessmen Before the American Chamber of Commerce for Brazil, São Paulo, Brazil (Nov. 7, 1977) [hereinafter cited as Opice Remarks]. *See also* THE LAW AND YOU, Oct. 1981; O Estado de São Paulo, Nov. 8, 1981, at 56, col. 5.

By monitoring all such investment, registration helps the Central Bank of Brazil⁵ prevent overvaluation of the incoming foreign capital that is the base upon which all future remittances abroad are calculated. In this way, registration helps to deter an excessive balance of payments deficit.

In spite of the Law's title, it covers more than simply the registration and taxation of profit remittances. It also regulates loans and interest payments between foreign creditors and Brazilian borrowers,⁶ the transfer of technology to Brazilian enterprises and subsequent payments abroad,⁷ the importation of machinery to Brazil,⁸ and other banking and exchange controls.⁹ In addition, the Law encourages national planning by providing a mechanism through which to channel incoming financial resources to priority economic sectors and geographic locations.¹⁰

Through this elaborate system of regulation, the Profit Remittance Law attempts to reconcile Brazil's immediate needs for capital, technology, imports, industrial development and growth, and increased employment opportunities, with its more long-term efforts to attain economic autonomy and control and larger foreign exchange reserves, to increase exports, to lower trade deficits, and to improve the balance of payments. These short- and long-term needs are often in conflict. For example, when short-term needs require increased imports, notably of oil, foreign currency leaves Brazil, creating a deficit in its balance of payments. Foreign reserves are

Registration of reinvested monetary correction reserves exclusively in *cruzeiros* merely represents the Central Bank's recognition of a foreign investor's increased capital participation in the Brazilian company in which he has invested. Remarks of José Cotrim, Price Waterhouse Seminar on Foreign Investments in Brazil, São Paulo, Brazil (Feb. 9, 1982) [hereinafter cited as Cotrim Remarks]. Dividends are calculated on the company's total corporate capital; paid-in capital is corrected annually; records of Brazilian companies are kept in *cruzeiros*. Brazilian Corporation Law, Law No. 6404 of Dec. 15, 1976, art. 5, [1976] 7 Coleção 105 [hereinafter cited as Brazilian Corporation Law]. The foreign investor, therefore, may remit his share of the dividends attributable to corporate capital registered in *cruzeiros*, but must pay the supplementary tax on the dividends remitted which exceed 12 percent of the registered foreign capital base, which is, as stated above, expressed in foreign currency. Profit Remittance Law, *supra* note 1, art. 43.

5. See *infra* note 11.

6. See *infra* notes 88-119 and accompanying text.

7. See *infra* notes 120-148 and accompanying text.

8. See *infra* notes 149-158 and accompanying text.

9. See *infra* notes 200-242 and accompanying text.

10. See *infra* notes 297-339 and accompanying text.

thereby depleted and are unavailable to repay the country's long-term debt. Simultaneously, Brazil needs foreign investment to enlarge the manufacturing and industrial sectors of its economy. As a result, precious foreign currency needed to repay the debt is remitted to foreign investors in the form of dividends, interest, royalty, and fee payments.

After first describing the Profit Remittance Law and related Brazilian legislation, this article will consider the impact on investment of the Law's implementation. The article will then analyze and assess the Law's effectiveness in its efforts to reconcile Brazil's competing foreign investment and development goals.

THE PROFIT REMITTANCE LAW AND ITS ADMINISTRATION

Registration of Foreign Investments

The Profit Remittance Law requires all foreign capital invested and reinvested in Brazil to be registered with the Central Bank of Brazil,¹¹ as a prerequisite to the repatriation of investments and the

11. Profit Remittance Law, *supra* note 1, art. 3. The statute guarantees non-discriminatory legal treatment of similarly situated foreign and national capital in situations not covered by the Profit Remittance Law. *Id.* art. 2. Some distinctions are drawn in the Law itself, such as the registration requirement and the prohibition against nonvoting shares and securities issued by foreign-controlled corporations being placed on the Brazilian Stock Exchange. *Id.* arts. 3, 40.

Registration was originally to be made with the Superintendency of Currency and Credit (SUMOC). Profit Remittance Law, *supra* note 1, art. 3. SUMOC was replaced by the Central Bank of Brazil, which was created on Dec. 31, 1964. The Central Bank executes the financial policies of the National Monetary Council, an interministerial body headed by the Minister of Finance. Exchange control, registration of foreign capital and profit remittance, control of credit transactions, regulation of financial institutions and issuance of currency are among the Central Bank's functions. Law No. 4595 of Dec. 31, 1964, arts. 2, 6, 8, 10, 11, [1964] 7 Coleção 519. Members of the Bank's Board of Directors and employees responsible for foreign capital registration must declare their assets and income annually to the Federal Accounting Tribunal. Profit Remittance Law, *supra* note 1, art. 36.

Approval by the Central Bank is needed for acquisition abroad of companies whose assets are preponderantly in Brazil. Regulations to the Profit Remittance Law, *supra* note 2, art. 60. Inheritances, prizes, awards, and authors' rights and revenues received or credited in Brazil must have Central Bank permission for remittance abroad. *Id.* art. 61. The Central Bank may investigate the veracity of declarations made to it and may demand all necessary information and evidence. *Id.* art. 62. The Central Bank publishes all foreign capital registrations daily in the nation's Official Gazette, the *Diário Oficial*. *Id.* art. 66. To this end, companies must provide the information necessary to keep registrations up to date when requested to do so by the Bank. Profit Remittance Law, *supra* note 1, art. 6. The

remittance of profits, dividends, and other payments abroad.¹² Capital is considered to be foreign when it belongs to an individual who resides or is domiciled outside of Brazil, or to a corporation headquartered abroad.¹³ Such capital includes assets, machinery, and equipment, bound for the production of goods and services, which enter Brazil without an initial outlay of foreign currency. It also includes other financial resources destined for use in economic activities.¹⁴

Regulations to the Profit Remittance Law require the Central Bank Board of Directors to determine the formalities and evidentiary documents required for granting registration of foreign capital and corresponding reinvestments. Regulations to the Profit Remittance Law, *supra* note 2, art. 13. This includes capital which was in Brazil at the time the law was enacted. *Id.*; Profit Remittance Law, *supra* note 1, art. 5, §§ 1, 2.

12. Profit Remittance Law, *supra* note 1, art. 9. In 1978, investors in Brazil registered US \$13.7 billion in foreign capital and investments, but remitted only US \$564 million. Araújo, *supra* note 3, at 39. Remittances comprised only just over 4 percent of registered investments. *Id.* From 1971 to 1974 the average remittances to all countries did not exceed 5.5 percent of the registered foreign capital. Pinheiro Neto, *Multinationals in Brazil*, 8 CASE W. RES. J. INT'L L. 311, 315 (1976).

13. Profit Remittance Law, *supra* note 1, art. 1.

14. Intangible property such as patents and know-how cannot be directly registered as foreign capital. Profit Remittance Law, *supra* note 1, art. 1. Know-how is sold rather than licensed, because, unlike patents and trademarks, technical assistance and other forms of know-how are not considered industrial property in Brazil. Law No. 5772 of Dec. 21, 1971, *augmented by* Normative Ruling No. 15 of Sept. 11, 1976, arts. 4.1, 4.5.2(a) [hereinafter cited as Normative Ruling No. 15].

Contracts for the sale of intangible technology must be approved and registered with the Central Bank and the National Institute for Industrial Property (INPI) so that subsequent payments may be remitted abroad or reinvested. *See* Rowland, *Foreign Investment in Brazil: A Reconciliation of Perspectives*, 14 J. INT'L L. & ECON. 39, 52 (1979).

Article 1 of the Profit Remittance Law does not exclude mortgaged property from the definition of registered foreign capital. Article 46 makes profits from the sale of real estate subject to the supplementary tax when the seller is a nonresident. Profit Remittance Law, *supra* note 1. A nonresident corporation can issue debentures abroad guaranteed by a mortgage on property located in Brazil only with Central Bank's prior approval. Brazilian Corporation Law, *supra* note 4, art. 73.

In practice, it is difficult to effect a foreign investment through a contribution of imported goods. Prior Central Bank approval is required to import the goods (equipment and machinery) to be used in industrial activities without exchange cover. Profit Remittance Law, *supra* note 1, art. 1. Goods are imported "without exchange cover" when they are imported into Brazil without any expenditure on the part of the Brazilian company to which they were delivered. No money is sent to the investor contributing the goods as capital. Remarks by Eric Street, Barros, Machado & Meyer, Seminar for Newly-Arrived

Procedurally, a foreign investor who intends to make future payments abroad must, when bringing foreign capital into Brazil, "request registration"¹⁵ from the Central Bank within thirty days of the date of entry through an intermediary bank authorized to deal in foreign exchange, or from the date of the accounting entry of a reinvestment.¹⁶ No tax or charge need be paid.¹⁷ Upon registration, the Central Bank determines the elements necessary to characterize the operation and to identify the parties.¹⁸ As part of the registration requirement, an extract of balance sheets of receiving companies¹⁹ must be provided to the Central Bank showing the amount of registered foreign capital or credit.²⁰ Profit and loss accounts²¹ must also be produced, showing profits, dividends, interest, or other returns attributed to persons or entities domiciled or headquartered abroad whose capital was initially registered.²² Upon registration, the Bank issues a certificate which must be presented when making payments abroad.²³

There is no *per se* penalty for failing to register because registration is only required if the investor intends future payments abroad. However, if registration is not requested, the foreign currency investment will be converted into Brazilian currency, *cruzeiros*, and

Businessmen Before the American Chamber of Commerce, São Paulo, Brazil, Sept. 28, 1976 [hereinafter cited as Street Remarks]. Since the value of the goods when registered increases the foreign capital base, the Law provides for "pricing." Profit Remittance Law, *supra* note 1, art. 5. However, due to import disincentives requiring a compulsory deposit with the Central Bank for later purchased capital equipment imports, initial investment of imported goods without exchange cover, which requires no deposit, is becoming more attractive despite the time it takes to obtain approval. Central Bank Resolution No. 443 of Sept. 14, 1977; P. GARLAND, *DOING BUSINESS IN BRAZIL* 114 (1978).

The approval process involves Central Bank examination to ascertain that equipment entering the country is new and that there is no locally manufactured equivalent. Decree No. 61,574 of Oct. 20, 1967. If the equipment is used, it must be unique in the world. Street Remarks, *supra*. See National Council of Foreign Trade, Resolution No. 64 of Sept. 23, 1974 [hereinafter cited as Foreign Trade Resolution No. 64].

15. Profit Remittance Law, *supra* note 1, arts. 1, 5.

16. *Id.* art. 5.

17. Profit Remittance Law, *supra* note 1, art. 5.

18. Regulations to the Profit Remittance Law, *supra* note 2, art. 3, § 1.

19. Brazilian Corporation Law, *supra* note 4, arts. 176, 178.

20. Profit Remittance Law, *supra* note 1, art. 21.

21. Brazilian Corporation Law, *supra* note 4, arts. 176, 178.

22. Profit Remittance Law, *supra* note 1, art. 22.

23. Regulations to the Profit Remittance Law, *supra* note 2, arts. 6-7.

will not be available for repatriation.²⁴ By requiring registration, the Central Bank controls the conversion of *cruzeiros* into remittable foreign currency, and prevents the overvaluation of capital assets imported as initial investments in anticipation of future repatriation or other payments abroad.²⁵

The registration procedure applies to all direct foreign investment entering Brazil, whether in the form of money or goods, including loans.²⁶ In addition, transfer of technology contracts and licenses, subsequent remittances of profits, dividends, interest, amortization, royalties for patents and trademarks, fees for technical assistance, and capital repatriation are all subject to Central Bank registration procedures.²⁷ Foreign capital is registered in the currency in which it enters Brazil.²⁸ Incoming capital in the form of goods is valued for registration purposes at its market value in the country of origin,²⁹ or, in the absence of satisfactory evidence of this price, at the value recorded by the receiving company in Brazil. Once determined, the value is registered in the currency of its country of origin.³⁰

The percentage of permitted remittances, reinvestments, or repatriations corresponds to the percentage of foreign capital registered by the Central Bank when the investment is initially made. If, for example, a foreign investor invests in a Brazilian company,³¹ either already existing or newly created by the investor, the

24. *Id.* art. 9.

25. See A. ANDRADE, *O CAPITAL ESTRANGEIRO NO SISTEMA JURIDICO BRASILEIRO* 76 (1979).

26. Profit Remittance Law, *supra* note 1, art. 3(a).

27. Profit Remittance Law, *supra* note 1, art. 3.

28. *Id.* art. 4. Registration of contracts that involve royalties or technical payments is made in the currency of the country where the beneficiary of the remittances is domiciled or headquartered. *Id.* art. 17.

29. *Id.* arts. 1, 4; Regulations to the Profit Remittance Law, *supra* note 2, art. 5 (“[f]oreign capital which enters in the form of goods shall be registered at the price shown in the commercial invoice . . .”).

30. Profit Remittance Law, *supra* note 1, art. 4. In general, the Central Bank requests an appraisal made by experts who are indicated at the company’s general shareholders’ meeting.

31. *Limitadas*—limited liability companies—and *Sociedades Anônimas*—stock corporations—are two Brazilian corporate forms. Decree No. 3708 of Jan. 10, 1919, art. 1, [1919] 1 Coleção 155; Brazilian Corporation Law, *supra* note 4, art. 3. See PRICE WATERHOUSE, *DOING BUSINESS IN BRAZIL* 23, 37–39 (1980), for a general description of Brazilian corporate forms [hereinafter cited as PRICE WATERHOUSE].

Central Bank will register in foreign currency only the value of the number of shares actually paid in, even though there may be a greater number of shares subscribed under the charter.³² Thereafter, only that same percentage of remittances, reinvestments, or repatriation will be allowed.³³

To be eligible for registration, reinvested profits, generated by registered foreign capital, must first be effectively capitalized.³⁴ In the case of a corporation, capitalization is achieved by a resolution at a shareholders' meeting.³⁵ As with repatriation and other remittances derived from direct investments, registration with the Central Bank is required for all remittances derived from reinvestments, whether or not the company is a Brazilian affiliate³⁶ of a foreign enterprise, or a majority of the Brazilian company's shares is owned

32. See Profit Remittance Law, *supra* note 1, arts. 1, 3(a); ANDRADE, *supra* note 25, at 167.

33. ANDRADE, *supra* note 25, at 167.

34. Retained earnings and profits of Brazilian companies are "reinvested" when capitalized and credited to non-Brazilians and put back into the national economy. See Profit Remittance Law, *supra* note 1, arts. 3, 5, 7. The statute provides that income will be considered reinvested when "reapplied in the same companies from which [it arose] or in another sector of the national economy." *Id.* art. 7.

There are a number of uncertainties as to the tax treatment of a branch in Brazil resulting in part from its ambivalent nature and in part from the fact that much legislation deals with the branch only to a limited extent or not at all. Uncertainties regarding the possibility of capitalizing a branch's earnings, the treatment of its investment income, and the applicability of taxes on distributed earnings of closely held companies makes financial planning of a branch difficult. GARLAND, *supra* note 14, at 167.

