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VGL NEWS

Special Edition No. 33 - May 17th, 2011

Normative Ruling n. 1,154/11: Regulation on Special Tax Deductibility Rules specifically Thin-Capitalization and Anti-Abusive Rules

On May 13, 2011, Normative Ruling of the Brazilian Internal Federal Revenue ("IN RFB") n. 1,154 was published in the Official Gazette, regulating the so called "**Special Tax Deductibility Rules**" or, specifically, "**Thin-Capitalization Rules**" and "**Anti-Abusive Rule**", originally introduced in Brazil by Provisional Measure n. 472, dated December 15, 2009, which was later converted into Law n. 12,249, of June 11, 2010.

Such rules (already covered by two VGL News – Extra Editions: n. 94, dated December 22, 2009, and n. 104, dated June 16, 2010) set forth conditions and limits for Corporate Income Tax ("**IRPJ**") and the Social Contribution on Net Profits ("**CSLL**") tax deductibility of interest and amounts paid/credited by sources located in Brazil to individuals or legal entities domiciled abroad ("**non-residents**"), considered as related party as to the Brazilian entity ("**Related Parties**"), or domiciled in a Tax Favorable Jurisdiction ("**TFJ**") or under a Privileged Tax Regime ("**PTR**").

The IN RFB n. 1,154/11 repeated (as means of regulating) the criteria and limits set forth in Law n. 12,249/10, related to:

- (i) **Thin-Capitalization Rules (articles 24 and 25 of Law n. 12,249/10):** tax deductibility of interest by the Brazilian legal entity based on the proportion of the indebtedness in relation to the entity's net equity, (pursuant to Articles 2 to 10 of IN RFB n. 1,154/11), being:
 - a. **Article 24 of Law n. 12,249/10:** debt with Related Parties (according to articles 2 to 4 and 6 to 10 of IN RFB n. 1,154/11); and
 - b. **Article 25 of Law n. 12,259/10:** debt with an individual or a legal entity resident in a TFJ or under PTR (regulation provided for in articles 5 to 10, of IN RFB n. 1,154/11).
- (ii) **Anti-Abusive Rule (art. 26 of Law n. 12,249/10):** in case of any amounts paid, credited, delivered, employed or remitted to an individual or to a legal entity resident in a TFJ or under PTR, the tax deductibility shall be subject to: (a) identification of the beneficial owner, (b) evidence of the operational capacity of the individual or legal entity domiciled abroad, and (c) documentary evidence of payment (according to articles 11 and 12 of the IN RFB n. 1,154/11).

IN RFB n. 1,154/11, besides repeating the requirements and conditions of Law n. 12,249/10 and organizing the law provisions in a more didactical manner, has brought some further clarifications, namely:

➤ **Thin-Capitalization Rules – Regulation of the Rules Contained in Articles 24 and 25 of Law n. 12,249/10 – Item (i) above:**

1. **Scope of the term "Intervient":** the Thin-Capitalization Rules under Articles 24 and 25 of Law n. 12,249/10 shall apply to the intervenient that is responsible, even if in a subsidiary manner, by the full or partial payment of the debt (paragraph 3 of **Articles 2 and 5** of IN RFB n. 1,154/11);
2. **Existence of an Intermediary Financial Institution between Related Parties:** the Thin-Capitalization Rules regarding indebtedness with Related Parties shall apply to loan transactions in which the Related Parties are the non-resident who granted/provided the funds and the Brazilian legal entity who ultimately takes the loan, and particularly to the latter, even if the transaction is performed with the participation of a

financial institution deemed as mere intermediary between the parties (Article 3 of IN RFB n. 1.154/11);

