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JOINT BUSINESS VENTURES IN BRAZIL:
A CANADIAN PERSPECTIVE

Government of Canada
Gouvernement du Canada

Industry, Trade and Commerce
Industrie et Commerce

[Canada. Consulate General (Brazil)]

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JOINT BUSINESS VENTURES IN BRAZIL: A CANADIAN PERSPECTIVE

April 1, 1981

Prepared by:
Canadian Consulate General
Caixa Postal 22002
Edificio Top Centre
Avenida Paulista, 854, 50 andar

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INTRODUCTION

The Federative Republic of Brazil, with a population of approximately 120 million people, represents the largest single market in Latin America. As such it has attracted considerable attention on the part of foreign businessmen, and Canadians have not been slow in exploring possibilities in the commercial sphere.

Economists have calculated that Brazil will need a growth rate of six per cent merely to stand still in economic terms as the population grows at an annual rate of 2.8 per cent and approximately three per cent of the population enters the market and monetary system each year. Currently, approximately 40 per cent of the population remains outside this market and monetary system.

Industrialization of the Brazilian economy has been a priority of the Brazilian government since the beginning of the 1950s. However, in recent years the government has decided to place more emphasis on the agricultural and energy sectors. The country remains very capital-hungry, however, and internal savings are nowhere near enough to provide the kind of growth that Brazil will require. Foreign debt is now estimated to be in excess of $55 million. Growth in this indebtedness has recently been limited by some reluctance on the part of foreign leaders to continue to provide funds to Brazil. To reduce the debt load, the Brazilian government has begun to encourage foreign investors to convert currency loans to the private sector into equity investment. Thus, foreign investors are finding that they are encouraged to commit their money to long-term investment.

While investment in Brazil has paid off for many foreign companies, the complex regulatory system and substantially different manner of doing business may preclude many Canadian businessmen from proceeding with investment. This paper describes some aspect of doing business in Brazil which may be of interest to prospective investors from Canada. Although we cannot deal comprehensively with all areas, we have attempted to highlight those areas in which Brazilian conditions differ from Canadian ones. For definitive interpretations of the Brazilian law relating to various items, Brazilian experts in the field should be consulted.

REASONS FOR ENTERING THE BRAZILIAN MARKET

The factors which may induce a businessman to invest in an enterprise in Brazil include the following:

1) Circumvention of restrictions on imports through manufacture within the country;

2) Entry into a rapidly expanding local market with a view to future increases in sales;

3) Sale of technology;

4) Creation of a Latin American base for manufacture of products for export.

In many instances Canadian firms have found that export to Brazil of semi- or fully-manufactured goods has become extremely difficult, if not impossible. The Brazilian government requires an import permit for goods to be brought into the country. Brazil is a signatory to the GATT agreement. Tariffs can often be very high and CACEX (the division of the Bank of Brazil which is responsible for issuing import permits) exercises administrative discretion in such a way as to discourage the entry of anything which it deems not essential to the Brazilian economy. There is a list of products whose importation is banned and this includes most luxury items, automobiles, as well as many processed food products. In 1981, CACEX introduced a system of "import programming" whereby any firm which wishes to import more than $100,000 worth of goods during the year must submit an import program to the Bank of Brazil and wait for it to be approved before an import permit is issued. In most cases, approval of the program will also involve an undertaking by the importer to export Brazilian goods abroad.

The higher the degree of processing of a product, the more difficult it is in most cases to bring it into Brazil, especially if similar articles are manufactured within the country. An examination of Statistics Canada export data for the last few years demonstrates that while Canadian exports to Brazil have increased remarkably, much of this increase can be attributed to increased purchases of Canadian raw materials by Brazilian firms. Fully-manufactured products account for 11 per cent of Canadian exports to Brazil, and semi-manufactured products for 30 per cent. Canadian manufacturers who have had most success selling in the Brazilian market are those producing high-technology goods such as aircraft engines, computer components and specialty chemicals.

ESTABLISHING IN BRAZIL: WHO MIGHT BE INTERESTED

The Brazilian industrial scene is characterized by a high level of development in many industries and in many cases a sophisticated approach to doing business. There is relatively little in the way of primary manufactured goods that is not being manufactured in Brazil today. The competition in many sectors is quite keen and it is unlikely that a Canadian manufacturer of basic industrial or

consumer goods will easily find a place in this market - unless it is a large multinational enterprise prepared to invest large sums of money in preliminary groundwork and sustained manufacturing and marketing efforts. This might well entail losses for a number of years until the enterprise is able to stand on its own.

While the Brazilian government welcomes foreign investment in principle, it has also indicated that it does not favour purchases of domestic firms by foreigners unless the purchases bring new technology or capital to the Brazilian concern. Brazil does not currently have the equivalent of Canada's Foreign Investment Review Agency. This does not mean, however, that there is no control over foreign acquisitions. The controls are exercised informally and sometimes are imposed more in the form of refusal of permits or denial of access to concessional financing rather than outright administrative edicts as in Canada.

Notwithstanding the above, there are attractive opportunities for joint ventures in Brazil for companies with something to offer in the way of technology which does not exist in the country. Such firms might include those in the energy field which have developed sophisticated equipment, metallurgical companies, firms in the forestry or paper sector and agribusiness concerns willing to bring both capital and expertise to the development of Brazil's agricultural frontier areas.