This is part of the Brazilian government's policy against the establishment of branches. *Id.* An executive decree is needed to open a branch in Brazil. Decree Law No. 2627 of Sept. 26, 1940, art. 64. Branch income is also subject to the 25 percent withholding tax because it is deemed at the immediate disposal of the foreign corporation. *Id.* art. 555, § 9.

35. Brazilian Corporation Law, *supra* note 4, arts. 132, 170.

36. *Id.* art. 3. "Affiliated"—*filiada*—is used in the Profit Remittance Law but it is not defined. *Id.* Under the Brazilian Corporation Law, "[c]ompanies are affiliated when one participates with 10% (ten percent) or more of the capital of another, without controlling it." Brazilian Corporation Law, *supra* note 4, art. 243, § 1. A controlling company holds rights which assure it "control" of corporate decisions and the power to elect a majority of the officers of the controlled company—*controlada*. *Id.* art. 243, § 2. An investment of less than 10 percent of the voting stock of a Brazilian company is a portfolio investment, which must be registered. Purchase and registration of such an investment in a Brazilian company must be made through specially chartered investment companies. Central Bank of Brazil, Regulations attached to Resolution No. 323 of May 8, 1975, arts. 25, 26, 34, *reprinted in* 11 ANEXO DO BOLETIM DO BANCO CENTRAL DO BRASIL, No. 5 (1975) [hereinafter cited as Regulations to Resolution No. 323]; Decree Law No. 1401 of May 8, 1975, [1975] 5 Coleção 6.

by nonresident individuals or corporations.³⁷

After capitalization, reinvestments are registered simultaneously in Brazilian currency and in the currency of the country to which the profits, if not reinvested, could have been remitted.³⁸ The conversion to foreign currency is based on the average exchange rate in effect between the date the profits appear on the company's balance sheet and the date the reinvestment becomes effective.³⁹ The average exchange rate is calculated on the basis of quotations of the foreign exchange market on which the reinvested profits could have been transferred abroad.⁴⁰

The Central Bank's policy, although as yet unwritten, has been that capitalization of monetary correction reserves, which are adjustments in the monetary value of a company's capital to compensate for inflation,⁴¹ must be registered in Brazilian currency only.⁴² Thus, monetary correction reserves are not treated as accretions to the registered foreign investment base,⁴³ but merely reflect a readjustment of the *cruzeiro* value of the initial investment. Therefore, they cannot be remitted as profit, nor repatriated as capital.⁴⁴ This unwritten rule is at present under consideration as the subject of new Central Bank regulations, and it is likely, although of course not certain, that it will be adopted.⁴⁵

Brazil needs advanced technology and therefore provides

37. The Profit Remittance Law applies to all foreign capital regardless of whether property used in the production of goods and services is owned by natural or juridical persons resident, domiciled, or having their main offices abroad. See Regulations to the Profit Remittance Law, *supra* note 2, art. 1. If an assignment or transfer of capital, creditor's rights, or contract rights is traded to a Brazilian company or individual, Central Bank registration is automatically cancelled. *Id.* art. 52.

38. Profit Remittance Law, *supra* note 1, art. 4.

39. *Id.* art. 4; Regulations to the Profit Remittance Law, *supra* note 2, art. 10, § 1.

40. Regulations to the Profit Remittance Law, *supra* note 2, art. 10, § 2.

41. See *infra* notes 68-72 and accompanying text.

42. The statute provides that, "[a]lterations in the monetary value in company capital" are to be registered with the Central Bank of Brazil under the Profit Remittance Law, but does not declare in which currency they are to be registered. See Profit Remittance Law, *supra* note 1, art. 3(d).

43. Article 3(d) of the Profit Remittance Law provides for registration of monetary correction. *Id.* The policy of the Central Bank, however, is to register its currency only in *cruzeiros*. See ANDRADE, *supra* note 25, at 156; Cotrim Remarks, *supra* note 4.

44. See *infra* note 72 and accompanying text.

45. See O Estado de São Paulo, Nov. 8, 1981, at 56, col. 5, for a report of Central Bank solicitation for comments regarding proposed regulations.

favorable tax treatment for royalty and technical assistance remittances.⁴⁶ Stringent registration requirements for transfer of technology, however, help prevent potential abuses of the favored tax status accorded technology, by requiring that its value be verified⁴⁷ and that the technical services for which the Brazilian economy is paying are actually being rendered.⁴⁸ When registering contracts involving payment of royalties for the use of patents or industrial trademarks, the investor must provide documents certifying that the patent and trademark rights are valid in Brazil⁴⁹ and in their country of origin.⁵⁰ International licensing agreements and technical assistance and service contracts involving remittances abroad must be registered with the National Institute of Industrial Property (INPI) as well as with the Central Bank.⁵¹

Indirect foreign investment, that is, foreign investment in the Brazilian stock market, must be made through investment companies approved by the Central Bank.⁵² Nonresidents invest in the investment companies through subscription agents, accredited by agency agreements registered with the Central Bank.⁵³ The companies purchase the stock and register the investment.⁵⁴ As with direct investment, registration is a prerequisite to any future remit-

46. Royalties and technical remittances, for example, are not subject to the supplementary tax which is levied on net profits and dividends actually remitted. Profit Remittance Law, *supra* note 1, art. 43. Royalties and technical remittances are also deductible on income tax returns, up to a percentage of gross receipts set by the Ministry of Finance. *Id.* art. 12; Regulations to the Profit Remittance Law, *supra* note 2, art. 18.

47. *See* Normative Ruling No. 15, *supra* note 14.

48. The Central Bank of Brazil may verify the effectiveness of technical assistance where a remittance of foreign exchange abroad is involved. Profit Remittance Law, *supra* note 1, art. 10; Regulations to the Profit Remittance Law, *supra* note 2, art. 19.

49. Normative Ruling No. 15, *supra* note 14, art. 2.5.1; Profit Remittance Law, *supra* note 1, art. 11.

50. Profit Remittance Law, *supra* note 1, art. 11.

51. Central Bank of Brazil, Foreign Capital Supervision and Registration Department (FIRCE), Communiqué No. 19 of Dec. 16, 1972, *reprinted in* 9 ANEXO DO BOLETIM DO BANCO CENTRAL DO BRASIL, No. 1 (1973); Profit Remittance Law, *supra* note 1, art. 12, § 2.

52. Regulations to Resolution No. 323, *supra* note 36, arts. 4, 12, 25, 26. Investment companies were created to mobilize foreign resources for application in the Brazilian capital market through diversified securities portfolios. *Id.* preamble, art. 3.

53. *Id.* art. 13. Accredited subscription agents must be institutions permitted to operate in the capital markets in the country of their principal office. *Id.*

54. Nonresidents invest in the investment companies which then purchase stock. *See id.* arts. 25, 26. All portfolio securities of investment companies are kept in the custody of a commercial or investment bank or securities exchange. *Id.* art. 51.

tances — in this case, of cash dividends and capital gains from the sale of shares issued by the investment company.⁵⁵ Thus all investment, portfolio as well as direct, must be registered upon entering Brazil.

Remittances Abroad: Requirements and Limits

Remittances abroad of profits, dividends, interest, amortization, royalties, and fees for technical, scientific, and administrative assistance generated by registered foreign investments must be transferred abroad through banks authorized to operate in foreign exchange.⁵⁶ Investors desiring the remittances must submit contracts and documents to the Central Bank which justify such transfers.⁵⁷ The investor must also present to the transferring bank the certificate of registration which had been issued by the Central Bank upon the investment's initial entry, as well as proof that income taxes have been paid.⁵⁸ When these requirements are fulfilled the remittance may be made.

55. *Id.* art. 25. Investments in investment companies must remain in Brazil for 3 years before the investment may be liquidated by sale of the shares and capital from the sale may be repatriated. *Id.* art. 19.

56. Profit Remittance Law, *supra* note 1, arts. 9, 23. Although article 23 initially states only that, "[e]xchange operations . . . shall be realized through establishments authorized to operate in exchange," the provision later makes reference to "banking establishment[s]." *Id.*

57. *Id.* art. 9. Article 9 states that persons desiring to make remittances abroad must submit to the Central Bank and the Income Tax Division "the contracts and documents which are considered necessary to justify the remittance." *Id.* Apparently the Central Bank determines what is "necessary." *See id.*; Regulations to the Profit Remittance Law, *supra* note 2, art. 14. This would be consistent with the responsibilities delegated to the Bank elsewhere in the statute to establish documentary requirements for registration and reinvestment. Profit Remittance Law, *supra* note 1, art. 5, § 2. In order to remit profits, one must present to a bank dealing in foreign exchange: (1) a certificate of registration; (2) a balance sheet with profits or losses for the year or period in which the profits or losses were generated; (3) minutes of the shareholders' meeting that authorized distribution; and (4) a chart of supplementary tax, whether or not due. The bank then annotates the back of the certificate of registration. Central Bank Circular Letter FIRCE No. 101 of July 14, 1978 [hereinafter cited as FIRCE Letter No. 101]. *See also* ANDRADE, *supra* note 25, at 164. For repatriation, documents including registration certificates, proof of sale of shares, proof of alteration of by-laws where corporate capital is reduced, proof of payment of tax, if remittance is greater than the amount registered on the certificate, and evidence of Central Bank approval of any such remittance, among others, must be produced. These requirements are subject to change as per the Profit Remittance Law. Profit Remittance Law, *supra* note 1, art. 9.

58. The Central Bank is required to furnish the interested party with the appropriate cer-

Although remittances of profits and dividends derived from registered foreign investments are limited, at present, only by the amount of registered capital,⁵⁹ they are subject to a fairly elaborate scheme of taxation. In addition to a general corporate income tax,⁶⁰ all earnings distributed to nonresidents, whether or not actually remitted, are subject to a withholding tax.⁶¹ Profits and dividends actually remitted are also subject to a supplementary income tax if, when averaged over a three-year period, they exceed 12 percent per annum of the originally registered foreign investment and any registered reinvestment.⁶² This progressive supplementary tax is withheld each time such an "excessive" remittance is made.⁶³ Profit remittances are made at the exchange rate prevailing at the time of the remittance.⁶⁴

To calculate the percentage of profits being remitted for the purpose of determining whether the remittance is excessive, the profit remitted, as calculated at the exchange rate on the date of remittance, is compared to the original foreign registered capital investment, which is frozen on the registration certificate at the exchange rate prevailing on the date of entry.⁶⁵ Because the *cruzeiro* has been steadily decreasing in value relative to the U.S. dollar,⁶⁶ the amount

tificate once registration has been granted. Regulations to the Profit Remittance Law, *supra* note 2, art. 6. Proof of payment of income tax is required by the company seeking to transfer its profits. Profit Remittance Law, *supra* note 1, art. 9, § 1. This proof of payment and registration must then be presented to the bank effecting the exchange operation. *See id.*; Regulations to the Profit Remittance Law, *supra* note 2, art. 7.

59. *See* Profit Remittance Law, *supra* note 1, art. 28; Amendments to the Profit Remittance Law, *supra* note 2, art. 2, § 2. If a serious distortion in the balance of payments exists or there is serious reason to believe that such distortion may be imminent, article 28 of the statute and article 2, § 2 of the Amendments allow the Central Bank to impose restrictions, for a limited period, on remittance of profits.

60. Decree No. 85,450 of Dec. 4, 1980, arts. 95-96, [1980] 4 Coleção 727 [hereinafter cited as Brazilian Income Tax Law].

61. *See id.* art. 555. Earnings are considered "realized" and therefore subject to the 25 percent withholding tax when they are entered in the books of the Brazilian company as credited to the nonresident taxpayer. *Id.* art. 575(IV)(c); *See also* ANDRADE GUIDELINES, *supra* note 4, at 68.

62. Profit Remittance Law, *supra* note 1, art. 43.

63. *Id.* art. 43, §§ 1, 2.

64. J. ARAUJO, INVESTMENTS IN BRAZIL: BASIC LEGAL ASPECTS 50 (5th ed. 1981) [hereinafter cited as INVESTMENTS IN BRAZIL].

65. *Id.* at 49-50. *See supra* note 16 and accompanying text.

66. The Central Bank devalued the *cruzeiro* vis-a-vis the U.S. dollar by over 96 percent between February 1981 and February 1982 in a series of exchange rate adjustments. For ex-

of remittable dollars, as compared to the earlier registered investment base, has decreased, the percentage of profit has therefore fallen, and excessive remittances are rarer.⁶⁷

In addition to the declining exchange rate, inflation has created a problem in the calculation of the percentage of profits over time. Monetary correction, a form of indexation, is the Brazilian solution to this problem. Each month, the Brazilian government sets a coefficient, representing the rate of correction for inflation that it is willing to pay investors in national treasury bills, *Obrigações Reajustáveis do Tesouro Nacional*, above the interest rate.⁶⁸ The monetary correction

ample, on February 24, 1982, the exchange rate was readjusted for the sixth time since January 1, 1982 to Cr. \$140.45 per US \$1.00 for Central Bank purchases, and to Cr. \$141.15 per US \$1.00 for sales. *O Estado de São Paulo*, Feb. 20, 1982, at 27, col. 3.

67. The following is a simplified illustration of the effect of Brazilian currency devaluation on profit remittances (exchange rates are for illustration only):

	Case I		
	US\$	Exchange Rate	CR\$
Registered Investment Base	1,000.00	100.00	100.000,00
Profit	130.00	100.00	13.000,00
Percentage	13		13

If the exchange rate were to be the same at the time of the remittance as it was at the time of the investment, the remittance would be higher than 12 percent of the registered foreign capital and the supplementary tax would be imposed on the excess remittance (exchange rates are for illustrations only):

	Case II		
	US\$	Exchange Rate	CR\$
Registered Investment Base	1,000.00	100.00	100.000,00
Profit	104.00	125.00	13.000,00
Percentage	10.4		13

In this case the exchange rate is modified, resulting in a *cruzeiro* devaluation. The investor is realizing a profit higher than 12 percent of his registered investment in *cruzeiros*, but is considered to be remitting less than 12 percent and escapes the supplementary tax. The preceding illustrations were adapted from *INVESTMENTS IN BRAZIL*, *supra* note 64, at 50.

68. M. Sills, *Joint Ventures in Brazil: A Canadian Perspective* (April 1, 1981) [hereinafter cited as Sills] (unpublished article on file at the offices of *Law & Policy in International Business*).

coefficient is applied to fixed assets,⁶⁹ capital investments,⁷⁰ and shareholders' equity.⁷¹ Surplus created by monetary correction is placed in a reserve of the Brazilian company and, when it is capitalized, it is registered with the Central Bank in *cruzeiros* only and does not, therefore, affect the registered foreign investment base, nor can it be remitted or repatriated.⁷²

Unlike the remittance of profits, the repatriation of foreign capital that has been invested or reinvested in Brazil remains untaxed up to the registered amount, upon presentation of the registration certificate.⁷³ In addition, the Central Bank requires documentation of capital withdrawal,⁷⁴ for example, the minutes of a shareholders' meeting authorizing the sale of shares,⁷⁵ the reduction of corporate capital,⁷⁶ or liquidation.⁷⁷ These documentation requirements are subject to constant change. The Central Bank in its discretion issues nonpublic internal orders⁷⁸ which may at one time require the production of balance sheets of a company for the preceding three years and, at another time, require the financial statement for only one year.⁷⁹ This flexibility affords the Bank the opportunity to regulate outgoing foreign currency by imposing stricter regulations

69. Brazilian Corporation Law, *supra* note 4, art. 185, § 1(a).

70. *Id.*

71. *Id.* arts. 167, 182.