3. **Interpretation of the term “Related Parties”:** For the application of the Thin-Capitalization Rules related to Item (i.a) above, IN RFB n. 1,154/11 defines in its **Article 4** the Related Parties to the legal entity domiciled in Brazil, pursuant to Article 23 of Law n. 9,430, dated December 27, 1996, and its regulations, making clarifications on:
 - 3.1. For the purpose of determining the relationship (“vinculação”): meaning of (a) same corporate/governance control; (b) association via consortium (“consórcio”)/condominium (“condomínio”); (c) companion of a member of the board, associate or controlling shareholder; and (d) exclusive distributor or concessionaire.
 - 3.2. That Thin-Capitalization Rules apply to loans and financing made through a non-Related intermediary;
 - 3.3. The existence/occurrence of relationship with regard to the loan/financing transactions, year shall be reported to the RFB in the Corporate Income Tax Return (“DIPJ”).
4. **Definition of On-Lending Transaction:** when regulating the inapplicability (already set forth by Law n. 12,249/10) of the Thin-Capitalization Rules to external funding obtained by a financial institution for On-Lending Transactions, IN RFB n. 1,154/11 defines On-Lending Transactions (**Article 6**, paragraph one) as a credit transaction connected to external funding, in which the on-lender transfers the risk of FX variation to the on-lending individual/legal entity, under the same indexing used for the external funding, not charging for the financial intermediation services any amounts other than the on-lending commission.
5. **Indebtedness Calculation:** in addition to the formulas provided to obtain the value of the non-deductible excess of interest (**Article 8**), IN RFB n. 1,154/11 clarifies, in **Article 7**, the procedures to be taken in case of merger, consolidation, spin-off/split-off or extinction due to dissolution or liquidation of legal entities, and also elucidates that:
 - 5.1. For purposes of the **indebtedness amount**: (a) the monthly weighted average shall be calculated by the sum of indebtedness divided by the number of days of the corresponding month, (b) the interest incurred and not paid until the last day of the month calculation shall be added to the principal amount of the debt;
 - 5.2. The **amount of the net equity** shall be the one reported in the latest balance sheet or, alternatively, the results obtained until the month prior to the interest appropriation/recognition (entered in the Daily Book).
6. **Concurrence between Thin-Capitalization Rules:** the limits defined by the two Thin-Capitalization Rules (Related Parties and TFJ/PTR) shall be calculated independently (**Article 9**) and, in the case of concomitance of both scenarios, the prevailing rule shall be:
 - 6.1. The rules concerning indebtedness with Related Parties, in case the creditor is a Related Party, and the guarantor, surety agent, attorney-in-fact, or any intervenient in the transaction is a legal entity located in a TFJ or under PTR;
 - 6.2. The rules concerning the debt with a legal entity domiciled in a TFJ or under PTR, in case the creditor is a legal entity located in a TFJ or under PTR, and the guarantor, surety agent, attorney-in-fact, or any intervenient in the transaction is a Related Party.
7. **Inapplicability of the Rules to the Transactions with Creditor Domiciled in Brazil:** **Article 10** of the IN RFB n. 1,154/11 states that the Thin-Capitalization Rules do not apply to debt transaction in which the creditor is resident/domiciled in Brazil, even if the transaction has as guarantor, surety agent, attorney-in-fact or any intervenient non-resident considered as a Related Party, or domiciled in a TFJ or under PTR, except in case of: (a) nonpayment of the debt transaction with respect to interest accrued from the date on which the person abroad performs the payment of the debt, or (b) the Brazilian creditor (legal entity) being a mere intermediate between the guarantor, surety agent or attorney-in-fact abroad and the Brazilian borrower.

➤ **Anti-Abusive Rule – Regulation of the Rules of Article 26 of Law n. 12,249/10 – Item (ii) above**

8. **Collective Investment Entities, including Investment Funds, as the Beneficial Owner:** for the purpose of application of Anti-Abusive Rules, the condition of identifying the beneficial owner shall be satisfied with the identification of collective investment entities, including investment funds (**Article 11**, §2, of the IN RFB n. 1,154/11);
9. **Inapplicability to Financial Transactions supported by the National Monetary Council (“CMN”):** the Anti-Abusive Rule does not apply to transactions entered into by a non-resident investor (whether it is an individual or a collective one) who carries out the financial transaction in compliance with the rules and conditions established by the CMN (**Article 12** of the IN RFB n. 1,154/11).

➤ **Common Provisions – Applicable to Articles 24 to 26 of Law 12,249/10**

Inapplicability of the Special Tax Deductibility Rules (Thin-Capitalization Rules and Anti-Abusive Rules)

to the Issuance of Bonds: international fundraising transactions made by legal entities domiciled in Brazil via issuance of bonds shall not be subject to the relevant Rules, once the following requirements are fulfilled, cumulatively: (a) the bonds shall be distributed to at least 40 investors; (b) the investor, either alone or jointly with other related persons, shall not obtain 20% or more of the totality of bonds issued, and (c) the investor, either alone or together with other people related parties, shall not earn income in an amount higher than 20% of the total income paid by the totality of bonds issued (**Article 13** of IN RFB 1.154/11).

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