Certain areas are officially "off limits" to foreign investors. Foreigners may not own, in any form, newspapers, television or radio stations. Exploration and extraction of petroleum is restricted to the national oil company PETROBRAS. However, "risk contracts" for oil exploration may be signed by foreign firms with Petrobras or its State of Sao Paulo counterpart, Paulipetro. Coastal shipping, airlines, arms and munitions are effectively restricted to Brazilian ownership. Foreign ownership in financial institutions after 1964 has been restricted to minority control, although those with majority foreign ownership before 1964 have been allowed to continue. Establishment of representative offices of foreign banks requires prior Central Bank approval. The right of a foreign bank to open a branch in Brazil is governed by reciprocity in awardance of similar rights to Brazilian banks in the foreign country. The development of hydroelectric energy has been restricted to Brazilian nationals or entities incorporated in Brazil. While the same type of restrictions apply to mining companies, a number of foreign mining firms have been allowed to operate wholly-owned Brazilian subsidiaries. 10

Likewise, the Brazilian government will only approve projects where there is majority Brazilian ownership in the following areas: fishing, insurance and iron and steel.

Direct or indirect ownership by foreigners of land in rural areas is regulated and subject to quantitative controls. Brazilian law permits foreigners resident in Brazil or Brazilian registered corporations to purchase large tracts of rural land if they have a plan for development of the area which has been approved by the National Institute of Colonization and Agrarian Reform (INCRA) of the federal Ministry of Agriculture. These restrictions have been circumvented in some cases through purchase of property in the name of a Brazilian nominee.

Establishing or buying into a business in Brazil requires substantial sums of capital - investment counsellors use the figure of $500,000 as a minimum. Those companies unable or unwilling to commit such sums should consider other forms of participation in the Brazilian market such as supplying technology under a short-term contract or a licensing agreement.

INVESTIGATING THE MARKET AND INVESTMENT CLIMATE

Prospective investors will want to investigate the Brazilian market as thoroughly as they would the Canadian before committing funds. A wealth of free information about Brazil is available in Canada from the Bureau of Latin American and Caribbean Affairs of the Department of Industry, Trade and Commerce in Ottawa. Background material can also be obtained from the Brazil-Canada Chamber of Commerce and the Canadian Association for Latin America both in Toronto, the Brazilian Embassy in Ottawa, the Brazilian Consulates in Montreal and Toronto, as well as representative offices of Brazilian banks in Toronto, including the Bank of Brazil, Banco Real, and the Bank of the State of Sao Paulo (BANESPA).

Within Brazil, the Canadian Embassy in Brasilia and the Canadian Consulates General in Sao Paulo and Rio de Janeiro are well-equipped to answer questions regarding possible markets for Canadian goods as well as the prevailing climate for investment. The counterpart of the Brazil-Canada Chamber of Commerce in Sao Paulo, the "Camara de Comércio Brasil-Canada", may also be able to provide assistance. (Full addresses for all of these organizations may be found in the Appendix to this report.)

Following the preliminary study, a detailed market and investment study can be performed in Brazil. There are a number of first-class accounting and management consulting firms in Brazil which provide excellent market studies for foreign clients. Names can be obtained from the Canadian missions listed above. As well, the Bank of Montreal, the Toronto-Dominion Bank, the Royal Bank of Canada and the Canadian Imperial Bank of Commerce have representative offices in Sao Paulo and the Bank of Nova Scotia maintains a representative office in Rio de Janeiro. Representatives of these banks are good sources of

information on the investment climate and can suggest names of good contacts for further information.

POSSIBLE FORMS OF JOINT BUSINESS VENTURES IN BRAZIL

"Greenfields" Venture: Is a Partner Necessary?

A "Greenfields" venture has become increasingly difficult to undertake in Brazil. The complexity of the Brazilian regulatory structure, substantially different ways of doing business from those of Canada, the necessity of good relationships within senior levels of the Brazilian government and the spiralling cost of equipment and local managerial talent often make it inadvisable for a Canadian company to consider "going it alone".

Some sort of association with a local firm or firms can often be advantageous. This association may be achieved either by taking a position in an existing concern or through the formation of a new joint venture with a Brazilian partner. However, a potential partner who meets all the technical, business and other requirements of the Canadian investor can be difficult to find. The principal task for most investors will be the identification of individuals who have substantially the same short-term and long-term goals as the Canadian partner. This process can take more than a year for those who are interested in securing a partner of first rank with the management skills and overall attitudes which will make the investment work for both sides.

Many foreign investors have certain misconceptions about Brazilian partners. Politically prominent individuals who enter joint ventures with foreign partners solely on the basis of supposed connections within the government and who have little business experience of their own often prove to be more of a liability than an asset. Governments change quickly and good connections at some point often disappear. There is an "old school" network in Brazil, but those with an "independent" power base resting on personal or family achievements and not on transient connections within the government are much rarer than those who claim that they can get things done solely on the basis of who they know. The ideal partner is one who combines demonstrated management and financial skills as evidenced through management of an ongoing business and an ability to negotiate effectively with the Brazilian government and private sectors.

Possible sources of information on potential partners include the Canadian diplomatic missions in Brazil, the Canadian banks, the Chamber of Commerce, reputable Brazilian law firms and accounting and management consulting firms such as Peat Marwick, Price Waterhouse and Arthur Anderson. Credit reporting firms such as Dunn and Bradstreet

can supplement the credit reporting of the Canadian banks established in Brazil.

If it proves impossible to find a satisfactory partner, many investment counsellors recommend no partner rather than one who does not meet the Canadian investor's requirements.

Acquisition of a Stake in an Existing Enterprise

Asset Purchase v Share Purchase

A number of factors make a share purchase of control of a firm more attractive than an asset purchase. From the seller's point of view, there are unfavourable tax consequences in an asset purchase in that he may be required to pay corporate tax on the increase in value of assets over the value previously declared to the tax authorities. This may make him reluctant to consider an asset purchase. In addition, Brazilian Corporation Law contains the concept of "succession" whereby purchasers of more than 50 per cent of the assets of a legal entity may be deemed to be the successors of the previous owners and may be fixed with legal responsibilities for the company's liabilities as well. In other words, one cannot avoid responsibility for debts and other liabilities through an asset purchase.

A purchase of shares in a Brazilian firm will be exempt from capital gains tax if the vendor has owned the shares in question for at least five years before the date of sale.