72. *Id.* art. 182, para. 2. See also *supra* notes 43-44 and accompanying text.

73. Remittance abroad is made by presenting the certificate of registration issued by the Central Bank to the bank involved in the exchange. Regulations to the Profit Remittance Law, *supra* note 2, art. 7. Reinvested profits must remain in Brazil for at least five years before they can be repatriated, tax free, along with the original investment. Decree Law No. 1598 of Dec. 26, 1977, art. 63; Decree Law No. 1109 of June 26, 1970, art. 3. T. FELSBERG, *FOREIGN BUSINESS IN BRAZIL* 65 (2d ed. 1976). Repatriation of reinvested profits is permitted tax free to encourage lower remittances and higher reinvestments. See Pinheiro Neto, *supra* note 12, at 315.

74. See FIRCE Letter No. 101, *supra* note 57, pt. II; Regulations to the Profit Remittance Law, *supra* note 2, arts. 7, 14; Profit Remittance Law, *supra* note 1, art. 9.

75. The articles of incorporation or the shareholders may authorize a redemption of stock. Brazilian Corporation Law, *supra* note 4, arts. 30, §§ 1, 44.

76. A general meeting of the shareholders can reduce the level of corporate capital with the shareholders receiving a part of the value of their shares. *Id.* art. 174.

77. The manner of liquidation is determined by a general meeting of the shareholders where the articles of incorporation are silent as to the issue. *Id.* art. 208.

78. Andrade Interview, *supra* note 4. One such internal rule regulates remittances abroad from profit reserves of Brazilian companies. If, when profits are remitted, the Central Bank finds that funds other than operating profit are included in the reserves, it will disallow the remittance of that portion. *Id.*

79. Article 5, § 2 of the Profit Remittance Law, allows the Central Bank to establish

when it believes it to be necessary. Its disadvantage is that it makes it difficult for the public to predict which documents will be required for repatriation.

Capital is repatriated in the foreign currency in which it was registered, at the exchange rate in effect at the time of repatriation.⁸⁰ If the *cruzeiro* has been devalued between the date of initial investment and the date of repatriation, fewer U.S. dollars than comprised the initial investment would be permitted to be repatriated.⁸¹ Paradoxically, this apparently negative effect of devaluation can be advantageous to the foreign investor. If the initial investment has generated a profit, when the investor winds up the company, only the amount of profit above the initial investment, as it appears on the registration certificate at the earlier, more favorable exchange rate, will be subject to the foreign nonresident withholding tax.⁸² Capital gain, that is capital which exceeds the amount appearing on

these requirements by authorizing it to take the necessary steps to assure that the registration of data is maintained on a current basis. Interview with Ms. Gelza Bueno, Attorney, Campos, Salles, Portugal & Vaz, in São Paulo, Brazil (Sept. 18, 1981).

80. FELSBERG, *supra* note 73, at 65; INVESTMENTS IN BRAZIL, *supra* note 64, at 50.

81. INVESTMENTS IN BRAZIL, *supra* note 64, at 50.

82. The following is a simplified illustration of the effect of a Brazilian currency devaluation on capital repatriation to a foreign investor (exchange rates are for illustration only):

	US\$	Exchange Rate	CR\$
Registered Investment in Year One	1,000.00	100.00	100,000.00
Value of Registered Investment in Year Two	800.00	125.00	100,000.00

In year two, the foreign investor could repatriate the US \$ 800.00 without paying tax of any kind. In fact, he could remit up to US \$1,000.00 tax free, even if some of it is actually profit, as the following illustration shows:

	US\$	Exchange Rate	CR\$
Registered Investment in Year One	1,000.00	100.00	100,000.00
Value in Year Two	800.00	125.00	100,000.00
Profit	400.00	125.00	50,000.00
Profit Remittance	1,200.00	125.00	150,000.00

In this case, the foreign investor would be permitted to remit part of his profit (US \$200.00) as repatriation of capital. Only the amount of profit above the US \$1,000.00 ini-

the registration certificate, may be repatriated only with prior approval from the Central Bank.⁸³ If such approval is requested, the Central Bank performs an accounting analysis to determine the origin of the capital gains and, if it finds that any premium being paid for the shares is economically justifiable, it will approve the remittance.⁸⁴ To determine whether the payment of such a premium is justifiable, the Central Bank assesses the company's prospects for future profit-making and its development of goodwill.⁸⁵ The excess capital remitted is considered profit and taxed accordingly.⁸⁶ For example, if the certificate of registration is for \$250,000.00 and the shares or quotas of the company are sold for more than that amount, the 25 percent nonresident withholding tax is paid on the excess.⁸⁷

Loans, Credit, and Financing

The Central Bank, in the opinion of many observers, maintains a cautious policy regarding government financing and guarantees to Brazilian⁸⁸ and foreign debtors.⁸⁹ Careful scrutiny of foreign loans helps prevent lenders from charging excess interest to Brazilian debtors as a device to avoid the supplementary tax on profits and dividends.⁹⁰ Without this control, the government would risk exacerbating Brazil's already growing foreign debt by permitting

tial investment (US \$200.00) would be exposed to the foreign nonresident withholding tax. The preceding illustration was adapted from INVESTMENTS IN BRAZIL, *supra* note 64, at 50-51.

83. See GARLAND, *supra* note 14, at 107; PRICE WATERHOUSE, *supra* note 31, at 120.

84. Andrade Interview, *supra* note 4.

85. *Id.*

86. FELSBERG, *supra* note 73, at 65; see Brazilian Income Tax Law, *supra* note 60, arts. 551, 555.

87. Brazilian Income Tax Law, *supra* note 60, art. 555.

88. See Pinheiro Neto, *supra* note 12, at 324.

89. See *id.* at 318.

90. The supplementary tax is levied only on remittances of net profits and dividends which fall within the scope of the provision. Profit Remittance Law, *supra* note 1, art. 43. The 25 percent withholding tax—less where a double taxation treaty exists—applies to remittances of interest as well as profits and dividends. Brazilian Income Tax Law, *supra* note 60, art. 555; Profit Remittance Law, *supra* note 1, art. 42. However, the Brazilian taxpayer receives a 40 percent rebate of the paid tax, and does not pay supplementary tax on interest payments. See *id.* art. 43; Central Bank of Brazil Resolution No. 613 of May 8, 1980, reprinted in 16 ANEXO DO BOLETIM DO BANCO CENTRAL DO BRASIL, No. 5 (1980) [hereinafter cited as Central Bank Resolution No. 613].

an increased number of foreign loans with high interest rates, repayable in foreign currency at high exchange rates.⁹¹ The Central Bank implements these controls by challenging and refusing to register the interest rate stipulated in a submitted foreign currency loan contract, import credit, or financing through offerings on an external market,⁹² if it exceeds the prevailing rate for similar operations in the foreign financial market where the loan, credit, or financing originated.⁹³

The interest rate set out in a foreign loan contract, once recorded on the registration certificate, is the maximum rate allowed for that transaction.⁹⁴ Since the Central Bank sets the maximum interest which may be remitted and diligently monitors the remittances, it is very rare for a debtor to remit more than the rate of interest set forth in the loan agreement.⁹⁵ When repaying a loan, in addition to paying the interest, the debtor repays in each installment a portion of the principal. If, in an unusual situation, the debtor pays more interest than the approved percentage provided in the contract, the Central Bank will credit the average of the interest paid to the amortization to be paid in the following installment, effectively limiting the rate of interest actually charged,⁹⁶ and lowering the total permitted remittance for the next installment.⁹⁷

Foreign loans may be made directly from a bank abroad to a Brazilian borrower,⁹⁸ or through a local bank acting as intermediary.⁹⁹ Prior Central Bank approval and registration are required before interest payments may be remitted.¹⁰⁰ Moreover, the

91. See Gereffi & Evans, *Transnational Corporations, Dependent Development, and State Policy in the Semiperiphery: A Comparison of Brazil and Mexico*, 16 *LATIN AM. RESEARCH REV.* at 55 (1981). See also *supra* note 66 and accompanying text.

92. Profit Remittance Law, *supra* note 1, art. 8.

93. *Id.*

94. See *id.*

95. Andrade Interview, *supra* note 4.

96. Profit Remittance Law, *supra* note 1, art. 8.

97. *Id.*

98. See Central Bank of Brazil Resolution No. 229 of Sept. 1, 1972, reprinted in 8 ANEXO DO BOLETIM DO BANCO CENTRAL DO BRASIL, No. 9 (1972); Profit Remittance Law, *supra* note 1, art. 1. See also Araújo, *supra* note 3, at 28-29; ANDRADE GUIDELINES, *supra* note 4, at 83-84.

99. Central Bank of Brazil Resolution No. 63 of Aug. 21, 1967, reprinted in 13 ANEXO DO BOLETIM DO BANCO CENTRAL DO BRASIL, No. 8 (1967).

100. In the case of loans made directly to Brazilian borrowers, see FIRCE Communique

restrictive government policy towards foreign loans has resulted in other Central Bank restrictions, including, as of December 1981, a thirty-month mandatory grace period, an eight-year minimum repayment schedule, and a non-interest bearing deposit with the Central Bank.¹⁰¹ It should be noted, however, that these requirements are subject to modification.¹⁰² Foreign credit used to finance imports of capital goods, raw materials, and merchandise is permitted only upon authorization by the Central Bank.¹⁰³ The issuance of debentures abroad based on guarantees of assets in Brazil—another form of foreign financing—is also subject to prior Central Bank approval.¹⁰⁴

A counterpoint to the Brazilian government's conservative approach to foreign loans is its desire for foreign currency to service its foreign debt. To encourage loans to Brazilian borrowers, the government is currently giving a 40 percent rebate on the 25 percent withholding tax on interest payments abroad, provided that the tax burden is shifted to the Brazilian debtor in the loan agreement.¹⁰⁵ Indeed, in 1981 alone, Brazil attracted 17.4 billion U.S. dollars in foreign loans.¹⁰⁶

The Central Bank, in the past few years, has adopted a policy en-

No. 10 of Dec. 10, 1969, *reprinted in* 6 ANEXO DO BOLETIM DO BANCO CENTRAL DO BRASIL, No. 1 (1970). In the case of Central Bank No. 63 loans, approval is referred to as a "Certificate of Authorization" and the certificate of registration as a "Schedule of Payments." See also Skola, *Foreign Loans in Brazil: Theory and Practice*, 15 INT'L LAW. 73, 76 (1981).

101. See ANDRADE GUIDELINES, *supra* note 4, at 83-84.

102. Central Bank Resolution No. 638 of Sept. 24, 1980; Central Bank Circular No. 574 of Oct. 22, 1980; Central Bank Circular No. 584 of Dec. 3, 1980; Central Bank Resolution No. 355 of Feb. 26, 1982. Some provisions exempt certain import financing from existing requirements for incoming foreign loans.

103. Central Bank of Brazil Resolution No. 355 of Dec. 2, 1975, *reprinted in* 12 ANEXO DO BOLETIM DO BANCO CENTRAL DO BRASIL, No. 1 (1976); FIRCE Communiqué No. 25 of Dec. 2, 1975, *reprinted in* 12 ANEXO DO BOLETIM DO BANCO CENTRAL DO BRASIL, No. 1 (1976).

Imports made with foreign credit must be licensed. The Brazilian agency that authorizes imports and grants import licenses is the Foreign Trade Department of the Bank of Brazil, the *Carteira do Comércio Exterior do Banco do Brasil S.A.* (CACEX). FIRCE Communiqué No. 25 of Dec. 2, 1975, *supra*.

104. Brazilian Corporation Law, *supra* note 4, art. 73.

105. Central Bank Resolution No. 613, *supra* note 90. Decree Law No. 1351 of Oct. 24, 1974, art. 9, [1974] 7 Coleção 10, 11; Decree Law No. 1411 of July 31, 1975, [1975] 5 Coleção 11.

106. O Estado de São Paulo, Dec. 23, 1981, at 34, col. 5.

couraging conversion of debt into equity,¹⁰⁷ in which it offers financial benefits to the creditor to induce him to leave his money in Brazil for a longer period of time than it would otherwise remain in the form in which it entered.¹⁰⁸ This policy reflects Brazil's eagerness for foreign currency. Although the process of conversion is routine,¹⁰⁹ the policy has not been very successful; in spite of the government incentives, foreign investors generally prefer debt to equity because the return on debt is for a sum certain, and the supplementary tax is not applicable to interest payments.¹¹⁰

The Brazilian government also encourages foreign companies in Brazil to obtain financing abroad by favoring domestic enterprises in the distribution of government financial support and guarantees. The National Treasury¹¹¹ and federal and state credit entities accordingly guarantee foreign loans, credit, and financing obtained by companies whose majority of voting stock is in foreign hands only when authorized by executive decree.¹¹²

The National Bank for Economic and Social Development (BNDES),¹¹³ a wholly-owned government bank, generally provides credit only to Brazilian-controlled companies.¹¹⁴ Nevertheless, foreign-controlled companies can receive some financing from Brazil. They can, for example, obtain Brazilian financing, including resources from public funds,¹¹⁵ for new fixed

107. Regulations to the Profit Remittance Law, *supra* note 2, art. 50(a).

108. ANDRADE, *supra* note 25, at 87-88.

109. *Id.* To obtain conversion of debt into equity a foreigner needs only to request it.

110. *See* Profit Remittance Law, *supra* note 1, art. 43; *see also supra* note 90 and accompanying text.

111. The National Treasury is the federal agency responsible for the federal budget and acts through the Bank of Brazil which is the financial agent.

112. Profit Remittance Law, *supra* note 1, art. 37. Executive approval is based upon an opinion issued by the Minister of Planning and General Coordination on the priority rating of the project and the ability of the debtor to repay the loan. Decree Law No. 1312 of Feb. 15, 1974, art. 4, [1974] 1 Coleção 9.

113. The *Banco Nacional de Desenvolvimento Econômico* (BNDE) was created in 1974 by Decree No. 73,713 of Mar. 1, 1974, [1974] 2 Coleção 305, amended by Decree No. 74,011 of May 6, 1974, [1974] 4 Coleção 86. The Bank's name was changed to *Banco Nacional de Desenvolvimento Econômico e Social* (BNDES) in 1982. Decree Law No. 1940 of May 6, 1982.

