



# VELLOZA, GIROTTO E LINDENBOJM

*Advogados Associados*

## VGL NEWS

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### "Provisional Measure ("PM") 472/09 – Articles 24 to 26: New Restrictions on Corporate Tax Deductibility Rules"

On December 16, 2009, PM 472 was issued and introduced (Articles 24 to 26) the so-called: **"thin capitalization"** rules; and other **"anti-abusive"** rules aiming to limit/restrict the tax deductibility ability (**"Specific Tax Deductibility Limitations"**) for purposes of Corporate Income Tax (**"IRPJ"**) and Social Contribution on Profits (**"CSLL"**) calculation, for "interest" and "other amounts" paid or credited by a Brazilian source either to related individuals or legal entities domiciled abroad (the **"Foreign Related Parties"** as defined by Transfer Pricing Rules) or; residents in Tax Favorable Jurisdictions (**"TFJ"**) or a country/territory having Privileged Tax Regime (**"PTR"**). The Legislative Intent (Exposição de Motivos) of PM 472 uses terms such as **"abuse"** and **"artificiality"** to justify the new rules of articles 24 to 26 (that is, the new Special Tax Deductibility Limitations), aiming to reach transactions carried out exclusively for tax avoidance purposes, indicating the anti-abusive feature of these new rules.

In broad terms, the new rules determine the following:

- **Article 24 – Thin Capitalization Rules:** Article 24 of the PM establishes that Interest paid or credited by a Brazilian source (borrower) to a Foreign Related Party (lender) not resident/domiciled in TFJ or country/territory with PTR, will only be deductible for IRPJ/CSLL purposes when they constitute necessary expenses to the Brazilian borrower's activities and cumulatively fulfill the following requirements: **(i)** the indebtedness amount on the date of the interest's accrual does not exceed 2 (two) times the amount of the corporate equity interest held by the foreign lender into the net worth/equity of the Brazilian borrower (**"individual requirement"**); and **(ii)** the total sum value of indebtednesses on the date of the interest's accrual does not exceed 2 (two) times the sum of all corporate equity interest held abroad by different Foreign Related Parties into the net worth/equity of the same Brazilian borrower (**"global requirement"**).
- **Article 25 – Anti-Abusive Rules for Interest Deductibility paid to TFJ or PTR resident beneficiaries:** regarding Interest paid or credited to beneficiaries resident in TFJ or PTR countries/territories, Article 25 of PM also determines that the expenses must be necessary to the Brazilian borrower's activities for purposes of IRPJ and CSLL deductibility, and that the following requirements should also be observed cumulatively: **(i)** the debt value does not exceed 30% (thirty percent) of the net worth/equity of the Brazilian borrower (**"individual requirement"**); and **(ii)** the total sum value of indebtednesses to all entities located in TFJ or PTR does not exceed 30% (thirty percent) of the net worth/equity of the Brazilian borrower (**"global requirement"**).
- **General Rules applicable to Articles 24 and 25:** The rules commented above contained in Articles 24 and 25 of PM 472/09 (dealing with additional interest deductibility rules) will apply together with: **(a)** the general deductibility rule of costs and expenses (**"General Deductibility Rule"**) provided under article 299 of the Income Tax Regulation, that establishes certain requirements for tax deductibility purposes, including the **"Need requirement"**; and **(b)** the Transfer Pricing Rules concerning Interest deductibility (under Article 22 of Law 9,430/96).

For the indebtedness (debt transactions) concept in those Articles, all types of debt transactions should be considered e.g. any loan or financing transaction, including all terms, conditions and length of financing transactions, regardless of the transactions being registered or not before the Brazilian Central Bank. Those rules will also apply for debt transactions undertaken by Brazilian borrowers in case a Foreign Related Party (Article 24); or a TFJ or Privileged Tax Regime resident (Article 25) assumes the position of co-signer (avalista), guarantor (fiador), legal representative/attorney-in-fact (procurador) or intervenient (interveniente). There is no legal definition for "intervenient" under the Brazilian legislation currently in force.

- **Tax Effects in case the Brazilian entity does not meet the requirements determined under Articles 24 and 25 of PM 472/09:** In case both (cumulatively) the individual and global requirements of Articles 24 and 25 of PM 472/09 are not fulfilled by the Brazilian entity (the borrower), the **excess interest amount** will be considered as unneeded expenses (that is, not meeting the Need requirement of the General Deductibility Rule) and would therefore be non-deductible expenses for IRPJ and CSLL calculation purposes.
- **Article 26 – Anti-Abusive Rules for Amounts of any nature – Deductibility Restriction:** Irrespective of other applicable rules for IRPJ purpose, Article 26 of the PM 472 establishes, as a general rule, , the amounts of any nature paid, credited, delivered, used or remitted directly or indirectly from a Brazilian source to beneficiaries resident in TFJ or subject to PTR as a nondeductible expense for IRPJ and CSLL purposes. However, these expenses may be deductible, provided the following cumulative conditions are observed: **(i)** identification of the beneficial owner ("**Beneficial Owner**" or "**BO**") of the foreign entity to whom those amounts are remitted; **(ii)** evidence of the operational capacity of the foreign individual or entity for performing the respective operation; and **(iii)** documentary evidence of payment of the respective price and acknowledgement of receipt of goods, rights or the usage of services.

For the first time in the Brazilian tax legislation, the concept of BO has been established: BO is an individual or a legal entity not incorporated with the sole or primary purpose of saving taxes, earning these amounts for its own account and not as an agent, fiduciary administrator (such as trusts) or legal representative of a third-party.

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These new rules introduced by Articles 24 to 26 of PM 472 are still very incipient and debatable, since there is still no regulation on them. We expect that any future regulation (Decree or Normative Instruction) on Articles 24 to 26 be issued to clarify their application, extension, effectiveness and some definitions, and also to provide for exceptions, when applicable. To date, no infra-legal regulations have been issued.

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São Paulo	Rio de Janeiro	Brasília
<p>&gt; Av. Paulista, 901 17º e 18º andares Bela Vista - São Paulo - SP CEP 01311-100 Tel.: (55-11) 3145.0055 Fax: (55-11) 3145.0050</p>	<p>&gt; Rua da Assembléia, 10 Sala 1801 Rio de Janeiro - RJ CEP 20011-901 Tel.: (55-21) 2509.0055 Fax: (55-21) 2509.1568</p>	<p>&gt; SRTV Sul, Quadra 710 Cj. D, nº 100 Sala 234 Brasília - DF CEP 70340-000 Tel.: (55-61) 323-8848 Fax: (55-61) 428-7308</p>

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