General Considerations on Share Purchases

Canadians wishing to acquire a share in an existing venture will find that purchase of shares on a Brazilian stock exchange is in most cases not a viable proposition. The Brazilian stock market is extremely thin by Canadian standards, with only about 400 companies listed, of which five to 10 are actively traded on a daily basis. There are no truly public companies in the Canadian sense of the word. Most firms are only "public" to the extent of 25 to 30 per cent of their equity, and the balance is held by either the Brazilian government or private individuals. The major equity owners in Brazil are the mutual funds. A direct purchase, on the other hand, is safer, can be accomplished more quickly, and has the advantage of permitting advance negotiation of post-acquisition management and control.

Evaluation of a Brazilian company for purposes of determining an acquisition price for part or all of its shares will present considerably more difficulties in Brazil than it would in a Canadian situation. While Canadian businessmen would be accustomed to evaluation of a company's net worth in terms of multiples of earnings,

in Brazil this is usually not a reliable indicator of a company's value. Typically, corporate earnings are understated in Brazil for taxation and other reasons, and in smaller companies the accounting system and financial controls are often sporadic. In addition, earnings in cruzeiros will have to be adjusted over a given period to reflect monetary correction and other peculiarities of the Brazilian financial scene.

Most foreign companies have found that evaluation of assets adjusted for monetary correction will provide a more reliable base for evaluation of net worth. In most cases the value of real estate held by the Brazilian company will comprise a much larger proportion of the value of the Brazilian firms than it would in a comparable Canadian operation. In smaller operations, the proprietor will tend to value the goodwill of the business at a far higher rate than would a foreign buyer.

Minority Stakes in Brazilian Firms

Many foreign investors, particularly those from the United States, insist on majority ownership of a firm as a precondition to investing abroad. While having the last word in a dispute with a local partner is extremely attractive, minority participation in a firm should not necessarily be ruled out. What should be ruled out is a 50-50 shareholding between the Canadian and Brazilian partner. This will invariably lead to a deadlock in corporate decision-making and will preclude the advantages given by the government to Brazilian-controlled corporations.

A number of Canadian firms have found that minority participation in a foreign firm can be an effective way to participate in the local market. This approach assumes a "meeting of the minds" of the partners and similar long-term goals in terms of the company's operation. This assumes as well that the Brazilian partner will continue to have a need for the Canadian shareholder and that mutually acceptable forms of resolving disputes over operations of the firm are respected by both parties. Communication between both parties must be as full, open and as frank as possible. None of the above implies, however, that a Canadian investor should not have independent professional advice - to the contrary, competent legal, tax and accounting advice is highly recommended.

A minority shareholding position in a Brazilian firm carries the additional advantage of substantial legal protection for the minority shareholder - more protection than is currently afforded under Canadian Corporation Law. For example: there is a statutory provision allowing for withdrawal from the company in certain circumstances with reimbursement of the value of the shares when a shareholder disagrees with company resolutions which have a fundamental effect on the

company's operations. There are, in addition, statutory rights to receipt of annual dividends, and Brazilian Corporation Law now provides that a shareholder can be held legally responsible for damages to minority shareholders caused by abuse of his voting rights. Determination of abuse and consequent damages is made by a Brazilian court; additionally minority shareholders representing five per cent or more of the voting capital may insist on the appointment of a "fiscal council" whose function is analogous in some respects to that of an auditor and to whom the board of directors must report. They may also insist on application to the high court for a public examination of the corporation's books.

Shareholders' Agreements

In cases where acquisition of a minority stake is done with the full co-operation and approval of the Brazilian owner, shareholders' agreements will normally be drafted and agreement obtained on matters such as minimum dividend policy, future capitalization policy, management remuneration, reporting requirements and protection of technology transfer to the Brazilian firm. Brazilian Corporation Law provides that provisions of the shareholders' agreements which are filed with the company and related to the purchase and sale of shares or exercise of voting rights may be specifically enforced against one party. The general rule, however, is that specific performance of contracts may not be obtained. This in the eyes of some Canadians will be a serious disadvantage.

Canadian investors will generally be surprised at the level of remuneration existing for top management in Brazil. In many cases it will be two to three times what would normally be paid in Canada for someone performing similar functions. As well, protection of technology is rendered difficult under Brazilian law.

Advantages of Majority Brazilian Control in Terms of Concessional Financing

Government concessional financing becomes an important issue when businessmen come to grips with the cost of financing from non-Brazilian sources. Foreign loans have historically been relatively expensive sources of financing in Brazil and will probably continue to be so in the future. Brazil is extremely hungry for foreign capital. In the past (most recently in 1979), the government imposed a series of restrictions on foreign loans which effectively permitted it to make use of part of foreign loans contracted on behalf of private entities. Currently, a direct loan from a foreign lender to a Brazilian borrower must be for a minimum of eight or 10 years, with repayment of the principal in equal instalments starting in the thirtieth month of the loan period. Ten-year loans attract no withholding tax on repayment of interest.

Currently, foreign loans are disbursed as follows: 25 per cent is immediately available to the borrower, a further 25 per cent after 60 days, a further 25 per cent after 90 days and the final 25 per cent after 120 days. The Central Bank will cover devaluation and interest expenses for the period in which it withholds the funds. This requires the Brazilian borrower, however, to look to other sources of financing until the amount of the loan is fully disbursed by the Central Bank. There have been instances where the Central Bank has frozen up to 50 per cent of any foreign loan to a Brazilian borrower and only allowed the remaining 50 per cent to be disbursed in stages over a period of seven months.