114. Pinheiro Neto, *supra* note 12, at 318.

115. The Profit Remittance Law provides that public investment funds, *i.e.*, funds generated by government incentive programs, such as SUDENE (Northeast Development Program) and SUDAM (Amazon Basin Development Program), are subject to the same

assets invested in designated high priority economic sectors and geographic regions.¹¹⁶ Brazilian credit institutions may also reloan, to foreign companies operating in Brazil, resources generated from financing put at their disposal by foreign governments and other international entities.¹¹⁷ The foreign credit source in such cases may require that any risk of exchange be placed on itself or on the ultimate beneficiary.¹¹⁸

Before the National Treasury or the BNDES grants credit of any kind to subsidiaries or branches of foreign corporations, evidence that their operations in Brazil have already been initiated is required, unless the executive branch has specifically authorized the project as an especially high priority.¹¹⁹

Transfer of Technology

Transfer of technology is essential to Brazil's economic and industrial development. The Profit Remittance Law, therefore, provides favorable tax treatment for royalties and technical assistance fees paid to unrelated foreign investors; such payments may be made free of the supplementary tax applied to profits and dividends.¹²⁰ Misuse of technology's privileged status to avoid supplementary taxation, however, has led the government to impose certain limitations, including strict registration requirements on the transfer of advanced technology to Brazil and on subsequent remittances of royalties and fees abroad.¹²¹

Central Bank registration of contracts involving remittances of

restrictions when applied to foreign controlled corporations as are other forms of government financing. Profit Remittance Law, *supra* note 1, art. 39.

116. Although article 1 of Decree No. 62,252 of Feb. 9, 1968, delegates to the Minister of Planning the responsibility of determining what is of "great interest to the national economy," under articles 38 and 39 of the Profit Remittance Law, no decrees or administrative norms have been issued by the Minister defining such priority sectors. AN-DRADE, *supra* note 25, at 303.

117. Regulations to the Profit Remittance Law, *supra* note 2, art. 35, § 2.

118. *Id.*

119. Profit Remittance Law, *supra* note 1, art. 38.

120. *Id.* art. 12.

121. *Id.* arts. 3, 10-12.

royalties for the use of patents and trademarks¹²² is conditioned upon production of certificates of validity from the National Institute for Industrial Property (INPI),¹²³ showing that the patents or trademarks have not expired in their country of origin, and that the patent or trademark grant applications have been filed and published in Brazil.¹²⁴ The INPI also requires registration of contracts involving licenses for the use of patents, industrial and commercial trademarks, supply of industrial technology, technical and industrial cooperation, and specialized technical services.¹²⁵ Each of these categories of technology transfer requires a separate contract, even if they all comprise the same joint venture agreement.¹²⁶

Before any royalties, fees, or other payments for the transfer of technology can be remitted, both Central Bank and INPI registration are necessary.¹²⁷ In addition, before approving the contract, the INPI often requests that the proposed technology transfer agreement be modified to comply with statutory requirements.¹²⁸ The Central Bank is permitted to verify the effectiveness of technical assistance rendered to a Brazilian company before authorizing a foreign currency remittance of fees.¹²⁹ It may also demand proof that a parent for which royalties are being remitted is actually being used.¹³⁰ The Central Bank may also approve remittances paying for designs and special technical services, or for the acquisition of in-

122. FIRCE Communiqué No. 19 of Dec. 16, 1972, *reprinted in* 9 ANEXO DO BOLETIM DO BANCO CENTRAL DO BRASIL, No. 1 (1973) [hereinafter cited as FIRCE Communiqué No. 19].

123. *See* Law No. 5648 of Dec. 11, 1970; Law No. 5772 of Dec. 21, 1971 (creating the National Institute for Industrial Property (INPI)).

124. FIRCE Communiqué No. 19, *supra* note 122; Profit Remittance Law, *supra* note 1, art. 11. *See* Nattier, *Limitations on Marketing Foreign Technology in Brazil*, 11 INT'L LAW. 437, 438 (1977). In practice, the INPI can take up to 5 years to grant a patent.

125. Normative Ruling No. 15, *supra* note 14, para. 1.1.

126. *Id.* para. 1.1.1.

127. *See* FIRCE Communiqué No. 19, *supra* note 122; Profit Remittance Law, *supra* note 1, art. 11. For further discussion of the transfer of technology to Brazil, see Nattier, *supra* note 124, at 437; Rowland, *supra* note 14, at 39.

128. Address by Mauro Fernando M. Arruda, Director for Transfer of Technology Contracts of the INPI, Seminar on Transfer of Technology Sponsored by American Chamber of Commerce for Brazil, in São Paulo, Brazil (Jan. 27, 1982) [hereinafter cited as Arruda Address].

129. Profit Remittance Law, *supra* note 1, art. 10; Regulations to the Profit Remittance Law, *supra* note 2, art. 19.

130. *See* Regulations to the Profit Remittance Law, *supra* note 2, art. 19.

dustrial drawings and models.¹³¹

Under some circumstances, payments abroad of royalties are not allowed. For example, remittances of royalties for the use of patents and trademarks from Brazilian companies to related corporations abroad are prohibited;¹³² neither Brazilian branch offices nor subsidiaries¹³³ may make such remittances to head offices or parents abroad;¹³⁴ the payments are also prohibited when the majority of voting capital of a Brazilian company belongs to the foreign recipient of the royalties.¹³⁵

In spite of this ban on remittances of royalties, a Brazilian company may make such payments in Brazilian currency to the foreign corporation's Brazilian account, provided that the payments remain in Brazil, and that the contract, as with any such contract, is approved by the INPI.¹³⁶ If the INPI were to approve such a contract, the deduction, normally disallowed to subsidiaries in such a case, would be permitted.¹³⁷ Unlike royalties for patents and trademarks, remittances abroad of fees for technical assistance are legally permitted between affiliated companies.¹³⁸ In practice, however, technical assistance contracts calling for payment of fees by Brazilian subsidiaries to foreign parents are rarely approved by the INPI.¹³⁹ The purposes of these prohibitions is to keep foreign corporations from evading the supplementary tax on profits.¹⁴⁰

131. *Id.* art. 59.

132. Profit Remittance Law, *supra* note 1, art. 14; Regulations to the Profit Remittance Law, *supra* note 2, art. 20. There is no similar prohibition with regard to remittances for know-how. Rowland, *supra* note 14, at 57 n.91.

133. A subsidiary is defined as a juridical person established in Brazil with at least 50 per cent of its voting capital owned, directly or indirectly, by an enterprise headquartered abroad. Regulations to the Profit Remittance Law, *supra* note 2, art. 20.

134. Profit Remittance Law, *supra* note 1, art. 14.

135. *Id.*; Regulations to the Profit Remittance Law, *supra* note 2, art. 20.

136. Andrade Interview, *supra* note 4.

137. *Id.* Article 12 of the Profit Remittance Law refers to a deduction from income tax for royalty payments. Profit Remittance Law, *supra* note 1, art. 12; Brazilian Income Tax Law, *supra* note 60, art. 233.

138. The statutory provision which prohibits remittance of royalties for the use of patents and trademarks to affiliated companies abroad makes no mention of fees for technical assistance. *See* Profit Remittance Law, *supra* note 1, art. 14.

139. Arruda Address, *supra* note 128.

140. The supplementary tax is levied only on net profits and dividends remitted abroad and not on fees and royalties. *See* Profit Remittance law, *supra* note 1, art. 43; *see also*

Other than the prohibition of payments between related companies,¹⁴¹ the Profit Remittance Law sets no limits on technology payments abroad. The Central Bank and the INPI have, nevertheless, adopted limits on remittances which correspond to the limits on deductions from income tax allowed to Brazilian companies for royalties and fees.¹⁴² Such deductions are limited to a maximum of 5 percent of the net receipts from the product made or sold.¹⁴³ The Minister of Finance sets the percentage based on the type and significance of the product or activity involved.¹⁴⁴

The Profit Remittance Law, while providing incentives to encourage agreements that include technology transfer, also sets time limits on these agreements. Contracts for technical assistance are generally permitted for only five years.¹⁴⁵ Fees for the rendering of such assistance are also deductible for only five years, from the initiation of the company's operation, or from the introduction of a special production process.¹⁴⁶ The Central Bank may authorize an additional five years.¹⁴⁷ When Central Bank and INPI approval is needed, whether for initiation or renewal, the parties must show that

Wionczek, *A Latin American View*, in *HOW LATIN AMERICA VIEWS THE U.S. INVESTOR* 21 (R. Vernon ed. 1966).

141. Profit Remittance Law, *supra* note 1, art. 14.

142. Rowland, *supra* note 14, at 53 n.70; Sills, *supra* note 68, at 13; ANDRADE GUIDELINES, *supra* note 4, at 44.

143. The statute originally placed the 5 percent limit on "gross receipts from the product manufactured or sold." Profit Remittance Law, *supra* note 1, art. 12. Decree Law No. 1730, art. 6, changed "gross" to "net." Decree Law No. 1730 of Dec. 12, 1979, [1979] 7 Coleção 30. "Net Sales Value" is the invoice value, minus taxes, returns, discounts, freight, packaging and insurance expenses, and the cost of imported materials and components purchased from the provider of the technology or from third parties directly tied to the provider. Normative Ruling No. 15, *supra* note 14, para. 2.2.1.

144. Profit Remittance Law, *supra* note 1. The Ministry of Finance has set percentages for various activities. Ministry of Finance Portaria No. 436 of Dec. 30, 1958. Percentages range between 1 percent and 5 percent. *Id.* The maximum allowable deduction for trademarks generally is 1 percent. *Id.* In general, industries considered essential to the economy, communications and equipment manufacturers, for example, are permitted to remit and deduct higher fees than others considered less essential, such as office equipment manufacturers. *Id.*

145. Normative Ruling No. 15, *supra* note 14, para. 5.4. While the language of Normative Ruling No. 15 is far from clear, it has been construed in practice to set a five year ceiling on contract terms. See Araújo, *supra* note 3.

146. Profit Remittance Law, *supra* note 1, art. 12, § 3.

147. *Id.*

the technical assistance is new and of great value to the Brazilian company receiving the assistance.¹⁴⁸

Importation of Machinery and Equipment

Brazil's increasing need for foreign currency, and its desire to encourage domestic production of capital equipment, have led to high import taxes¹⁴⁹ and strict license requirements on the importation of machinery and equipment.¹⁵⁰ Incentive agencies of the executive branch, such as the Council for Industrial Development (CDI), the Amazon Development Superintendency (SUDAM), and the Northeast Development Superintendency (SUDENE), often mitigate these requirements, however, by granting partial tax exemptions for importation into regions and economic sectors of national interest.¹⁵¹ The Customs Policy Council, also an executive agency, may increase or decrease import duties on machinery and equipment by as much as 30 percent.¹⁵² Factors considered by the Council in deciding whether to change import duties include the peculiarities of the region to which the items are destined, the level of industrial concentration in the target area, and the degree of present utilization of machinery and equipment similar to the desired imports.¹⁵³

148. Technical assistance, when rendered by nonresident technicians, must be consistent with technical standards not yet achieved in Brazil, established through comparison with available know-how or alternative existing sources. The INPI will consult with Brazilian companies engaged in similar areas. Normative Ruling No. 60 of Mar. 24, 1982, para. 2.2; Normative Ruling No. 15, *supra* note 14, paras. 4.1.2, 5.1.2.

149. Law No. 3244 of Aug. 4, 1957 is the basic Brazilian law that establishes the system of import duties. Aside from import duties, a federal excise tax, *Imposto sobre Produtos Industrializados* (IPI), is imposed on all goods and products imported or produced in Brazil. Decree No. 83,263 of Mar. 9, 1979, [1979] 2 Coleção 185. IPI is paid at the point of importation or production. *Id.* arts. 42, 43 I(a),(b). The percentage varies according to the category of the product. A state value added tax, *Imposto sobre Circulação de Mercadoria* (ICM), is also imposed on all physical movements of merchandise.

150. See PRICE WATERHOUSE, *supra* note 31, at 15. Central Bank Resolution No. 355 requires registration with the Central Bank of any external financing of imported capital goods and plant. Central Bank Resolution No. 355 of Dec. 2, 1975. In addition, where such external financing calls for repayment over a period of time longer than one year, approval of the Central Bank must be obtained. *Id.*

151. See GARLAND, *supra* note 14, at 116.

152. Profit Remittance Law, *supra* note 1, art. 49.

153. *Id.*

Both foreign and Brazilian investors must meet government criteria and obtain prior approval by the Foreign Trade Department of the Bank of Brazil (CACEX) to import either new or used machinery and equipment.¹⁵⁴ CACEX requires the used machinery and equipment to be no more than five years old.¹⁵⁵ Furthermore, it must meet operating conditions and tolerances in its country of origin.¹⁵⁶ The equipment must be used in the importer's production process, and may not be destined for quality control in Brazil.¹⁵⁷ In addition, the importer must provide proof that there are no national manufactured substitutes for the used items.¹⁵⁸ The government imposes these relatively rigorous requirements on the importation of equipment in an attempt to discourage dumping.

Income Taxation

Branches and subsidiaries of foreign corporations as well as Brazilian companies with a predominance of foreign capital are subject to Brazilian income tax laws.¹⁵⁹ Corporations are taxed at the rate of 35 percent of net income arising in Brazil.¹⁶⁰ Capital gains and losses are treated as ordinary income and losses.¹⁶¹ Business expenses such as interest, tax payments, straight-line depreciation of capital assets, and amortization of patents, trademarks, and copyrights are deductible from gross income.¹⁶² However,

154. *See id.* arts. 47-48; Foreign Trade Resolution No. 64, *supra* note 14, para. I(a).

155. Foreign Trade Resolution No. 64, *supra* note 14, para. I(a).

156. *Id.* para. II(c).

157. *Id.* para. I(a), (c).

158. *Id.* paras. I(b), II. Other information required by CACEX includes the year of manufacture, the estimated life and market value of the used item and of a similar new one, and the technological differences between the examined unit and a new one of the same type. *Id.* para. II. A potential importer must also report its amount of capital and ties it may have to companies abroad. *Id.* para. IV(a), (b).

159. Profit Remittance Law, *supra* note 1, art. 42.

160. Brazilian Income Tax Law, *supra* note 60, art. 405. Decree Law No. 1704 of Oct. 23, 1979, [1979] 4 *Coleção* 823. There is a 5 percent surtax on profits in excess of Cr. \$88,350,000.00. *Id.*

161. PRICE WATERHOUSE, *supra* note 31; P. GARLAND, *supra* note 14, at 93.

162. Decree Law No. 1351 of Oct. 24, 1974, art. 8, [1974] 7 *Coleção* 109; Brazilian Income Tax Law, *supra* note 60, arts. 198, 209.

as described above, royalties for patents and trademarks paid by a Brazilian company to the account of a related foreign enterprise are not deductible.¹⁶³

A basic nonresident withholding tax of 25 percent is imposed on all income, interest, royalties, and technical assistance fees remitted abroad or even merely placed at the disposal of, or credited to, a foreign individual or corporation.¹⁶⁴ No withholding tax is due on stock dividends derived from the mandatory yearly revaluation of fixed assets, nor on the capitalization of reserves for monetary correction purposes.¹⁶⁵ In all other cases, the tax is withheld by the Brazilian entity, which pays it whether or not it is discounted from the amount received by, or credited to, the nonresident.¹⁶⁶ This tax is deductible if, by contract, the responsibility for paying it falls on the Brazilian party.¹⁶⁷ The tax burden is often shifted in this way in loans, licensing, agreements, and technical assistance agreements.¹⁶⁸

When the tax burden on interest payments is shifted to a Brazilian borrower, relief from the nonresident withholding tax is available to the foreign lender. The lender, who would otherwise owe withholding tax on interest payments by the Brazilian borrower, may, through an express provision in the loan agreement, shift payment of the tax to the Brazilian party,¹⁶⁹ thus providing an incentive to attract the foreign loan to Brazil. To shift the withholding tax effectively, a Brazilian debtor must remit 33 percent more than the actual obligation.¹⁷⁰ The 25 percent withholding tax rate is then applied to the total remitted. Tax authorities receive the tax, and the foreign creditor receives the gross interest payment due him.¹⁷¹ The Brazilian debtor is then entitled to a rebate on the

163. Profit Remittance Law, *supra* note 1, art. 14; *see supra* notes 136-137 and accompanying text.

164. *See* Brazilian Income Tax Law, *supra* note 60, arts. 554, 555; Profit Remittance Law, *supra* note 1, art. 42.

