



# What's new! In M&A TAX

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By Rodrigo Bastos, M&A Tax Partner and Private Equity Tax Leader in Brazil

Some very welcome news, such as the Pre-Salt Oil, 2014 World Cup, the 2016 Olympic Games in Rio, the award of Investment Grade by Moody's, the formal announcement of the recession end, amongst many others, have changed the mood for businesses in Brazil. Under this booming scenario, the third quarter just ended showing a clear recovery in our M&A industry. Most of the outstanding M&A transactions came to life, after months of uncertainty, supported by more reliable forecasts, encouraging economic indicators, new IPOs waves and also the undisputable necessity of joining forces in order to survive the tough and very competitive periods to come. As a consequence, out of the 440 disclosed transactions for the first 3 quarters, 184 transactions (or about 42%) refer to Q3, which brings us to approximately the same levels observed during the period before the economic crisis.

On the tax side, one quite important aspect has been the new amnesty program (the Crisis Refis) recently launched by the Federal Government, that has made it possible for buyers to revisit past potential local acquisitions. The significant reductions in interest and penalties, the use of NOLs, the possibility of electing tax debts with low chances of success in court and to pay them over 180 months are encouraging local companies to join this program. It makes their profile of tax risk more predictable, and as a consequence, it substantially reduces the acquisition risk related to tax succession in connection with tax contingencies that have not yet materialized.

In this context, investors who have still not looked again at transactions which were discarded in the past should speed up in order to get the best the Crisis Refis. Other investors may be looking at these very same companies with different eyes. The conclusion is that this is the time to act quickly, the economics are looking different now, some quite interesting tax incentives are still available and the M&A Market is moving faster.

## IPI Premium Credit

By Marcos Tabatschnic and Rita Canto, M&A Tax Managers

In order to stimulate the export of manufactured goods in the past, Law Decree 491/69 brought to exporting companies the right to calculate and record a tax credit named "IPI Premium Credit". According to the applicable legislation, such tax credit could be used to offset IPI tax debts and other Federal tax debts of the exporting companies. Moreover, the tax legislation also allowed taxpayers to transfer such credits to third parties.

Since then, the applicable legislation has suffered many changes and, as a consequence, various discussions have been initiated, including about the time limit to record the "IPI Premium Credits". Accordingly, several taxpayers filed lawsuits claiming their right to record and offset such tax credits, even though the tax authorities understand that this right had already been revoked.

Despite the existence of lawsuits and doubts in relation to the validity of the "IPI Premium Credits", exporting companies continued using those tax credits and, in some cases, even transferred tax credits under judicial discussion to third parties.

Recently, however, the Brazilian Supreme Court ruled that the right to the "IPI Premium Credit" was extinguished in October 1990.

Since a considerable part of the exporting companies only stopped recognizing "IPI Premium Credits" in the mid-2000's, the

decision handed down by the Brazilian Supreme Court has enormous repercussions, involving very significant amounts. Moreover, taking into consideration that many exporting companies transferred "IPI Premium Credits" to third parties, the consequences of the Brazilian Supreme Court decision affect not only the exporting companies themselves, but every single company that had acquired "IPI Premium Credits".

Based on all of the above, the use of such "IPI Premium Credits" in the past currently represents a liability for these taxpayers. Notwithstanding, as a unique alternative for such taxpayers, the Brazilian tax legislation gave them the possibility to apply, until Nov 09 (next month), for a special installment program (Crisis Refis), applicable to federal tax debts, which granted significant reductions in interest, penalties and other charges.

In addition, the tax authorities recently granted to companies that have debts related to the "IPI Premium Credits" a second option of an installment program in which the penalties and interest are reduced between 90% and 100% and payments can be made in 12 installments (election up to Nov 09).

Such possibility has, in many cases, allowed sellers and buyers to reach satisfactory agreements and close important deals, which would not be possible in some cases if dealt with only through representations and warranties, escrow accounts and similar mechanisms.

## The Brazilian Government increases IOF taxation on stock market transactions and Investment Participation Funds (FIP)

By Fábio Dantas, Senior Manager - M&A Tax

Enacted on October 20, 2009, Federal Decree 6,983 increased to 2% the taxation of the IOF (Tax on Credit, Exchange and Insurance Transactions) levied on inflow of foreign capital invested in the Brazilian stock market.

Before this Federal Decree, foreign investments made in the local stock market were subject to zero (0%) rate taxation. The Brazilian Government increased the taxation on foreign capital trying to mitigate the recent appreciation of the Brazilian Real against the US Dollar/Euro which, according to the Government, is caused by the inflow of "volatile foreign capital", i.e., short-term investments made through the BOVESPA<sup>1</sup>. The over-valuation of the Brazilian Real would, in the Government's opinion, increase the cost of Brazilian exports, affect the local FX market, amongst other consequences which they believe are detrimental.