Further, the continuing devaluation of the Brazilian cruzeiro means that loans contracted abroad and repayable in hard currencies will become progressively more expensive in cruzeiro terms for Brazilian firms. Unless the company's overall performance provides ever-increasing flows of capital available for repayment of loans, a foreign loan often becomes an unattractive proposition. In December 1979, for example, when the Brazilian government devalued the cruzeiro by 30 per cent, a number of subsidiaries of foreign companies operating in Brazil found themselves in serious financial straits. One possible avenue for avoiding the exchange risk lies in repassing a loan obtained from a foreign bank through a Brazilian bank. The Brazilian government allows this type of loan to be made for periods less than the eight years required of direct foreign loans, but the arrangement must be for more than six months. Depending on current conditions on the money market, a Brazilian bank may or may not be interested in this type of arrangement. Under current conditions, most Brazilian firms prefer to work with loans denominated in cruzeiros, despite interest rates in triple-digit figures.

It is at this juncture that a local partner is particularly invaluable in Brazil as he may be able to obtain some relatively cheap local financing from local banks and government agencies. For example, a Central Bank directive currently requires local banks to reserve 70 per cent of their funds for Brazilian-controlled enterprises. Thirty per cent of the funds may be provided to government agencies and multinational firms. Such Brazilian enterprises may also qualify for medium- and long-term credits from the National Development Bank (BNDE). The BNDE interest rates currently are running at about three to 10 per cent per annum. In the current state of the Brazilian economy, where inflation is running at approximately 110 per cent a year, this in effect amounts to a loan at a negative rate of interest. Further details on concessional financing can be provided by professional advisers in Brazil.

FORMS OF ORGANIZATION OF NEW VENTURES

"Limitada"

The Brazilian "Limitada" is analogous in some respects to the limited partnership in a common law jurisdiction. It must have at least two members - either individuals or companies - and be formed through a Deed of Constitution which must be registered in the Commercial Registry. Capital is denominated in quotas with fixed unit values, although most firms would consider it unusual to issue certificates for their quotas. Members are liable for debts and losses up to the value of their capital contributions. Also, all members are jointly liable to the extent of capital not actually paid in by other members in case of bankruptcy.

"Sociedade Anonima"

A Brazilian "Sociedade Anonima" can be either an open or a closed corporation analogous in some respects to private and public corporations under Canadian law. The by-laws establish the number and par value of the shares and can provide for future capital increases up to authorized limits. Generally, the same permutations and combinations available under Canadian Corporation law in terms of capital structuring are also available under Brazilian law; i.e. shares may be ordinary, preferred and voting or non-voting. Preferred shares without voting rights cannot exceed two-thirds of the total capital.

In a Brazilian "open corporation", capitalization by public subscription is subject to previous registration of the issue with the Comissao de Valores Mobiliarios, which is equivalent in some respects to the Security Commissions in Canada. Generally, the security laws are nowhere near as rigorous as those in Canada in terms of disclosure requirements. By the same token, however, the relative thinness of the stock market in Brazil generally means more public exposure for those engaged in offering stock to the public. Initial public stock offerings of small corporations are not considered to be a viable method of capitalizing new ventures in Brazil.

One feature of Brazilian Corporation Law which is quite different from the Canadian situation is the provision for "administrative councils" and "fiscal councils".

The administrative council is obligatory for corporations with authorized capital and all "open" companies. The administrative council defines policy including nominations and dismissals of directors, defines responsibilities of the board of directors, and provides supervision of the board's performance as well as the appointment of auditors. It does not, however, have an executive function - this devolves directly upon the board of directors, which may be elected by the administrative council or, if there is no council, by the stockholders' meeting.

The fiscal council is in some respects analogous in function to an in-house auditing body. There are normally three members on the committee. It is either appointed on the initiative of the board of directors or it can be set up on the application of shareholders holding a minimum of 10 per cent of voting or five per cent of non-voting stock, as well as in certain other circumstances. Generally, the fiscal council's authority and powers are wide and it may review a variety of acts of both the administrative council and the board of directors. Service on a fiscal council is prohibited to officers of the corporation, spouses, relatives, employees of the company or related firms such as subsidiaries.

Another provision of the Brazilian company law which differs somewhat from the Canadian is the general requirement that remuneration of company directors, administrative and fiscal counsellors be "reasonable" in accordance with degrees of responsibility, time spent in performance of duties, competence and level of remuneration with reference to current market conditions. This determination presumably is to be made by Brazilian courts upon the application of an interested party.

Choice Between "Limitada", "Sociedade Anonima","Sociedade em Conta de Participaçao" and "Consortium"

When two partners decide to go into a joint venture together, the "Limitada" is normally the form of organization chosen. If different classes of shares are envisaged or public share offerings are planned for the future, a "Sociedade Anonima" must be the form of organization used. The "Sociedada Anonima", as a corporation, will require the preparation of annual accounts and minutes of shareholders' meetings which the "Limitada" does not require. The "Sociedade Anonima" must also set aside five per cent of its profits to a legal reserve which the "Limitada" is not required to do. Nevertheless, the transformation of a "Limitada" to a "Sociedade Anonima" or vice versa is relatively easily effected in Brazil and need not unduly concern a potential investor.

A joint venture as such is not considered to have a legal personality in Brazil. The normal procedure has been for two parties to enter into a form of a "Limitada" or "Sociedade Anonima". A third form of organization which is available for joint ventures (though not as common as the "Sociedade Anonima" or the "Limitada") is the "Sociedade em Conta de Participaçao". This is a "participation account" registered in the books of the principal partner and requires the participation of one registered Brazilian businessman or enterprise to appear as the representative of the venture before third parties. The "Sociedade em Conta de Participaçao" requires fewer accounting and legal arrangements than does the "Limitada" and may appeal to those who

wish to remain as flexible as possible in their joint venture operation.