165. *Id.* arts. 326, 347.

166. *Id.* arts. 554, 555.

167. *Id.* art. 225, § 2.

168. Andrade Interview, *supra* note 4.

169. Araújo, *supra* note 3, at 48; Central Bank Resolution No. 613, *supra* note 90.

170. Araújo, *supra* note 3, at 48.

171. *Id.*

25 percent tax.¹⁷²

The Brazilian government thus encourages that the tax burden be shifted in order to attract foreign loans to Brazilian enterprises. Such tax shifting is effective because it results in the foreign lender not paying any tax on the interest he received from Brazil. Also, because the amount of interest to be remitted that is registered with the Central Bank is 33 percent higher than the obligation itself, it is always possible to remit as much as the higher registered amount. If the foreign creditor agrees to pay part of the interest remitted to the Brazilian debtor's foreign parent corporation, any payment which might otherwise be considered "excessive" profits, on which supplementary tax would be due if sent directly to the parent, could be remitted as interest and not further taxed.

Another option available to foreign creditors is shifting the withholding tax burden to the Brazilian borrower to obtain the rebate, and then entering into a separate agreement to repay the balance of the tax to the debtor. The foreign lender, if a U.S. corporation, could then utilize the foreign tax credit provided by the Internal Revenue Code.¹⁷³ Of course, if this option is chosen, the amount appearing on the Central Bank's certificate of registration would be lower, thereby foreclosing the possibility of using the maximum allowance registration for other purposes.

Another example of partial relief from the withholding tax is the treatment of cash dividends and bonuses distributed to investors abroad by investment companies. These distributions are taxed at only 15 percent.¹⁷⁴ The rate is further reduced to 12 percent when dividends are produced by investments which have been retained in Brazil for more than six years.¹⁷⁵ When held for eight years, the withholding tax drops even further to 8 percent.¹⁷⁶

172. The percentage of the rebate has fluctuated frequently in recent years. Currently, the Central Bank is giving a 40 percent rebate on the 25 percent withholding tax when paid by Brazilian borrowers on interest remitted to foreign creditors. Central Bank Resolution No. 613, *supra* note 90. Loan agreements must include a clause providing that all taxes will be paid by the Brazilian borrower to ensure the rebate. See E. Henry, 4 *COMENTARIOS AO NOVO REGULAMENTO DO IMPOSTO DE RENDA*, 46 (1978).

173. I.R.C. § 901 (1976 & Supp. IV 1980).

174. Decree Law No. 1401 of May 7, 1975, art. 2, [1975] 5 *Coleção* 6.

175. *Id.* art. 5.

176. *Id.*

The income generated by branch offices of foreign corporations is subject to the withholding tax because it is deemed to be immediately at the disposal of the head office abroad.¹⁷⁷ When branch profits are retained for investment in plant expansion the tax rate is only 15 percent.¹⁷⁸ Tax treaties between Brazil and various other countries that lower the withholding tax rate to 10 or 15 percent have been signed in recent years so as to avoid double taxation.¹⁷⁹

The investment income received by foreign individuals, corporations, and their branches and subsidiaries is also subject to the withholding tax.¹⁸⁰ Investment income consists of dividends and bonuses attributed to bearer shares,¹⁸¹ interest and other income from founders' shares in bearer form,¹⁸² and profits, dividends, interest, and any other income from nominative shares and securities.¹⁸³

Revenue from imported films exhibited in Brazil is subject to a 25 percent withholding tax, paid by the foreign importer or

177. Brazilian Income Tax Law, *supra* note 60, art. 555, § 9.

178. *Id.* art. 555(III)(a). This rate can be contrasted with the normal withholding tax of 25 percent. Brazilian Income Tax Law, *supra* note 60, art. 555.

179. Several countries, including France, Germany and Austria, have treaties with Brazil lowering the rate to 15 percent. Japan is the only nation with a 10 percent agreement in force. The United States does not have such a treaty with Brazil. See Pinheiro Neto, *supra* note 12, at 314, for a comprehensive listing of tax treaties in force with Brazil.

180. Profit Remittance Law, *supra* note 1, art. 41.

181. *Id.* Anonymous ownership of corporate capital may be accomplished through bearer shares. Brazilian Corporation Law, *supra* note 4, art. 20. Coupons evidencing dividends or other rights may be attached to the share certificates. *Id.* art. 26. Transfer of bearer shares is by delivery and the holder of the certificates is presumed to be the owner of the bearer shares. *Id.* art. 33. Holders of bearer shares have no voting rights. *Id.* art. 112.

182. Profit Remittance Law, *supra* note 1, art. 41(b). Founders' shares, also called *partes beneficiarias*, may be issued at any time and have no par value. Brazilian Corporation Law, *supra* note 4, art. 46. Holders of founders' shares do not have voting rights but do have the right to participate in the current profits of the company. *Id.* para. 3. The maximum aggregate participation of founders' shares is 10 percent of the company's profit. *Id.* para. 2. Founders' shares may be issued to employees, administrators, founders or shareholders as remuneration for services, or sold for cold cash under conditions determined by the articles of incorporation or by a general meeting of the shareholders. *Id.* art. 47.

183. Profit Remittance Law *supra* note 1, art. 41(c). Nominative shares are registered in the books of the company and are also known as registered shares. *See id.*; Brazilian Corporation Law, *supra* note 4, arts. 20, 31.

distributor.¹⁸⁴ Instead of having the tax withheld, however, the taxpayer may opt to deposit 70 percent of the tax in a special account with the Bank of Brazil.¹⁸⁵ With the authorization of the *Emprêsa Brasileira de Filmes S.A. (EMBRAFILME)*, the amount accumulated in the account may be used for film production in Brazil.¹⁸⁶

No withholding tax is imposed on reinvestments, provided that they are not repatriated within 5 years.¹⁸⁷ Once capitalized, retained earnings become reinvestments and may be registered with the Central Bank.¹⁸⁸ Registration of reinvestments is usually advantageous because it increases the investor's overall foreign investment base, allowing for higher remittances in subsequent years. In addition, by increasing the registered foreign capital base, the investor avoids the supplementary tax¹⁸⁹ on excess profits and dividends actually remitted.¹⁹⁰ Because the calculation of the amount of excess profits is made after the usual 25 percent withholding tax is deducted from income,¹⁹¹ up to 16 percent of the registered investment can be effectively remitted annually before the supplementary tax is applied. The three-year averaging provision allows lower remittances in one

184. Brazilian Income Tax Law, *supra* note 60, art. 560.

185. The deposit is made to the account of EMBRAFILME (*Emprêsa Brasileira de Filmes S.A.*). Brazilian Income Tax Law, *supra* note 60, art. 560.

186. Profit Remittance Law, *supra* note 1, art. 45.

187. Decree Law No. 1598 of Dec. 26, 1977, art. 63; Decree Law No. 1109 of June 26, 1970, art. 3. *See supra* note 73 and accompanying text. In order for a reinvestment to escape taxation, it must remain in the company for five years. FELSBERG, *supra* note 73, at 65. If, during such five year period, the company repatriates the reinvested capital, it will be taxed as a distribution of profit subject to the withholding tax. *Id.*

188. *See supra* notes 34-37 and accompanying text.

189. *See supra* notes 62-67 and accompanying text.

190. Profit Remittance Law, *supra* note 1, art. 43. The supplementary income tax of the Law also applies to profits from the sale of real property or from the assignment of real property rights when the seller is a nonresident. *Id.* art. 46. The supplementary tax on profits may be increased by 20 percent in the case of a company whose capital is invested in activities that are not considered of vital interest to the Brazilian economy. High priority activities are defined by executive decree. *Id.* art. 44. Location of the firm's operation is an important factor in determining the importance of its activities. *Id.*

191. *See* Brazilian Income Tax Law, *supra* note 60, art. 559, § 3.

year to be set off against higher payments in the following year.¹⁹²

The supplementary tax is graduated and applies only to income remitted abroad which exceeds 12 percent per annum of registered foreign capital.¹⁹³ Remitted profits and dividends between 12 and 15 percent of registered foreign capital are taxed at a rate of 40 percent.¹⁹⁴ Remittances between 15 and 25 percent are taxed at 50 percent, and those over 25 percent of registered foreign capital are taxed at 60 percent.¹⁹⁵ Tax treaties do not reduce the supplementary tax, but foreign offsetting tax credits may be available in the investor's country.¹⁹⁶

Interest payments and reinvested profits are not affected by the supplementary tax.¹⁹⁷ Dividends from investment companies are also not subject to the supplementary tax if the original investment remains in Brazil for at least eight years.¹⁹⁸ The usual 25 percent nonresident withholding tax, however, is applied to all profit, interest, capital gains, royalties, and technical assistance

192. Normative Ruling No. 77 of Sept. 4, 1978 defines the three year period and explains the effects of averaging remittances over such a span. The last two years of one period are also the first two years of the next period. *See also* Brazilian Income Tax Law, *supra* note 60 art. 559, §§ 5-7. Until July 1982, the supplementary tax withheld in one three year period was included in the base calculation for the following three year period, thus creating a surtax on the tax itself. Normative Ruling No. 49 of July 14, 1982, rectified this problem by stating that the supplementary tax will be calculated based on amounts of dividends and profits effectively remitted in foreign currency as they appear on the exchange contract. From now on, whenever a remittance is made, the tax paid will be deducted from the base of the calculation and will not be taxed again.

193. *See supra* notes 62-67 and accompanying text.

194. Profit Remittance Law, *supra* note 1, art. 43.

195. *Id.* The normal tax rate of 25 percent is applied to profits up to the 12 percent level. Beyond that amount, the higher supplementary tax rates apply. *INVESTMENTS IN BRAZIL*, *supra* note 64, at 47-48.

196. *See* GARLAND, *supra* note 14, at 107. U.S. tax law, for example, provides a credit against U.S. income for foreign taxes paid by U.S. businesses abroad. I.R.C. § 901 (1976 & Supp. IV 1980).

197. The statute levies the supplementary tax only on net profits and dividends actually remitted and makes no mention of interest payments or reinvested funds. Profit Remittance Law, *supra* note 1, art. 43.

198. Decree Law No. 1401 of May 7, 1975, art. 6, § 2.

remittances.¹⁹⁹

Banking and Exchange Controls

The Central Bank has broad authority to regulate exchange and banking activities in Brazil. As discussed earlier, the Central Bank controls the conversion of a loan into an investment, which involves a symbolic exchange operation,²⁰⁰ executed for accounting and registration purposes.²⁰¹ In addition, the Central Bank controls foreign currency transactions²⁰² and the operation of foreign banks in Brazil.²⁰³ Finally, the Central Bank has other powers it may exercise in the event an emergency is declared.²⁰⁴

Foreign Currency Transactions

All foreign currency transactions must be effectuated through a bank authorized to deal in exchange with a licensed broker acting as intermediary.²⁰⁵ When remitting income abroad, the bank through which the payment is made annotates the registration certificate and sends a copy to the Central Bank.²⁰⁶ A separate form, signed by the client who is effecting the transaction, by the broker, and by the bank, is required in every exchange operation.²⁰⁷ The form must include the text of article 23 of the Profit Remittance Law, which enumerates the liabilities incurred if the reporting requirements are violated.²⁰⁸

199. Brazilian Income Tax Law, *supra* note 60, art. 555.

200. Regulations to the Profit Remittance Law, *supra* note 2, art. 50, para. 1.

201. Basically, a symbolic exchange operation is the execution of an exchange contract just as though money had been converted. ANDRADE GUIDELINES, *supra* note 4, at 38-39. Symbolic exchange operations are unnecessary for reinvestment of profits and transfers or assignments of capital credit or contracts among nonresidents. Regulations to the Profit Remittance Law, *supra* note 2, art. 52.

202. *See infra* notes 205-214 and accompanying text.

203. *See infra* notes 215-222 and accompanying text.

204. *See infra* notes 223-242 and accompanying text.

205. Profit Remittance Law, *supra* note 1, art. 23.

206. Regulations to the Profit Remittance Law, *supra* note 2, arts. 7, paras. 1, 27.

207. Profit Remittance Law, *supra* note 1, art. 23, § 2.

208. *Id.* § 6. Liability for falsifying a declaration of the client's identity falls on the bank, broker and client. *Id.* § 2. Each must pay three times the amount of the exchange transaction in the event of such fraud. *Id.* Other false statements by the client

Banks authorized to operate in exchange must transmit to the Central Bank daily reports on the amount of exchange purchased and sold.²⁰⁹ If the buyer or seller is a corporation, this information must correspond exactly to the equivalent entries in the corporation's books.²¹⁰ Banks that do not report the exact amounts are subject to a variable penalty of up to thirty times the highest minimum wage in force in Brazil,²¹¹ and this penalty is trebled for repeat offenders.²¹²

Repeated infractions of the rules governing banks and brokers may lead the Central Bank to cancel the offending bank's authorization to engage in exchange operations.²¹³ Similar action against the broker may be taken by revocation of his license.²¹⁴

The Operation of Foreign Banks in Brazil

The right of a foreign bank to open a branch in Brazil is determined by reciprocal agreements awarding similar rights to Brazilian banks in the foreign bank's country.²¹⁵ Additionally, the foreign bank must obtain a presidential decree to open a branch in Brazil;²¹⁶ Central Bank approval is also required.²¹⁷

Foreign investment in the Brazilian banking industry, whether through direct shareholder participation, branch operation, or

which appear on the exchange operation form expose the client to a fine of 100 percent of the transaction amount. *Id.* § 3. Inaccurate disclosure of the client's information on the form is a violation imputable to the bank and broker and can bring a penalty of 5 percent to 100 percent of the amount involved. *Id.* § 4.

209. *Id.*

210. *Id.* art. 24.

211. *Id.* art. 25; Decree Law No. 5452 of Nov. 10, 1943, arts. 76, 81-84 (determining how the minimum wage is set).

212. Profit Remittance Law, *supra* note 1, art. 25.

213. *Id.* arts. 23, §§ 5, 26.

214. *Id.* art. 26. In the case of repeated violations of article 23's reporting requirements, the Profit Remittance Law authorizes the Central Bank to propose to the proper authority a revocation of a broker's right to operate in the exchange system. *Id.* art. 23, § 5.

