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Law n. 12,431, of 06.27.11 ("Law 12,431/11") – Conversion of Provisional Measure n. 517, of 12.30.10 ("PM 517/10")

On 06.27.2011, Law n. 12,431 was published, as a result of the conversion of PM 517/10, which had changed several provisions of Brazilian tax legislation. The PM 517/10 has been subject of our NewsLetter – Extra Edition n. 30, of 01.03.2011, in which we have analyzed the tax rules provided by that PM relevant to nonresident investors. Below are our comments on the provisions regarding tax matters given by Law n. 12,431/11, also only particularly the tax rules relevant for nonresident investors:

➤ **RULES PROVIDED BY PM 517/10**

Article 1: Foreign Investors' Zero-WHT for Brazilian Private Bonds or Securities ("Bonds") purchased under Public Distribution

- Law n. 12,431/11 maintained the Zero-WHT rate levied on "**Income**" produced by Bonds, provided that such Bonds are not issued by "**financial institutions**", acquired since 01.01.2011, when paid for, credited, delivered or remitted to a beneficiary resident or domiciled abroad not in countries that do not tax income, or that tax it at a maximum rate lower than 20% ("**non-tax favorable jurisdiction foreign investor**") – the "**Special Zero-WHT Rule on Private Bonds under Public Distribution**".

- Bonds' Conditions for the Special Zero-WHT Rule on Private Bonds under Public Distribution: Law n. 12,431/11 maintained the Conditions provided by PM 517/10 but included prohibitions to two of them: (i) first, with regard to the total or partial agreement on post-fixed interest rate; and (ii) second, with regard to the early settlement of the Bonds by means of its redemption or pre-payment. Another change made by Law n. 12,431/11 regards the Condition of "a simplified procedure that demonstrates the purpose of the allocation of the funds raised within investment projects": the Law has included among such projects the ones for purposes of research, development and innovation.

- Financial institutions – Law n. 12,431/11 clarified that, for purposes of the application of the Special Zero-WHT Rule on Private Bonds under Public Distribution, the following legal entities shall be considered as financial institutions: banks of any kind, credit unions, the Savings Bank, security distributors companies, exchange and securities brokerage companies, loan societies, financing companies, investment companies, real estate loan companies and leasing companies.

- Beneficiaries of the Special Zero-WHT Rule on Private Bonds under Public Distribution – the Law n. 12,431/11: (i) restricted its application to Foreign Investors who carry out financial transactions in Brazil in accordance with the rules and conditions established by the National Monetary Council ("**CMN**"), and (ii) extended its application for non-tax favorable jurisdiction foreign investor investing in shares of exclusive investment funds ("**Funds**") who possess at least 98% of the fund's equity invested on the Bonds described on Article 1.

- In the case of settlement or transformation of such Funds, the following tax rates will apply to the different types of investors: (a) 15% tax rate, in case of non-tax favorable jurisdiction foreign investor carrying out financial transactions in Brazil in accordance with the rules and conditions established by CMN; and (b) the "**Regressive Tax Rates**" (of 22.5% to 15%) in case of either an individual or a legal entity resident in Brazil (not applying the exclusive withholding levy to legal entities).

- Investments in bonds and/or securities held on 01.01.11: Law n. 12,431/11 has offered the Ministry of Finance the option of regulating the calculation of the WHT owed by the non-resident investor who chooses for the WHT early payment until 06.30.11, taking into account, for its calculation: (i) the Bonds' market price, defined by the arithmetic mean between the negotiated values verified within the ten working days previous to the early payment of the WHT; or (ii) the price calculated taking into consideration the yield curve of the paper, in cases in which, cumulatively or not, (a) there is no negotiation of the Bond in an electronic trading platform within the ten working days previous to the early payment of the WHT; (b) the amount negotiated is unable to demonstrate that the adopted price reflects the actual value of the security.

Article 3: Investment Funds investing in Debentures issued by Special Purpose Entities ("SPE") – Zero WHT for the Funds' Foreign Investors

- Law n. 12,431/11 maintained the same Conditions and WHT rates already established by PM 517/10 for the revenues derived from the Investment Funds investing in Debentures – "**Debentures' Investment Fund**" (being the Debentures issued by a special-purpose company constituted for the implementation of investment projects in infrastructure and intensive economic production in research, development and innovation – according to Article 2 rules) – "**Special Zero-WHT Rule on Debenture Investment Funds**" –, but it has also restrained the applicability of the Zero WHT to non-tax favorable jurisdiction foreign investor carrying out financial transactions in Brazil in accordance with the rules and conditions established by the CMN.

- Law n. 12,431/11 clarified that the Special Zero-WHT Rule is applicable to the overall income deriving from the Debentures' Investment Fund and not only to the revenues derived from Debentures.

- Tax treatment in case of settlement or transformation of the Debentures' Investment Fund: Law n. 12,431/11 clarified that, in case of liquidation or transformation of the Debentures' Investment Fund, a tax rate of 15% shall be applicable to non-tax favorable jurisdiction foreign investor, and the Regressive Tax Rates shall be applicable to investors resident in Brazil (either individuals or legal entities).

- Calculation of the Actual Profit Regime (*lucro real*): Law n. 12,431/11 provides that (i) income exclusively levied under the withholding method may be excluded from the Actual Profit calculation; and (ii) the losses verified in transactions involving shares of Debentures' Funds shall not be deductible when carried out by legal entities taxed under the Actual Profit Regime.

➤ **RULE ESTABLISHED BY LAW N. 12,431/11**

Article 45: Zero-WHT on Leasing Transactions' installments involving Aircraft for Regular Public Air Transport:

- Law 12,431/11 changed article 16 of Law n. 11,371, of 11.28.06, which provides the Zero-WHT applicable to the payment, credit, delivery, use or remittance ("**triggering events**") made by a source located in Brazil to a legal entity domiciled abroad, in connection with leasing transactions involving aircraft, or engines meant for it, undertaken by a regular public air transport (of either passengers or freight) company. According to the new wording, such benefit is applicable to the triggering events occurred until 12.31.16, in connection with leasing agreements executed until 12.31.13.

Law 12,431/11 comes into force on the date of its publication (06.27.11).

THIS IS MERELY AN INFORMATIVE NEWSLETTER, RESTRICTED TO VGL CLIENTS. QUESTIONS AND CLARIFICATIONS ON THE MATTERS CONTAINED HEREIN SHOULD BE ADDRESSED TO OUR OFFICE.

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