In addition to the stock market investments, the increase of the IOF taxation will also affect foreign investments made via Investment Participation Funds (FIP). Despite not necessarily involving publicly-traded companies, FIP structures are subject to the control of the Brazilian Central Bank (Resolution 2689) and to the rules of the Brazilian Securities Commission (CVM).

FIP investments made by foreign investors are exempt from taxes in Brazil and, without doubt, this more favorable tax treatment has been contributing to the growth of foreign investments in Brazil. Indeed, FIP does not consist of a structure for short-term investments, i.e., investments that the Brazilian Government wants to minimize. This new 2% taxation, however, may jeopardize the inflow of foreign capital to Brazil. Future M&A transactions involving the traditional FIP structure should consider such higher taxation from now on.



<sup>1</sup> São Paulo Stock Exchange

## SPED and its effects on the Brazilian M&A tax environment

By André Massao, Supervisor – M&A Tax

Brazilian taxpayers are facing a change in the relationship and exchange of information with the local tax authorities. The Public Digital Bookkeeping System (“SPED”) is responsible for this.

SPED is a recently released program which intends to unify information to be provided by taxpayers to the local tax authorities in order to increase the level of state oversight of a company’s operations.

In summary, through the SPED, Brazilian tax authorities may have electronic real time access to a wide range of information. This means that improper procedures adopted may be instantly noticed.

As a consequence, it is expected that in the short-term, due to the combination of complex tax rules and a newly imposed electronic tax platform, the number of tax assessments will increase.

Additionally, it is important to mention that the costs of the implementation of all technical requirements to set up an efficient SPED system, fully integrated with ERP platforms, could be significant and, consequently, should be considered in the determination of the general costs of M&A transactions.

We believe however that Brazilian companies will be more likely to look for judicial protection in order to support their tax position against any demands from the local tax administration, guaranteeing the legitimacy of procedures that could be potentially questioned by tax authorities, and therefore avoiding assessments.

Despite the high level of control by the tax authorities in the future, the SPED tends to reduce some tax risks in M&A transactions, due to the fact that, after some years, its implementation will stimulate companies to adopt procedures more in compliance with tax legislation. Consequently, this should reduce the number of tax exposures, especially those related to the lack of regular monthly tax payments, recognition of revenues, ancillary obligations amongst others.



## State Tax Incentives and the tax war

By Marcos Tabatschnic and Rita Canto, M&A Tax Managers

Brazil is one of the biggest countries in the world. As a consequence, the Brazilian territory is divided in several States, some of them completely different in economic, cultural and other aspects. Moreover, each State has certain autonomies, such as in the political, legislative and economic areas.

In order to attract industries for their states, reinforce the local economy through employment generation, increased production of goods and services and consequently increase tax collections, the States began to grant ICMS (State VAT) tax incentives, which reduce the monthly amounts payable.

In accordance with the applicable federal legislation, State tax incentives can only be granted after a formal approval by the other Brazilian States, a requirement which was not observed in several of these tax incentives. Although tax incentives were granted without the necessary approval from the other States, many companies decided to install themselves in, or even move to, States offering benefits.

Because some States began to lose potential and existing taxpayers, those that felt harmed filed lawsuits in order to question the validity of those tax incentives. It is important to stress that these judicial disputes have a political component which made the outcome unpredictable.

Despite the fact that such lawsuits became common in Brazil and nowadays several tax incentives are under judicial disputes, there is no consolidated case law in this regard in the Brazilian Supreme Court. However, there are precedents in which the tax incentives granted contrary to the Federal legislation were ruled unconstitutional. In these cases the States, as a result of judicial orders, must revoke the tax incentives and demand payment of the ICMS previously exempted.

In addition, some States also started to disallow tax credits recorded by companies receiving goods benefited by tax incentives granted in other States, which increased the ICMS monthly tax payment of such companies.

Although the tax incentives, in a M&A transaction analysis, have some advantages, such as reduction of the tax burden, improvement of cash flow and increase of profitability, any decisions unfavorable to the target company handed down by the Supreme Court may lead to significant tax contingencies.

The disputes related to the granting of irregular tax incentives may lead to an uncertainty that impacts a M&A transaction and must be taken into account in the analysis of the financial and tax aspects of the deal, as any potential invalidation of the tax incentive may change all projections and studies of profitability, EBITDA and ability to generate cash, besides tax contingencies that may arise, as mentioned above.

We will be glad to hear from you. Please let **What's new!** have your comments, suggestions and ideas. E-mail to [fabio.dantas@br.pwc.com](mailto:fabio.dantas@br.pwc.com) or [rita.canto@br.pwc.com](mailto:rita.canto@br.pwc.com)

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