215. Sills, *supra* note 68, at 3.

216. Law No. 2627 of Sept. 26, 1940, art. 64. *See also* GARLAND, *supra* note 14, at 166; PRICE WATERHOUSE, *supra* note 31, at 390.

217. Sills, *supra* note 68, at 3.

representative office, is highly regulated. Brazil restricts the permissible foreign ownership of financial institutions to minority control,²¹⁸ with the exception of those banks who possessed majority foreign ownership prior to 1964.²¹⁹ Foreign banks, from countries that place restrictions on Brazilian banks, are prohibited from acquiring more than 30 percent of the voting capital of any Brazilian bank.²²⁰ In addition, those foreign banks authorized to operate in Brazil are subject to the same restrictions imposed on Brazilian banks in the countries where the foreign banks are headquartered.²²¹ Both foreign and domestic banks in Brazil have been subject to a recent tax increase.²²²

Emergency Powers

The Law provides for emergency control restrictions to regulate exchange transactions when extreme shortages of foreign currency require drastic measures.²²³ If emergency powers were to be invoked, the Central Bank would establish a financial exchange market, which would be separate from the import-export market, and through which some or all exchange operations would be effected.²²⁴ For limited periods, the Central Bank also may impose actual restrictions on imports and income remittances under conditions described below.²²⁵ Toward this end, a total or partial monopoly of exchange operations would be granted to the Bank of Brazil.²²⁶

218. Profit Remittance Law, *supra* note 1, art. 51.

219. *Id.*

220. *Id.*

221. *Id.* art. 50.

222. Decree Law No. 1885 of Sept. 29, 1981 (increasing from 5 percent to 10 percent the share of income tax to be paid on bank profits that exceed Cr. \$88.35 million in the 1982 tax year).

223. These powers arise whenever "there occurs a serious imbalance of payments, or there are serious reasons to foresee the imminence of such a situation." Profit Remittance Law, *supra* note 1, art. 28.

224. *Id.* arts. 27, 28. Some Brazilian economists believe that there should be one exchange rate for foreign investments and remittances abroad and another rate for import and export operations. The Brazilian government, however, has a single rate for all operations and is not likely to change this exchange rate policy. See ANDRADE GUIDELINES, *supra* note 4, at 92-93.

225. Profit Remittance Law, *supra* note 1, art. 28. See *infra* notes 227-231 and accompanying text.

226. Profit Remittance Law, *supra* note 1, art. 28. The Bank of Brazil is a mixed capital corporation with a major role in the execution of foreign trade policy and administration of government-sponsored lending programs. It acts as the financial agent for the Brazilian

One emergency restriction applies to foreign capital invested in activities producing luxury goods and services.²²⁷ The executive branch of the Brazilian government has the power to limit annual profits remitted from these goods and services to 8 percent of registered capital.²²⁸ Another emergency restriction, which has also never been invoked, would be triggered by a declaration of the Brazilian government that a serious deficit existed in Brazil's balance of payments.²²⁹ Should such a grave imbalance develop, the executive branch could impose temporary restrictions on imports and on remittances of profits derived from registered foreign capital.²³⁰ Under these circumstances, return of capital would be prohibited and an annual ceiling of 10 percent of registered foreign investments and reinvestments would be imposed on profit remittances.²³¹

Monetary surcharges on financial transfers and on the import of merchandise are another method of exchange control which could be implemented should an emergency situation be declared. The maximum surcharges permitted would be 10 percent of the value of the imported products and 50 percent of the value of the financial transfer.²³² Should these surcharges be imposed, the amounts collected would be retained by the Central Bank in a reserve account in *cruzeiros*, and would be used only for the purchase of gold and foreign currency to back up reserves and available exchange.²³³ Under these same emergency circumstances, royalties and payments for technical, administrative, and other, similar assistance would be cumulatively restricted to 5 percent of the company's annual gross income.²³⁴ Also, the 8 percent limit on remittances of profits from

Treasury Department and deals in official and private financing. PRICE WATERHOUSE, *supra* note 31, at 19.

227. Amendments to the Profit Remittance Law, *supra* note 2, art. 2.

228. *Id.* Should this restriction be put into effect, payments exceeding the annual 8 percent limit would be considered repatriation of capital and deducted from the amount registered for the purposes of calculating future remittances. *Id.* art. 2, § 1. Alternatively, the profits could be reinvested in the same company or in a region or sector which the government has deemed important to the Brazilian economy. *Id.*

229. Profit Remittance Law, *supra* note 1, art. 28.

230. *Id.*

231. *Id.* § 1.

232. *Id.* art. 29.

233. *Id.* art. 30.

234. *Id.* art. 28, § 3. Earnings exceeding the limit would be reported to the Central Bank which could allow the excess to be remitted the following year, should the restriction last more than one year, provided that profits in that year do not exceed the 10 percent limit.

luxury goods and services would be lowered to an annual limit of 5 percent.²³⁵ Exchange provisions for international travel could similarly be limited.²³⁶ Interest and amortization payments made pursuant to duly registered loan contracts, however, would not be affected by any of these emergency restrictions.²³⁷ Foreign capital invested in less developed regions of Brazil would also be exempt.²³⁸

It must be emphasized that these emergency restrictions on profit remittances have never been implemented²³⁹ and, in the opinion of experienced observers, are not likely to be invoked in the foreseeable future.²⁴⁰ The application of emergency restrictions, besides being an extremely unpopular political and economic step, is actually unnecessary. The Central Bank uses less extreme, but equally effective, methods to keep Brazil's balance of payments deficit under some control, including restrictive requirements on foreign loans, disallowance of royalties to related companies abroad, and restrictions on importing foreign products with similar counterparts in Brazil.²⁴¹

Miscellaneous Mandates and Sanctions

Mandates

The Law provides for various surveys and plans in order to meet the government's twin goals of national development and control of the balance of payments. Among these mandates is a provision requiring the Brazilian Cabinet²⁴² to develop a general planning program for the country.²⁴³ As part of the program, the Cabinet must

Id. § 2.

235. Amendments to the Profit Remittance Law, *supra* note 2, art. 2.

236. Profit Remittance Law, *supra* note 1, art. 28, § 4. In fact, Central Bank Resolution No. 760 of Sept. 14, 1982 restricts the amount of U.S. dollars in traveller's checks, places a tax on exchange operations, cuts the amount permitted to minors for international travel, and creates other restrictions on personal exchange operations as well.

237. *Id.* § 5.

238. *Id.* art. 53.

239. See Pinheiro Neto, *supra* note 12, at 327; PRICE WATERHOUSE, *supra* note 31, at 12.

240. Observers point to the healthy \$1.2 billion surplus in Brazil's trade balance in 1981 as a reason why the chances of implementation of the emergency provision are remote. O Estado de São Paulo, Jan. 12, 1982, at 28, col. 3.

241. Andrade Interview, *supra* note 4.

242. CONSTITUICAO, pt. V (Braz.).

243. Profit Remittance Law, *supra* note 1, art. 52.

classify economic activities according to their degree of national importance.²⁴⁴ The priorities thus set are intended to ensure that foreign capital is invested in the less developed regions of Brazil.²⁴⁵ The Cabinet is also authorized to promote treaties with other member nations of the Latin American Free Trade Association (LAFTA)²⁴⁶ to encourage uniform foreign investment legislation and to promote common efforts to establish a global economic order.²⁴⁷ Coordination with other countries and with Brazil's own states and municipalities to increase efficiency in tax administration is encouraged as well.²⁴⁸ The executive branch must also establish uniform accounting and bookkeeping standards for groups of enterprises involved in similar activities.²⁴⁹

A 1962 provision of the Law mandated that surveys of foreign investments be undertaken in conjunction with the General Census of Brazil.²⁵⁰ The survey was intended to analyze the movement and effects of foreign capital invested and registered in Brazil that could subsequently be subject to future payments abroad.²⁵¹ Nevertheless, such a survey has never been performed, and this aspect of the Law continues to remain unenforced. Critics of Brazil's policies

244. *Id.*

245. While the Council is required to establish classifications, *id.*, the ministers are given broad discretion to determine those priorities. The statute provides that the Council may establish classifications which set priorities for investment of foreign capital in the less developed areas of the country or in other activities "considered to be of vital interest to the national economy." *Id.* art. 53.

246. LAFTA members include Argentina, Bolivia, Brazil, Chile, Columbia, Ecuador, Mexico, Paraguay, Peru, Uruguay and Venezuela. Treaty Establishing a Free Trade Area and Instituting the Latin American Free Trade Association (Montevideo Treaty), Feb. 18, 1960, O.A.S. Ser. H/V ES/Doc. 18/60, *reprinted in* INTERAMERICAN INSTITUTE OF INTERNATIONAL LEGAL STUDIES, INSTRUMENTS RELATING TO THE ECONOMIC INTEGRATION OF LATIN AMERICA 207 (1968). The name of the Latin American Free Trade Association was changed in 1981 to Latin American Association of Integration (*Associação Latino Americana de Integração*). Decree No. 85,893 of Apr. 9, 1981, changed the name of all pertinent agencies in Brazil so they would conform with the newly named association.

247. Profit Remittance Law, *supra* note 1, art. 54.

248. The statute authorizes the government to establish agreements with other countries and directs the government to attempt to establish agreements with states and municipalities with a goal toward administrative cooperation and efficiency in the collection of taxes. *Id.* art. 16.

249. *Id.* art. 20.

250. *Id.* arts. 55, 56.

251. In preparing the census forms, the Central Bank is to make possible "a complete analysis of the status, movement, and results of foreign capital." *Id.* art. 57.

regulating foreign investment believe that the lack of enforcement exemplifies the government's desire to encourage such investment at any cost.²⁵² One such critic, previously a member of the government, believes that the Law is too permissive and should instead give the government the option to refuse entry to foreign investments. Investments could be denied entry if they threatened the health of Brazilian national capital, and jeopardized the country's economic autonomy and the government's ability to fulfill the needs of its people.²⁵³

Sanctions

Violators of the Profit Remittance Law are subject to variable penalties consisting of fines levied by the Central Bank ranging from twenty to fifty times the highest minimum wage.²⁵⁴ One type of violation consists of remitting profits without paying the supplementary tax when it becomes due, thirty days after the end of a given three-year period. A foreign investor who remits profits subject to the supplementary tax without paying the tax will be fined and required to return such profit to Brazil.²⁵⁵

An investor must be careful to monitor the amount appearing on his Certificate of Registration. If, as often, *cruzeiro* registration is lower than the corporate capital, the difference is considered national capital, not registered in foreign currency, and not remittable.²⁵⁶ The percentage of corporate capital which is not registered is thereafter applied to remittances abroad; if any portion of profit attributable to the national capital percentage is remitted in error, it must be returned to Brazil and the investor will be fined for remitting "excessive" profits without paying the tax.²⁵⁷ This is also true of non-operating profit, which, if remitted, must be returned to Brazil if the Central Bank, during its standard examination of the company's books, discovers the error.²⁵⁸

252. Interview with Severo Gomes, Minister of Industry and Commerce of Brazil from Mar. 1974 to Feb. 1977, in São Paulo, Brazil (Nov. 5, 1981).

253. *Id.*

254. Profit Remittance Law, *supra* note 1, art. 58.

255. Brazilian Income Tax Law, *supra* note 60, art. 559, § 5; Andrade Interview, *supra* note 4.

256. Andrade Interview, *supra* note 4.

257. Profit Remittance Law, *supra* note 1, art. 58.

258. Andrade Interview, *supra* note 4.

The 1978 promulgation of Normative Ruling 77 increased the maximum tax impact on profit remittances by including, for tax purposes, the amount of supplementary tax due and withheld in one year in the net profit remittance in the following year, thus making the income tax paid subject to another income tax burden.²⁵⁹ Until July 1982, the tax authorities were imposing high penalties and were auditing books of investors who remitted profits since 1978, to discourage investors from ignoring the Ruling and remitting profits without paying the tax, while still taking a foreign tax credit in their home countries.²⁶⁰

The Corporation Law permits quarterly dividend declarations²⁶¹ only when a corporation maintains certain reserves, which few corporations have.²⁶² Investors who remit quarterly dividends without such reserves risk that the Central Bank will either disallow the remittances or will subsequently fine them. If the investors have not made a profit at the end of the year, or if their profit is less than their remittances during the year, they will have to pay income tax, possibly including late fines. The Central Bank will also require the violating investor to return the dividends to Brazil.²⁶³

RECONCILING CONFLICTING GOALS

Since the 1964 amendment of the Profit Remittance Law, the Brazilian government has actively encouraged economic and industrial development through foreign investment. Foreign direct investment provides technology, employment, and training, applied and adapted to locally managed operations. Brazil does not, however, permit uncontrolled foreign investment. The Law provides the government with sufficient discretion to attract foreign investors through incentives and other favorable treatment. At the

259. THE LAW AND YOU, Oct. 1981.

260. *Id.* Normative Ruling No. 49 of July 14, 1982 eliminated this problem. See *supra* note 192.

261. The Brazilian Corporation Law allows semi-annual dividend declarations by companies that prepare semi-annual balance sheets by reason of law or in accordance with the provisions of their articles. Brazilian Corporation Law, *supra* note 4, art. 204. Dividend declarations and distributions for lesser time periods are subject to the capital reserve limitations set forth in the Brazilian Corporation Law, art. 204, § 1.

262. Interview with Marco Antonio D'Utra Vaz, Attorney, Campos, Salles, Portugal & Vaz, in São Paulo, Brazil (Jan. 15, 1982). The capital reserve includes paid-in capital surplus, premiums on the issuance of debentures and grants and subsidies for investment. Brazilian Corporation Law, *supra* note 4, art. 182, § 1.

263. Profit Remittance Law, *supra* note 1.

same time, the flexibility of the Law permits the government to maintain leverage for Brazilian business, by reserving important activities to national capital and encouraging joint ventures between foreign and local investors.

Reinvestment Incentives

Among the changes made in 1964 which reflect this flexible approach to foreign investment was the removal of absolute limits on profit remittances,²⁶⁴ and their replacement by the supplementary tax on actually remitted excess profits and dividends.²⁶⁵ The investment base was expanded in 1964 to include reinvested profits, thus raising the amount available for supplementary tax-free remittances,²⁶⁶ and promoting reinvestment rather than the immediate foreign remittance of profits. Without the amended reinvestment provision, foreign investors would be more reluctant to reinvest, because of the difficulty in ultimately remitting the profits from the reinvestment.²⁶⁷

Foreign investors are presented with a difficult choice as a result of the reinvestment provisions of the Law. On the one hand, reinvestment increases the investment base and allows an investor to make larger profit remittances, unburdened at a later date by the highly progressive supplementary tax.²⁶⁸ On the other hand, because the Central Bank does not automatically increase the foreign capital

264. Prior to 1964 there was an absolute limit of 10 percent on remittances. Law No. 4131 of Sept. 3, 1962, [1962] 5 Coleção 117. Law No. 4390 of Aug. 20, 1964, provided for a more flexible approach and this change is now incorporated in article 43 of the Profit Remittance Law.