Another form of organization which is used in Brazil for joint ventures is a "consortium". This form of organization is used generally on single contract ventures for the supply of goods and services. In form it resembles a contract, having as an essential feature the association of two or more enterprises with the common objective of completing a specific undertaking. Each of the partners maintains a separate identity. The consortium is not considered to be a legal entity under Brazilian law and each of the associates is liable for his respective responsibilities and obligations under the contract. There is no joint liability. A consortium contract normally must be filed with the Brazilian Commercial Registry. The contract itself must settle the objectives of the undertaking, its duration, the specific obligations and responsibilities of each of the members of the consortium and their relationship to one another.

Branch

Another form of operation which foreign investors occasionally consider is a simple branch within Brazil of the foreign entity. As this type of organization requires the approval of the President of Brazil and as approval of the federal government must be obtained in the event of any change in the branch's organization resulting from alteration of the head office's by-laws, a branch is not generally considered to be an attractive vehicle for participation of foreign companies within Brazil. It should also be noted that the after-tax profits of the Brazilian branch are subject to withholding tax at the rate of 25 per cent even if the profits of the branch are not remitted abroad.

TRANSFER OF TECHNOLOGY TO BRAZILIAN ENTERPRISES

Canadian businessmen who wish to participate in the Brazilian market through a form of association with a Brazilian firm but who do not wish to become involved in the complication and expense of a joint venture with a Brazilian partner will probably be interested in some form of technology transfer. At the outset, they should be aware that Brazilian industrial property and technology transfer legislation is among the most restrictive in the world as regards foreign sellers of technology.

The National Institute of Industrial Property (INPI) is a regulatory body which supervises all aspects of industrial property regulations within Brazil and requires that all agreements relating to transfer of technology be submitted to it for approval. The institute is endowed with wide-ranging powers to impose modifications on proposed agreements between private parties. INPI approval is required under

Brazilian law for the technology transfer agreement to be made enforceable, and INPI approval is also required to enable the transferor to apply to the Central Bank of Brazil for authorization to make remittances of payments in foreign currency outside Brazil. The purpose of Brazil's industrial property legislation is to reduce the cost of foreign technology and to control the outflow of foreign exchange. The institute has, for example, made it the practice to delete the following contractual provisions in technology transfer agreements:

1) those which place export restrictions on products of the Brazilian licensee unless specific foreign legislation applies (e.g. the U.S. Trading with the Enemy Act);
2) requirements to purchase the licensor's products for incorporation in the end product;
3) restrictions on research or technological development of the licensee's products or requirements that the licensee's improvements on the product be retransmitted to the licensor;
4) prohibitions on the free use and disposal of technology and services once a reasonable period (to be determined by the institute) has elapsed after the transfer of technology.

INPI's stated objective is to stimulate Brazil's export drive and to prohibit limitations on Brazilian licensees' activities.

Payments for technology are strictly controlled. The INPI will determine the percentage of net sales which is allowed for remittance to the foreign owner of the technology. The Central Bank in all instances requires that the technology transfer agreement be registered. Further, the Central Bank has stated that remuneration only becomes due when the products which have been manufactured using the technology are actually sold. Monies accruing from the sale will be remitted at the official rate of exchange prevailing on the date of the remittance.

The Brazilian industrial property legislation does not specify the actual percentage of net sales which may be remitted but in practice the INPI has established a limit of five per cent of net sales as the maximum which can be remitted outside Brazil under a technology transfer agreement.

Under Normative Act 15, determination of the remuneration for the foreign owner of the technology is to be based on certain factors including the degree of innovation; the degree of complexity; the qualitative level of the product; a constant subsequent supply of updated information and technical information, particularly in those areas which are changing rapidly; the licensor's standing in the business world; its capacity for research and development; and the time-span for the total transfer of technology.

The five types of technology transfer recognized in Brazil under Normative Act 15 of INPI are:

1) The patent licence, which has a maximum term of registration of 15 years. The level of remuneration allowed is one to five per cent of the total sales as determined by the INPI.
2) The trademark licence. The maximum term for trademark licences is 10 years, which may be renewable for another 10-year term. Only one per cent of net sales may be remitted.
3) The supply of industrial technology. Contracts for the supply of industrial technology must be temporary and cannot exceed five years; between one and five per cent of net sales may be approved for remittance on an annual basis.
4) Technical industrial co-operation. These agreements can only run for a maximum of five years from the day of the start-up of production but may be extended on application to INPI. One to five per cent of net sales may be approved for remittance on an annual basis.
5) Specialized technical services. This generally involves the provision of services on a onetime basis for a specified amount and the INPI will decide the amount remittable on a case-by-case basis.

The INPI has in the past been disposed to negotiate some terms of technology transfer agreements with the parties involved. Generally, not many exceptions or concessions are made to foreign applicants.

Additional Observations on Transfer of Technology

Payments of fees for the use of patents or trademarks will not be permitted where the foreign owner of the technology holds more than 50 per cent of the voting capital of the Brazilian user, either directly or indirectly. Such a payment to a majority foreign owner is also not deductible for tax purposes and is considered the equivalent of a dividend and therefore subject to the limitations on remittance of profits.

Patents recorded at the Brazilian patent office must be worked on an industrial scale and this must occur within the first three years of registry. Interested parties may apply for a compulsory licence of the patent where industrial working of the patent does not occur within three years or if exploitation of the patent is suspended for a period of more than one year.

Finally, the INPI regards payment for technology as a payment whereby the recipient becomes the virtual owner of the acquired know-how and not a mere licensee of the right to use the technology.

TAXATION

The general consensus in Brazil is that, compared with many other Western countries including Canada, the total burden of direct taxation is not onerous. The Brazilian government has traditionally relied, however, on a high level of indirect taxation to produce revenues.

Direct Taxation

The corporate tax is currently 35 per cent up to the first 30 million cruzeiros of income and 40 per cent on income in excess of that figure. Certain exceptions are provided for agricultural companies (six per cent) and public utilities. Entities domiciled abroad and non-resident individuals must pay a withholding tax of 25 per cent on income earned as Brazilian branches of foreign companies. Although there is no tax treaty in effect yet between Brazil and Canada, such an agreement is currently under negotiation between the two governments.

There are some interesting tax exemptions available to firms producing in Brazil, the principal one being exemption from tax on export sales of manufactured goods made by the manufacturer himself or made by a registered trading company. Likewise income from exports of engineering technical assistance and income from foreign branch operations are also exempted from taxation in Brazil.

Another feature of the Brazilian taxation system which is quite different from the Canadian relates to filing of annual tax returns. The tax returns are based on the results of the accounting period closed within the preceding calendar year and tax becomes payable in 12 monthly instalments from January to December in the year the return is filed, i.e. the following year. Effectively then there is considerable time allowed between the time the taxable income accrues and the time in which the tax is actually due to the authorities. This is a considerable advantage.

Brazilians and foreign residents in Brazil are taxed on their world income. This is similar to Canadian law in that taxation is on the basis of residency.

There is a capital gains tax of 25 per cent on sales of equity investment. However, if the investment has been held for more than five years or the capital gain is realized on a Brazilian stock exchange, the capital gain is exempt from tax.

Personal tax rates reach a maximum of 55 per cent at approximately (U.S.)$40,000 per year, and tax is normally withheld at source of income on a monthly basis up to a maximum of 30 per cent of the income. Those in income tax brackets higher than 30 per cent

therefore will qualify for the tax advantage described above for corporations, in terms of later payment of tax owing.

Unlike Canada there is an "undisclosed gains" tax and individual taxpayers must file statements of assets and liabilities once a year, normally by December 31. Increases in quantity of net assets which are not attributable to reported taxable or non-taxable income are subject to tax in Brazil. However, as assets are carried on the declaration at historical value, this does not act as a capital gains tax. It merely taxes the funds used to acquire assets which have not been otherwise reported as income.

Income from capital assets located outside Brazil is exempt for the first five years of a foreigner's residence in Brazil but afterwards becomes taxable.

Indirect Taxation

There are several major indirect taxes levied in Brazil. The Industrialized Products Tax (IPI) is a value-added tax with rates which vary from three to 75 per cent (for luxury products such as alcohol and tobacco). IPI is imposed by the federal government on each stage of manufacture or production of goods in Brazil. Exemptions from IPI are granted for exports and the exporter may claim in addition credits for IPI already paid on material and packaging used in the production of goods. IPI is also leviable on imported products and becomes due once the imported products are cleared through customs.

The Distribution of Merchandise Tax (ICM) is also a type of value-added tax imposed on all stages of manufacturing and marketing of products made in Brazil. ICM is levied, however, by state governments. The rate of tax in 1981 is 15.5 per cent. On domestic sales in Brazil the basis of the tax is the value of the transaction. For imported goods the tax is levied on the cruzeiro import price plus import duties, IPI and customs charges.

The Service Tax (ISS) is a municipal tax levied on specified services provided by companies or professionals and varies from two to five per cent.

The Tax on Financial Transactions (ISOF) is a federal tax levied on credit and insurance transactions of financial institutions and insurance companies. The most visible area of its application is in foreign exchange transactions related to imports. Currently the tax is 25 per cent.

FOREIGN CAPITAL AND PROFIT REMITTANCE

Generally, the Brazilian government allows repatriation of foreign capital up to the amount of the "registered foreign capital

base" without payment of tax. Amounts in excess of the registered foreign capital base require special permission of the federal government and a withholding tax will be levied on a remittance of these amounts if approval is granted.

A restrictive feature of Brazilian legislation affecting foreign investment is that which relates to remittance of profits. Under the Brazilian Foreign Investment Law, the foreign investor can receive an average of 12 per cent per year on his registered foreign capital base after deducting the withholding tax (currently 25 per cent for Canadians).

Foreign capital is defined under Brazilian legislation either as financial or monetary resources introduced into the country for use in economic activities, or as assets, machinery and equipment entering Brazil without exchange control coverage used to produce goods or services. Capital contributions must be registered within 30 days of entry. In the case of equipment, an import permit will have to be obtained from CACEX before the equipment will be allowed into Brazil. Once in the country and duly registered, the capital contribution becomes the registered foreign capital base for purposes of future remittance of profits or repatriation of capital.

The Central Bank of Brazil issues a registration certificate for contributions of capital mentioned above, and this certificate is the basic document to support future remittances of profits or repatriation of capital. The importance of registering any foreign capital contributions within the time limits cannot be overemphasized.

The most important element from the foreign investor's point of view as regards this registered foreign capital base is that while he may remit 12 per cent annually without attracting punitive tax consequences, the balance of the profits may be capitalized on application to the Central Bank. Thus, profits over and above the 12 per cent can be used effectively to increase the size of his registered foreign capital base and consequently will increase the amount of profits remittable in succeeding years.

In fact, most foreign investors in Brazil have not found the 12 per cent limit on remittable profits to be unduly limiting. Price Waterhouse, for example, has estimated that the average remittance on foreign investment in Brazil has run at about three to four per cent annually in recent years.

Brazilian government policy with respect to foreign capital has been remarkably consistent since the early 1960s and the three basic pieces of legislation passed in 1962, 1964 and 1965 with regard to foreign capital have remained largely unaltered since their introduction. It is likely that Brazil will continue to require large

amounts of foreign capital for its development efforts. The consensus of most foreign businessmen operating in Brazil is that radical changes in legislation relating to foreign capital are unlikely in the immediate future, although there have been sporadic efforts by some legislators to restrict remittance of profits outside Brazil. These efforts have been unsuccessful to date.

EXPORT INCENTIVES

Brazil has developed one of the most complex systems of export incentives in the world. Owing to a long-standing balance of payments problem, the Brazilian government has oriented many sectors of the country's industry to the export market. Incentives range from tax exemptions and credits, to subsidized financing schemes for export-oriented enterprises, to outright cash grants in some cases to export firms. Many of these programs have aroused the wrath of Brazil's trading partners and, in some cases, have sacrificed production for the domestic market for export earnings.