265. Profit Remittance Law, *supra* note 1, art 43.

266. Amendments to the Profit Remittance Law, *supra* note 2, art. 70.

267. The subject of reinvestment is being examined by Brazilian tax authorities and the Central Bank. Currently, "financial income" arising from monetary correction of net worth accounts are registered only in Brazilian currency. *See supra* note 4 and accompanying text. As such, it is not remittable, nor is it added to the investment base for the purpose of calculating remittance percentages. *See supra* notes 68-72 and accompanying text. Should the Brazilian authorities decide to allow registration in both national and foreign currency, as capitalized retained earnings have been treated since 1964, *see supra* note 266, the investment base would be increased even further than the 1964 amendment expansion. In an effort to encourage foreigners to invest more and remit less, the Brazilian government may make this change in reinvestment policy.

268. Profit Remittance Law, *supra* note 1, arts. 4, 43.

appearing on the certificate of registration each time the investor recapitalizes profit reserves and requests reinvestment in the Brazilian company, there may be a delay in the investment base increase. Moreover, the continuing and rapid devaluation of the *cruzeiro* relative to the U.S. dollar²⁶⁹ means that the longer profits are kept in Brazil and in *cruzeiros*, the fewer dollars will be remittable in the future. Foreign investors must weigh, therefore, the benefit of an increased investment base and its accompanying tax advantages, against the risks associated with keeping the investment in Brazil.

The Profit Remittance Law further encourages foreign investment by exempting interest, royalties, reinvestments, repatriation of capital, amortization of principal, and capital gains from the supplementary tax.²⁷⁰ This exemption minimizes the chilling effect that the tax could have on foreign investment, and gives the foreign investor the option of a debt rather than an equity investment. The Profit Remittance Law fosters both the debt and equity forms of investment.²⁷¹ Longer term debt—eight or more years—is preferred by Brazilian business because it provides foreign currency for immediate needs such as oil and capital assets. Also, with the debt form, interest is remitted for a set repayment period, unlike equity investments. Debt also gives Brazilian business greater control over local operations. Equity investment, however, brings technology into Brazil. To that end, royalties and fees for the transfer of technology receive favorable treatment as well.²⁷²

269. See *supra* notes 66–67 and accompanying text.

270. Article 43 limits application of the supplementary tax to “net profits and dividends actually remitted.” Profit Remittance Law, *supra* note 1, art. 43. Capital gains are subject to withholding tax above the amount of registered capital, Brazilian Income Tax Law, *supra* note 60, art. 555, but are not subject to the supplementary tax, which is only applicable to dividends paid as shares. Normative Ruling No. 99 of Feb. 12, 1971; see also ANDRADE GUIDELINES, *supra* note 4, at 75. Capital gains from investment companies are subject to the supplementary tax unless the investment remains in Brazil for at least eight years. Decree Law No. 1401 of May 7, 1975; Brazilian Income Tax Law, *supra* note 60, art. 559, §§ 10, 12.

271. For an analysis of the implications of using debt versus equity investment, see Jaguaribe, *A Brazilian View*, in HOW LATIN AMERICA VIEWS THE U.S. INVESTOR 67, '84 (1966).

272. Profit Remittance Law, *supra* note 1, art. 12. Such deductions are limited to 5 percent of the net receipts from the products manufactured or sold. See *supra* notes 141–144 and accompanying text.

Investment Control

Although the Profit Remittance Law encourages national economic growth, Brazil is also concerned about maintaining local control over its development and protecting its foreign currency reserves.²⁷³ The country must confront the apparent paradox of "redirect[ing] the global rationality of the multinational when it conflicts with the necessities of local accumulation."²⁷⁴ Brazil's Profit Remittance Law and related legislation control foreign investment through a number of provisions designed to ensure that the Brazilian economy pays reasonable, but not exorbitant, prices for economic growth.²⁷⁵

One form of investment control is the registration process. Registration with the Central Bank of Brazil is a prerequisite to the taxation of remittances as well as to the remittance of returns from foreign investment, and to exchange control.²⁷⁶ Taxes are calculated on the basis of the registered investment and paid to the Brazilian government. The funds are used to buttress incentives and to support national economic activities.²⁷⁷ Registration also helps monitor the movement of foreign currency, an essential part of evaluating the effects of investments and subsequent remittances on the country's balance of payments.²⁷⁸ In recent years, exchange reserves have steadily decreased,²⁷⁹ thus reducing the hard currency

273. Gereffi & Evans, *supra* note 91, at 31, 54-57.

274. P. EVANS, *DEPENDENT DEVELOPMENT: THE ALLIANCE OF THE MULTINATIONAL, STATE AND LOCAL CAPITAL IN BRAZIL* 44 (1979).

275. *See, e.g.*, Profit Remittance Law, *supra* note 1, art. 8 (authorizing controls on interest rates of foreign loans); *id.* art. 14 (prohibiting royalty payments for use of patents and trademarks from Brazilian branch offices or subsidiaries to foreign parent); Normative Ruling No. 15, *supra* note 14 (establishing requirements involving the licensing of contracts with regard to the transfer of technology); Foreign Trade Resolution No. 64, *supra* note 14, (establishing requirements for the importation of used machinery or equipment).

276. Profit Remittance Law, *supra* note 1, art. 3.

277. *Id.* art. 9. *See* GARLAND, *supra* note 14, at 74-76, for a discussion of various government economic programs.

278. ANDRADE, *supra* note 25, at 76.

279. Brazil's foreign debt is estimated to be greater than \$55 billion. In 1981, Brazil's foreign debt reached \$61.4 billion. Folha de São Paulo, June 15, 1982, at 17, col. 4; Sills, *supra* note 68, at 1. Growth in foreign debt has recently been limited by a reluctance of foreign lenders to continue lending to Brazil. *Id.* *See also* AACCLA OUTLOOK, First

available to pay for the imports of capital assets essential to national capital formation, to the repayment of loans, and to the remittance of dividends, interest, and royalty payments.

The relationship between foreign investment and the balance of payments deficit is not a simple one, however.²⁸⁰ Although foreign investors take exchange out of Brazil as profit, interest, and capital repatriation, foreign investment can also increase the production of exportable goods, bringing foreign exchange back into the country. Foreign investment can, therefore, contribute to import substitution and actually improve the balance of payments. Even with an eventual increase in the deficit due to foreign investments, technological improvements brought by foreign equity investments may, in the long run, compensate for the deficit.

Another function of registration is to avoid overvaluation of incoming foreign capital, especially in the form of capital goods. The Central Bank can, to some extent, control incoming foreign capital and subsequent reinvestments by regulating the amount it will register in foreign currency and thus allow to be repatriated at a future time.²⁸¹ Moreover, the Bank may challenge and refuse registration of loans with excessive interest rates,²⁸² and may verify the effectiveness of services and the actual use of patents. Further, the Bank may deny authorization to licensing agreements that do not meet its requirements.²⁸³

Quarter, 1981, at 5 (published by the Association of American Chambers of Commerce in Latin America).

280. At least two commentators assert that foreign capital often intensifies balance-of-payments problems. Repatriation of funds, whether in the form of dividends, interest, fees or the initial investment itself, places a strain on the foreign exchange resources of a country. These commentators argue that reinvested profits inhibit the importation of new foreign currency and that foreign owned enterprises compete with domestic corporations for scarce national capital available from the local banking system. See H. STEINER & D. VAGTS, *TRANSNATIONAL LEGAL PROBLEMS* 87 (2d ed. 1976).

281. See Profit Remittance Law, *supra* note 1, art. 5, para. 2; Regulations to the Profit Remittance Law, *supra* note 2, art. 13; Andrade Interview, *supra* note 4.

282. The Central Bank is authorized to "challenge or refuse registration at the rate of interest in so far as it exceeds the then prevailing rate in the financial market where the loan, credit, or financing was obtained, for operations of the same type and on the same terms. Regulations to the Profit Remittance Law, *supra* note 2, art. 15.

283. *Id.* art. 19; see Profit Remittance Law, *supra* note 1, arts. 9-11. The Regulation states that where there are remittances abroad of foreign exchange, "the Superintendency of Cur-

The Law stems potential abuse of the favorable transfer of technology rules by forbidding royalties between Brazilian subsidiaries and foreign parents,²⁸⁴ and by limiting tax deductions for remittable royalties.²⁸⁵ Investment control legislation also addresses the problem of transfer pricing through importation of unique capital equipment. Import duties are high, and Central Bank authorization is required to obtain import credit. Importation of machinery and equipment is restricted to items that are less than five years old and that do not have domestically manufactured equivalents.²⁸⁶

Channeling economic and financial resources is another important aspect of foreign investment control. The government reserves certain key economic sectors to national ownership or control.²⁸⁷ For example, Brazilian companies under the control of foreigners are not permitted to own rural land without a special license,²⁸⁸ to manufacture or trade weapons,²⁸⁹ to engage in insurance activities,²⁹⁰ to produce electricity,²⁹¹ to render engineering services to the government,²⁹² or to develop telecommunications projects.²⁹³ Nonresidents may not participate as majority owners in

rency and Credit [now the Central Bank of Brazil], when it deems it necessary, may verify the effectiveness of technical, administrative, or similar assistance rendered to enterprises established in Brazil, or demand proof that the patents and registrations relating to royalties are being used." Regulations to the Profit Remittance Law, *supra* note 2, art. 19.

284. Profit Remittance Law, *supra* note 1, art. 14; Regulations to the Profit Remittance Law, *supra* note 2, art. 20. "A subsidiary of a foreign company shall be considered to be a juridical person established in Brazil, of whose voting capital at least 50% belongs directly or indirectly to a company with its head-office abroad." *Id.*

285. See *supra* notes 141-144 and accompanying text.

286. Foreign Trade Resolution No. 64, *supra* note 14, para 1. See also *supra* notes 149-159 and accompanying text.

287. For example, the Brazilian government controls the exploration and drilling of oil through its wholly-owned state petroleum company, Petrobras. See CONSTITUICAO, art. 169 (Braz.) ("Exploration for and extraction of petroleum in the national territory shall constitute a monopoly of the union, as prescribed by law."); Sills, *supra* note 68, at 3.

288. Decree Law No. 5709 of Oct. 7, 1971 (providing that non-nationals are not permitted to own rural land without a special license requiring approval of the Ministry of Agriculture).

289. Law No. 2579 of Sept. 12, 1955, arts. 6, 7.

290. Decree No. 60,459 of Mar. 13, 1967 (calling for Ministry of Industry and Commerce authorization for any insurance company to operate in Brazil). See Araújo, *supra* note 3, at 36.

291. CONSTITUICAO, art. 168, para. 1 (Braz.); see Araújo, *supra* note 3, at 36.

292. Decree No. 64,345 of Apr. 10, 1969, art. 2; Decree No. 73,685 of Feb. 19, 1974.

293. Decree No. 73,685 of Feb. 19, 1974; CONSTITUICAO art. 174 (Braz.).

Brazilian companies involved in maritime transportation,²⁹⁴ oil exploitation,²⁹⁵ and banking operations.²⁹⁶ The government maintains bargaining power for Brazilian capital by forbidding foreign investment in these areas.

Regional Incentives

The Law further aids in channeling foreign capital by granting the government the discretion to provide incentives for those who invest in priority economic sectors and geographic regions of Brazil.²⁹⁷ Along with the usual tax incentives, the government provides financing and import licenses to foreign investors for use in the designated sectors. Targeted as priorities are areas such as the Amazon and the Northeast, and activities such as forestation, tourism, fishing, industrial development, and the export of manufactured goods.²⁹⁸ These regional and sectoral incentives are granted by reducing or exempting from the calculation of income, excise and sales taxes, import duties and price controls, accelerated depreciation, and subsidized financing.²⁹⁹ The Brazilian government further attempts to strengthen national capital by demonstrating a general preference for enterprises with majority

294. Araújo, *supra* note 3, at 35; see CONSTITUICAO, art. 174 (Braz.).

295. CONSTITUICAO, art. 169 (Braz.).

296. The Profit Remittance Law provides that foreign banks whose home jurisdictions impose legislative restrictions on Brazilian banks are prohibited from acquiring more than 30 percent of the voting shares of a Brazilian bank. Profit Remittance Law, *supra* note 1, art. 51.

297. *Id.* arts. 38-39, 52-53. The Minister of Planning has discretion to declare certain activities of vital interest to the national economy and to allow government financing to foreign controlled companies. *Id.* arts. 38-39.

298. A. RAIA, BASIC LEGAL INFORMATION FOR FOREIGN INVESTORS IN BRAZIL 59 (5th ed. 1978). The federal executive branch established federal executive institutes to serve regulatory, administrative, and limited commercial purposes. GARLAND, *supra* note 14, at 44-47. The institute, SUDAM, exercises authority over the Amazon region which includes the States of Acre, Amapá, Amazonas, Pará, Rondônia, Roraima, and parts of Mato Grosso and Maranhão. SUDENE exercises authority over the Northeast region which includes the states of Alagoas, Bahia, Ceará, Paraíba, Pernambuco, Piauí, Rio Grande do Norte, Sergipe, and parts of Mato Grosso and Maranhão. *Id.* The government also has established the Superintendency for the Development of Fishing (SUDEPE) and the Brazilian Tourism Enterprise (Embratur). *Id.*

299. CONSTITUICAO, art. 23, para. 7 (Braz.) (providing that states may not tax industrial products and other products determined by law to be intended for export). See also GARLAND, *supra* note 14, at 52-67.

Brazilian capital participation. The government prefers the formation of joint ventures to wholly-owned subsidiaries or to foreign control of local companies.³⁰⁰ In keeping with this policy, the Industrial Development Council (CDI), an organ of the Ministry of Industry and Commerce, must approve all mergers and changes in the control of Brazilian companies which have obtained these tax incentives.³⁰¹

Regional development agencies³⁰² are responsible for authorizing new industrial projects or the expansion of existing projects in the priority regions. These agencies are also responsible for channeling the various incentives in their respective regions.³⁰³ Such regional incentives include: exemption from federal taxes and a portion of the customs duties on imported equipment for new industries; income tax "holidays" of ten to fifteen years, a 50 percent income tax reduction for expanding firms; reduced-rate loans from the National Bank for Economic and Social Development; loan guarantees; and the right to receive tax-money investments of other Brazilian companies.³⁰⁴

Tax-money incentives are available to projects already located in a priority region through regional financing agencies which obtain funds from other Brazilian companies operating anywhere in the country.³⁰⁵ Any company may invest in approved projects up to 50 percent of the corporate income tax it would otherwise owe.³⁰⁶ Half of the allowance is invested in specific federal development programs, and the other half is allocated to investment funds which are subsequently given to projects already located in the priority regions.³⁰⁷ Companies which own or are majority shareholders in

300. See Pinheiro Neto, *supra* note 12, at 317-18. While foreign multinational corporations are not discriminated against, see Profit Remittance Law, *supra* note 1, art. 2, "there is a definite attempt to support and help develop the Brazilian company in which the majority of voting stock or control rests in the hands of nationals." Pinheiro Neto, *supra* note 12, at 318. See Sills, *supra* note 68, at 3, for a discussion of the benefits of the joint venture form of operation in Brazil.