The area of export financing is of interest to the Canadian investor insofar as it may make exporting from a Brazilian base an extremely attractive proposition when viewed in conjunction with the fiscal and regional development incentives offered by the Brazilian government.

The programs below are mentioned only as an indication of what is available.

FINEX

The government has instituted a program known as FINEX under which export financing on favourable terms is available to either the Brazilian exporter, the foreign importer or foreign banks for up to 85 per cent of the FOB value of the goods. The program is administered through the Brazilian commercial banks.

Financing for capital and durable consumer items specified by the government is available at 7.5 or eight per cent per annum for periods of up to eight years. Financing for professional services is also available at these rates. Other products which may not fall within the FINEX guidelines may be considered for financing on a case-by-case basis.

Other Financing

Facilities exist for short-term financing for firms producing for export. Commercial banks are empowered to discount the full value of an export exchange contract at rates slightly above the London Inter-Bank Offer Rate (LIBOR). Financing can be for up to 180 days.

The same facilities exist for companies with foreign exchange receivables in hand.

Pre-production financing is available through a Central Bank line of credit passed through the commercial banking sector. Financing is available for up to 360 days and the amount is based on the previous year's volume of exports made by the firm requiring the financing. Interest rates are 40 per cent per annum. As well, trading companies with two-thirds or more Brazilian ownership also obtain financing for up to 180 days at 40 per cent per annum.

In addition, the Brazilian government has provided a system of export financing for certain other specified sectors which it deems to be of national interest.

BEFIEX

This program of the federal government undertakes contractual agreements with export companies for fixed terms up to 10 years. Companies may benefit from exemptions from IPI and ICM taxes and import duties on imports of machinery or industrial equipment. Foreign majority control may, in some cases, be an impediment to approval of a BEFIEX program.

Export Premium

On April 1, 1981, the Brazilian government announced that for the balance of 1981, a cash premium of 15 per cent would be paid to exporters of specified products on the adjusted FOB value of the goods.

Payment is made to the exporter by the Brazilian bank a maximum of 120 days after payment is remitted to Brazil by the purchaser and the foreign exchange contract is signed to convert the foreign currency into cruzeiros. The government plans to reduce this incentive to nine per cent in 1982 and three per cent in 1983. Current plans are for the premium to be phased out in 1983.

Fiscal Incentives to Export

(1) Income arising from export sales of Brazilian products is exempt from income tax.

(2) Expenses incurred in export sales may be eligible for an exemption from the withholding tax on interest.

(3) Exports of manufactured products enjoy an exemption from payment of IPI and ICM taxes if the sales are made by the manufacturer of the goods or a registered trading company.

(4) Export commissions paid to overseas agents are exempt from withholding tax.

SECTORIAL INVESTMENT INCENTIVES

An array of investment incentives is offered to investors on a regional and on an industry basis in addition to subsidized financing. The following are some important examples.

In the Northwestern Region comprising the states of Maranhao, Piaui, Ceara, Rio Grande do Norte, Paraiba, Pernambuco, Alagoas, Sergipe, Bahia and part of the state of Minas Gerais, the federal government offers various fiscal benefits for approved industrial projects or expansion through SUDENE, the regional development agency.

Such benefits may include:

(1) Exemption from all federal taxes and exemption from part of customs duties on imported equipment for proposed new industries.

(2) Income tax "holidays" for 10 to 15 years for new enterprises in specified sectors and 50 per cent income tax reduction for established firms undergoing expansion in areas approved by the government.

(3) Loans at concessional rates of financing from the BNDE or the Bank of the Brazilian Northeast. Loan guarantees may also be available.

(4) The right to receive tax-money investments of other Brazilian corporate entities subject to obtaining counterpart funds in an equivalent amount from other sources.

The same fiscal benefits are also available to companies proposing to invest in the Amazon Region of Brazil, including the states of Acre, Para, Amazonas, the federal territories of Rondonia, Amapa and Roraima and part of the states of Mato Grosso and Maranhao. The federal government body for this region is know as SUDAM.

Other incentives including long-term financing, subsidies and tax exemptions are available for investments in the mining and fishing industries, although there are restrictions on foreign ownership in these areas.

The Brazilian government has granted tax incentives with reductions of up to 50 per cent of income tax due, provided these monies are invested either in approved projects under the auspices of SUDENE or SUDAM, or in fishing, tourism or reforestation projects.

Tax monies owing may also be invested in fishing, tourism or reforestation industries outside the SUDENE or SUDAM regions in amounts of up to 35 per cent of taxable income under certain conditions.

There are numerous restrictions on the use of profits arising from investments which have benefited from the tax incentives above. The chief restriction for the foreign investor is that such profits are not remittable outside Brazil. The 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.

SPECIAL CHARACTERISTICS OF THE BRAZILIAN ENVIRONMENT

There are a number of features of the business environment in Brazil which warrant special mention as they differ considerably from conditions prevailing in Canada.

"Dirigismo": Government Direction of the Economy

Canadian businessmen uncomfortable with the degree of regulation in Canada will be astonished by the interventionist tendencies of the Brazilian government. Furthermore, the tendency over the past 10 years has been for the Brazilian government to take an ever-increasing role in the national economy. In a country where local financing is often only obtainable from government sources, the government has not only made it a policy to lay down broad guidelines for the development of various sectors of the economy but has also engaged in micro economic control of the economy. In most sectors prices cannot be increased without government approval and price increases are often related to the government's appraisal of a firm's performance in relation to the government's political and economic goals. While there is considerable complaint about the degree of government involvement in the Brazilian economy on the part of Brazilian businessmen, government intervention is accepted and businessmen are used to spending substantial portions of their time with politicians and the Brazilian bureaucracy in attempts to obtain support for various business projects. While the Brazilian bureaucracy often seems to be intractable from the outside, the Brazilian government has appointed a Minister of Debureaucratization specifically to deal with the almost unmanageable loads of paperwork which accompany virtually any transaction in Brazil, and some progress has been made to date. Likewise, the National Development Bank has begun to sell to the private sector some of the enterprises in which it has invested. A considerable degree of adaptation will normally be required for Canadian businessmen to operate successfully in this environment. A competent local partner and good professional counsel will greatly assist in doing most of the paperwork and bureaucratic negotiation.