301. Street Remarks, *supra* note 14; see Opice Remarks, *supra* note 4.

302. Opice Remarks, *supra* note 4. SUDAM is the government agency for the Amazon and SUDENE for the Northeast.

303. PRICE WATERHOUSE, *supra* note 31, at 85-86.

304. Sills, *supra* note 68, at 19-20.

305. See *id.* at 20; GARLAND *supra* note 14, at 57-59; RAIA *supra* note 298, at 60.

306. RAIA, *supra* note 298, at 60.

307. *Id.*; GARLAND, *supra* note 14, at 58.

projects in priority regions may invest half of the corporate income tax in federal development programs and channel the other half into their own regional projects.³⁰⁸ The investing company may then receive shares from the benefited company which may not be transferred for five years.³⁰⁹ Dividends issued upon the shares cannot be remitted abroad either directly or indirectly.³¹⁰ Thus, these tax incentives cannot be used as a tax avoidance device for foreign investors who wish to minimize their tax on income destined for remittance.³¹¹ Other than this prohibition, there are no restrictions on profit remittance related to regional incentives.

Other Incentives

The Industrial Development Council examines and approves projects for the installation and expansion of industries which the CDI considers to be in the national interest.³¹² Such approval is granted on a case-by-case basis and can result in exemption from the excise tax and the customs duties on imports of industrial equipment and machinery that have no equivalent on the domestic market, excise tax credits for purchasers of domestic industrial equipment, accelerated depreciation rates, and preferential governmental financial support.³¹³

The Brazilian government is, at present, giving top priority to export incentives in an effort to attract foreign currency and to alleviate balance of payments pressures.³¹⁴ The 1981 trade balance surplus evinces the positive results of this policy.³¹⁵ Critics of the policy, however, point to sacrifices in production for the domestic market. In the international arena, signatory countries of the

308. RAIA, *supra* note 298, at 60.

309. *Id.*

310. *Id.*

311. One commentator has stated that "[t]he incentives have been carefully structured to channel investment in certain directions in Brazil. They are not available as tax-avoidance devices for foreign companies wishing to minimize tax on income destined for remittance abroad." Sills, *supra* note 68, at 20.

312. As of October 1981 the CDI had approved the granting of fiscal incentives for the construction, expansion and modernization of 61 industrial projects for 1981. O Estado de São Paulo, Oct. 25, 1981, at 54, col. 1.

313. Decree Law No. 1137 of Dec. 7, 1970; RAIA, *supra* note 298, at 59.

314. Pinheiro Neto, *supra* note 12, at 319; Andrade Interview, *supra* note 4.

315. See *supra* note 240 and accompanying text.

General Agreement on Tariffs and Trade (GATT),³¹⁶ have protested the export incentives offered by Brazil, as well as those of other member nations.³¹⁷ Despite these complaints, Brazil has made a commitment to continue export incentives, and will probably maintain such programs for years to come.

Subsidized financing is a principal form of Brazilian export incentives. One such program, known as "FINEX," provides export financing through Brazilian commercial banks to Brazilian exporters, foreign importers of capital goods and foreign banks, for up to 85 percent of the FOB value of the goods.³¹⁸ There are also programs for short-term financing under which commercial banks can discount, at favorable rates, the value of export exchange contracts.³¹⁹

Joint Ventures

The Brazilian government provides a long-term program, known as "BEFIEX," for companies with majority national capital participation — usually joint ventures. Under this program, the federal government enters into contracts with approved companies for fixed periods of up to ten years.³²⁰ The usual export tax incentives³²¹ are, by this process, guaranteed for a period that goes beyond normally scheduled expiration dates. Companies in the program may import machinery and equipment free of customs duties, excise taxes, and

316. General Agreement on Tariffs and Trade, *opened for signature* Oct. 30, 1947, 61 Stat. A3, T.I.A.S. No. 1700, 55 U.N.T.S. 187. The current version of the Agreement is contained in 4 GENERAL AGREEMENT ON TARIFFS AND TRADE, BASIC INSTRUMENTS AND SELECTED DOCUMENTS (1969).

317. O Estado de São Paulo, Dec. 20, 1981, at 32, col. 2.

318. Sills, *supra* note 68, at 18.

319. Such financing can be for up to 180 days. *Id.*

320. *Id.* at 19; O Estado de São Paulo, Jan. 12, 1982, at 28, col. 1. In 1980, the BEFIEX program accounted for 20 percent of the sales of manufactured products and 10 percent of all exports. At the end of 1981, there were 125 programs projected to account for exports worth approximately US \$35 billion over the next eight years.

321. Export tax incentives include: (1) income tax deduction from taxable profits equivalent to a sum corresponding to profits earned through export of manufactured products listed by the Ministry of Finance, Decree Law No. 1158 of Mar. 16, 1971; (2) withholding tax exemptions for interest and commissions paid to agents abroad for financing Brazilian exports, Decree Law No. 1139 of Dec. 21, 1971; (3) reduction of withholding tax, as well as deductions from income tax for remittance of payments for publicity, sales promotion, market research, rents of premises for exhibitions, and installation and maintenance of offices, Decree Law No. 491 of Mar. 5, 1969; Decree No. 64,833 of July 8, 1969; (4) exemption from IPI, Law No. 4502 of Nov. 11, 1964, art. 7; (5) exemption from ICM, CONSTITUICAO, art. 23, para. 7 (Braz.); and (6) a "draw back" system which exempts

sales taxes.³²² In the case of nonresident investors making profit remittances subject to the supplementary tax, the BEFIEEX program allows an amount equal to the supplementary tax to be used as an income tax credit by the Brazilian company.³²³

These government incentives are often forthcoming only when foreign capital is joined with national capital in a joint venture.³²⁴ Government guaranteed loans, for example, are given to foreign corporations only when authorized by executive decree, and then only for investment in priority regions and sectors.³²⁵ With the Brazilian government's use of incentives to further its preference for majority national capital enterprises, joint ventures have become an increasingly attractive form of investment. This is especially true since the Brazilian Corporation Law was rewritten in 1976 to give greater protection to minority shareholders, to resolve issues of control, and to permit the use of shareholder agreements.³²⁶

A joint venture is conventionally formed as a jointly owned company, although a contractual or principal-agent, subcontracting approach is also possible. Forming a new company circumvents the problem of permit or financing refusal, which frequently arises when foreign investors attempt to buy out existing Brazilian companies.³²⁷ These informal controls over takeovers are the concrete expression of the Brazilian government's policy of protecting national capital. Forming a manufacturing joint venture within Brazil is another way of avoiding restrictions on imports, as well as of providing an opportunity to receive regional, sectoral, and export incentives. In addition, Brazilian joint ventures can often obtain government subsidized financing,³²⁸ which would obviate expenses

imports destined to produce manufactured goods for export from import duties, IPI and ICM, Decree No. 68,904 of July 12, 1971.

322. The BEFIEEX program was established by Decree Law No. 1219 of May 15, 1972. See GARLAND, *supra* note 14, at 122; Sills, *supra* note 68, at 19.

323. GARLAND, *supra* note 14, at 122.

324. See *id.* at 181.

325. Profit Remittance Law, *supra* note 1, arts. 37, 39.

326. The Corporation Law provides that a shareholder cannot be deprived of the right to participate in corporate profits, in the assets of the company on liquidation, or to withdraw from the corporation as provided in the statute. Brazilian Corporation Law, *supra* note 4, art. 109. The statute also details specific obligations of controlling shareholders. *Id.* arts. 116-117. See also GARLAND, *supra* note 14, at 161.

327. Brazilian Corporation Law, *supra* note 4, arts. 138-65.

328. GARLAND, *supra* note 14, at 181; Pinheiro Neto, *supra* note 12, at 316-17.

of borrowing abroad such as minimum term and grace period, and the negative effect of *cruzeiro* devaluations.

Although investment in the form of a joint venture has many advantages, it is important to remember that both partners, foreign and Brazilian, must have similar long-term goals for the company,³²⁹ and that there must be mutually accepted forms of dispute resolution. Three problems are frequently encountered in such joint ventures. First, with regard to the initial capital structure, the foreign investor will often prefer to make loans,³³⁰ while the Brazilian investor, who would prefer not to be burdened with servicing an expensive foreign loan, will prefer equity investment with its accompanying technology.³³¹ Second, foreign investors may prefer reinvestment of profits to avoid the supplementary tax on remittances abroad,³³² while the Brazilian partner may be more interested in immediate dividends.³³³ Third, the Brazilian investor would probably be anxious to take advantage of the attractive incentives offered by his government, while the foreign investor could have tax credits to offset his income at home, and earnings from tax-money incentives are not remittable.³³⁴

Another important decision must be made when Brazilian and foreign investors combine to form a company. They may either organize the company as a corporation or as a limited liability company. The corporation (*Sociedade Anônima* or S.A.) form provides substantial protection for minority shareholders, mandatory annual dividends, and liability for mismanagement and breach of fiduciary

329. While the concept of a joint venture was originally viewed with disdain by foreign investors because of conflicting objectives on the part of both potential partners, the business form is now being more widely utilized. See Pinheiro Neto, *supra* note 12, at 316-17; GARLAND, *supra* note 14, at 173-74.

330. The foreign investor will prefer loans to equity because of the certain return and the favorable tax treatment. See *supra* notes 271-272 and accompanying text.

331. In the early 1970's, a decree law was issued but not officially published which mandated government approval of foreign takeovers. Not having been published, the law never became effective. Nevertheless, some government officials felt that informal approval should be necessary, and at least one deal was blocked in its final stages when the government stepped in to prevent its consummation. Pinheiro Neto, *supra* note 12, at 317.

332. GARLAND, *supra* note 14, at 172. The supplementary tax applies only to net profits and dividends actually remitted. Profit Remittance Law, *supra* note 1, art. 43. The statute makes no mention of interest payments. *Id.*

333. See GARLAND, *supra* note 14, at 181.

334. *Id.* at 173.

duty.³³⁵ The limited liability (*limitada*) form is more flexible and does not require the publication of records and minutes.³³⁶ Both forms allow shareholder agreements,³³⁷ although there is generally no specific performance of contracts under Brazilian law except in the case of shareholder agreements relating to the purchase and sale of shares or exercise of voting rights.³³⁸

When the joint venture form is used by investors with subsidiaries already in Brazil, the subsidiary strategically should furnish the foreign investor's capital share so that there is only one large registration of foreign capital rather than two smaller ones. This would increase the overall investment base which in turn would lower or avoid supplementary taxation when profits are remitted. Intra-corporate dividends are taxed, but the tax is credited to the nonresident withholding tax to be paid when the subsidiary remits dividends to its parent abroad.³³⁹ Consequently, it would not prevent the use of a subsidiary as an intermediary investor.

Branches of Foreign Corporations

In contrast to the treatment given to joint venture companies, branches of foreign corporations are very difficult to establish in Brazil, requiring executive approval and carrying grave tax disadvantages. In fact, branches could be considered the least favored form of foreign investment by the Brazilian government because, along with failing to bring the risk capital into the country, they do not generally integrate new technology into the economy. Moreover, profits are deemed immediately attributable to the head office abroad, which usually means that the foreign corporation will not be investing profits within Brazil.

The presidential decree necessary for the initial establishment of a

335. Brazilian Corporation Law, *supra* note 4, arts. 109, 116, 117, 155-159, 202. The corporate law, in general, unless otherwise provided in the articles, requires a mandatory annual dividend of one half the net profit of the year. *Id.* art. 202.

336. *See* Decree No. 3708 of Jan. 10, 1919; Sills, *supra* note 68, at 10-11. The *limitada* form may be structured as a partnership for U.S. income tax purposes.

337. These translate into quota-holder agreements in the *limitada* form.

338. The statute provides for specific performance of valid shareholder's agreements. Brazilian Corporation Law, *supra* note 4, art. 118, § 3.

339. *See* Profit Remittance Law, *supra* note 1, art. 43; Brazilian Income Tax Law, *supra* note 60, art. 544(III) & § 3.

branch takes at least six months to obtain.³⁴⁰ Thereafter, an independent presidential decree and publication are required for any changes in the branch's organization resulting from alteration of the head office's by laws, charter amendment, or capital increase.³⁴¹ A branch must be represented by a Brazilian representative with unrestricted authority, while liability of the head office for debts and claims is not limited to the amount of capital it has assigned to that branch.³⁴²

Branches of foreign corporations are treated for tax purposes as both domestic and foreign entities. Accordingly, they are subject to domestic income tax as well as to the 25 percent nonresident withholding tax, whether or not the profits are remitted or credited to the head office.³⁴³ Income is deemed to be at the disposal of the foreign investor head office, and is therefore taxed immediately.³⁴⁴ If the head office reinvests its branch income in the branch's industrial plant, the withholding tax is lowered to 15 percent,³⁴⁵ but reinvestments are not free of tax as they are in the case of Brazilian companies with foreign owners.³⁴⁶ The possibility of capitalization of branch earnings is at best uncertain, as is Central Bank treatment of investment income such as dividends and interest. In addition, branches are discriminated against with regard to financing and incentives otherwise provided by the Brazilian government.³⁴⁷

Despite the Brazilian government's disapproval, there are two possible tax advantages to operating a branch in Brazil. First, if the head office anticipates an operating loss by the branch and files a consolidated tax return in its home country, it will be able to offset the branch's loss against its other corporate income. The second advantage is available when the head office has tax credits available in its home country. In such a case, the head office gets a dollar-for-dollar tax credit as it pays the corporate income and withholding taxes in Brazil. This credit could be viewed as a means of "remitting"

340. GARLAND, *supra* note 14, at 166; INVESTMENTS IN BRAZIL, *supra* note 64, at 41.

341. Decree Law No. 2627 of Sept. 26, 1940, art. 67.

342. GARLAND, *supra* note 14, at 167.

343. Brazilian Income Tax Law, *supra* note 60, art. 555, § 9.

344. *Id.*

345. See *supra* note 178 and accompanying text; Decree Law No. 2627 of Sept. 26, 1940, arts. 65-70; Araújo, *supra* note 3, at 37; GARLAND, *supra* note 14, at 166.

346. See *supra* note 187 and accompanying text

347. GARLAND, *supra* note 14, at 166-67; INVESTMENTS IN BRAZIL, *supra* note 64, at 41.

profits immediately, rather than wading through the Central Bank bureaucracy or being subject to the supplementary tax on profits. This tax avoidance aspect of investment may be another reason for the Brazilian government's unfavorable treatment of branches of foreign corporations.

CONCLUSION

Brazil's Profit Remittance Law does more than regulate the remittance of profits. It controls foreign exchange transactions and acts as a quasi-investment code. The Law, now in force unchanged for almost twenty years, affords foreign investors the stability of legislatively defined treatment, although there is some flexibility in the discretion given the Central Bank and executive branch. Foreign investment is favored by the Law because it brings capital assets into the country, the purchase of which would otherwise cost precious foreign currency. Foreign investment also brings the employment opportunities and technology necessary for continued economic development.

While encouraging foreign investment in Brazil, the Profit Remittance Law guards against the overvaluation of foreign capital entering the country, transfer pricing, dumping, competition with national companies, and excessive interest rates. The Law also helps channel foreign investment to priority economic sectors and geographic regions of Brazil so that specific development goals can be met. These restrictions on foreign investment are Brazil's response to the tension created by its competing goals — encouraging foreign investment and preventing balance of payments deficits.