Monetary Correction

Owing to traditional high levels of inflation in Brazil (currently about 110 per cent per annum), the Brazilian government has developed a system which "tends towards" price level accounting. This system is known as monetary correction and basically allows for the adjustment of the value of assets, income, salaries and other items in accordance with a predetermined government index. Salaries are readjusted twice annually taking into account inflationary increases.

The index used in making monetary correction calculations is closely related to the money market and is called the ORTN index. This index represents the rate of correction the government is prepared to pay investors in national treasury bills over and above the stipulated rate of interest. The correction factor is determined each month and varies considerably. It should be noted, however, that there have been major differences between the ORTN rate, increases in the cost of living and losses in dollar terms through devaluation of the Brazilian cruzeiro. In 1979, for example, the ORTN index was 47 per cent, the cost of living increased by 77 per cent and the cruzeiro was devalued against the dollar by 103 per cent. Generally, monetary correction will affect the following balance sheet items: fixed assets, investments and deferred charges, stockholders' equity, other assets and liabilities contractually subject to monetary reinstatement and denominated in cruzeiros, and assets and liabilities which are denominated in foreign currency.

With regard to fixed assets, all Brazilian companies are required to revalue their fixed assets within four months at the end of the fiscal year. Depreciation is normally provided on revalued assets at the same rate.

The results of the application of the ORTN index to working capital is recorded in the companies' books sometimes as a charge to surplus, i.e. a reduction of the companies' accumulated surplus, and sometimes as a charge to income, i.e. a reduction of taxable income.

The Brazilian system of monetary correction allows for some adjustments to counter the effects of inflation on the companies' taxable income. It is, however, far from being a perfect system.

Price Control

Companies producing goods not deemed to be basic foodstuffs or agricultural produce come under the control of the Conselho Interministerial de Preços (CIP). Those companies having gross billings of less than approximately $2 million per year generally are not subject to control, but companies with billings greater than that amount can increase their prices only after the CIP has granted its

approval. In certain cases companies with "good behaviour" records can operate under a system of "controlled liberty" whereby they may increase prices immediately after submission of a request to the CIP, subject to subsequent rollbacks should the CIP find increases unjustifiable. In a country with as high a rate of inflation as Brazil, a good relationship with CIP is essential for any large-scale company doing business.

Historically, it may be said that this price control tends to vary according to economic conditions, becoming more stringent in times of economic difficulties. In 1981, the Brazilian government liberated a number of items from control and there are signs that government planners may be taking a more laissez-faire approach to the economy.

Requirements for Specialized Advice

As with any other relatively advanced economy, Brazil has evolved a complex regulatory system, and high-quality legal and accounting advice is essential for anyone wishing to maximize the return on his investment. In the legal sphere, the Brazilian Civil Code is based on the French and interpretation of contracts and agreements tends to be highly formalistic. Further, unlike the common law system, precedent in other cases is not binding on a court confronted with a legal problem, and the judge has a relatively larger degree of discretion in arriving at a solution to a problem. As well, Brazilian government regulations tend to be loosely worded and the exact application of the regulations is left in the hands of civil servants. As a result there is a large degree of bureaucratic discretion in the application of the regulations and qualified representation is necessary in dealing with the government in these matters. In these areas a good lawyer is indispensable for a foreign investor.

Recourse to the courts in the event of commercial disputes is generally avoided whenever possible owing to a greatly overworked court system. Ordinary contract disputes may take upwards of five years to be resolved. Arbitration is a relatively new concept on the Brazilian commercial scene. Canadian investors should be aware of an Arbitration Committee recently set up by the Brazil-Canada Chamber of Commerce to resolve commercial disputes between Brazilian and Canadian businessmen. Further details may be obtained upon application to the Brazil-Canada Chamber of Commerce in Toronto, or the Camara de Comércio Brasil-Canada in Sao Paulo.

In obtaining legal representation, the Canadian diplomatic missions, the Canadian banks, the Chambers of Commerce and, in some cases, the investor's own Canadian lawyers or accountants are in a position to recommend the sort of competent and well-qualified counsel necessary for doing business in Brazil.

APPENDIX

Useful Addresses

Bureau of Latin America
and Caribbean Affairs
Department of Industry,
Trade and Commerce
235 Queen Street
Ottawa, Ontario
K1P 5E2

Brazil-Canada Chamber of Commerce
11 Adelaide Street West
Suite 307
Toronto, Ontario
M5H 1L9

Canadian Association - Latin
America and Caribbean
42 Charles Street East
Toronto, Ontario
M4Y 1T4

Brazilian Embassy in Ottawa
255 Albert Street
Suite 900
Ottawa, Ontario
K1P 6A9

Brazilian Consulate
1 Place Ville Marie
Suite 1505
Montreal, Quebec
H3B 2B5

Brazilian Consulate
130 Bloor Street West
Suite 616
Toronto, Ontario
M5S 1N5

Bank of Brazil
Commercial Union Tower
Toronto-Dominion Centre
King Street West
Suite 2312
Toronto, Ontario

Banco Real
Royal Trust Tower
Toronto-Dominion Centre
King Street West
Suite 3905
Toronto, Ontario

The Bank of the State of
Sao Paulo (BANESPA)
Royal Trust Tower
Toronto-Dominion Centre
King Street West
Suite 3301
Toronto, Ontario