Back to the Basics - Oil & Gas Industry in Brazil

Tax structures and transaction flows

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November, 2013

What is Repetro?

- Special Customs Regime for import and (fictitious) export of goods related to the exploration and production phase of Oil & Gas;
- Relief of Federal Taxes due on import of goods and national production;
- Applied only to goods set forth in legislation – E&P application;
- Importer must be authorized by Brazilian Federal Revenue (previous qualification – “habilitação”);
- Legal Basis: Decree No. 6.759/2009 and Normative Instruction RFB No. 844/2008.

Convention ICMS CONFAZ No. 130/2007

- Repetro benefits effective for ICMS (State VAT like tax) purposes
- Establishes exemption or reduction of taxation (0%, 1,5% or 3% without ICMS credits) in the import of goods for use in Oil & Gas Industry, depending on the phase (exploration or production);
- Operators and Services Providers facing difficulties to operate, due to differences of rules in each of the States;
- Annex list of goods authorized to be imported – different from Normative Ruling RFB No. 844/08.

Material Issues of Services Tax in the Energy Industry

- Strict "Services" concept in Brazil and its effects to services in the energy industry :

a) Strict "Services" concept in Brazil – "Human performance upon demand";

b) Services Tax and Withholding Social Contributions do not levy on pure charter/loan/lease contracts – temporary assignment of assets – the split of the contractual scope.

c) Services Tax and Withholding Social Contributions do not levy does not levy on pure licensing transactions (i.e. non-exclusive seismic data) due to lack of human performance upon demand.

Why should the scope of the contract be split between charter (lease/loan) and services?

- Special taxation on "Services" in Brazil – Municipal Tax ("ISS") and Withholding Social Contribution on rendering of services ("Advance payment of Payroll Social Contribution");
- Strict "Services" concept in Brazil – "Human performance upon demand";
- Exemption of Withholding Income Tax on outbound payments related to the Charter provided by foreign companies; and
- State VAT Tax (ICMS) applies only on transactions that entail transfer of title.

General concepts in Petrobras and IOC's "services" contracts in Brazil and their effects

- Scope of the contract is split into two contracts – "service" for strict human performance and "lease/charter/loan" for assets used in the provision of services with bulk of payment (70% to 95%) under "non-service" contract.
- Effects:

a) Payment of the Service Tax (ISS) and occasional Withholding of Social Contributions only on the "Services" contract; and

b) Exemption of Withholding Income Tax on outbound payments related to the Charter provided by foreign companies.

Recent questions raised by Tax Authorities regarding the tax planning.

- Lack of substance in the Contracts' split:

a) "Mirror image" Contracts;

b) Asset value not compatible with the lease/charter/loan Contract total amount;

c) Lack of sufficient revenues for the Brazilian Company to maintain its regular operation (when the charter/loan/lease contract is executed with the foreign company and the services contract with the Brazilian subsidiary); and

d) Impossibility of Contracts' split due to the link of human performance and operation of the asset.

Possible Effects of Tax Authorities disregarding the Contract scope split

- ISS Tax Assessments filed against the service provider on the charter/lease/loan Contract amount (from 2% to 5% plus monetary correction, interest and penalties);
- Withholding Social Contribution Tax Assessments filed against the retainer of the services over the [charter/lease/loan] Contract amount (11% of Services Provider charter/lease/loan Contract invoices plus monetary correction, interest and penalties) – can be cancelled if the service provider proves to have paid the full amount of Social Contribution on Payroll;
- Income Tax (15%) / Social Contributions on Profits (9%) / PIS and COFINS (Tax on Revenues – 0,65% and 3%); and
- Tax Assessments filed against Brazilian subsidiaries on the charter payments made by Petrobras or IOC's to foreign companies based on the assumption that part of the amount should have been paid to the Brazilian subsidiary.

Possible measures to mitigate risks of split contracts being disregarded.

- Better Contract wording:

a) Clear division of use of assets (charter/lease /loan) and human performance (services); and

b) Clear division of companies' duties if charter/lease/loan and services contracts are executed by two different companies of the group;

- Evaluation of the split percentages according to asset value.

- Providing sufficient revenue through different split percentages or intercompany arrangement for the Brazilian subsidiary to either break even or to be profitable.

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New Issues Affecting Temporary Imports

Normative Instruction RFB # 1.361, from May 21th, 2013.

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Normative Instruction RFB # 1.361/2013 – Introduction

- Enacted on May 21th, 2013, and published on Official Gazette on May 23th, 2013;
- Provides rules applies to import of goods under Temporary Admission Regime, which includes REPETRO operations;
- Revoke Normative Instruction RFB # 285/2003.

Normative Instruction RFB # 1.361/2013 – Controversial Aspects

1. **Bond** to be offered (posted) in case of import of goods with suspension of payment of taxes (Repetro case) due to application of Temporary Admission Special Regime (Article 11) – **Concept of disreputable bond** ("so called "fiança idônea");

2. **Demand of "legal default charge applied" (interest)** on extension of Temporary Admission Special Regime for economic use (Article 20); and

3. **Extinguishment of TR form** (responsibility term – so Called "Termo de Responsabilidade").

Concept of disreputable bond ("so called "fiança idônea")

- Controversial aspects of Normative Instruction RFB #1.361/2013 related to Bond solved by Normative Instruction RFB #1.404, from October 23th, 2013;

- **Between May 21th, 2013, and October 22th, 2013** grey zone = Customs Authorities applied Civil Code (article 825), in order that the Guarantor shall have net equity equal to the amount of suspended taxes

Some companies had to use other type of guarantee, such as insurance or letter of guarantees = increase the costs not set forth in the original contracts.

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Concept of disreputable bond ("so called "fiança idônea")

- Normative Instruction RFB # 1.404 establishes that the guarantor must be:
  - A financial institution (bank); or
  - A legal entity with net equity five times higher than the amount of the bond or superior to BRL 5 millions.
- The net equity must be assessed on the balance sheet from December 31^{th} of the previous year;
- Expenses with bank or insurance bond leads companies that had to offer guarantee during the "grey period" to evaluate the substitution of these guarantees next year (2014).

Extension of Temporary Admission Regime for Economic Use

- **Normative Instruction RFB #. 285/2003:**
  - **<u>No</u>** demand of “legal default charge applied” on the extension.

- **Normative Instruction RFB # 1.361/2013 (May 21th):**
  - **<u>Demand</u>** of “legal default charge applied” on the extension (Article 20) = which is interest (SELIC).

- **Normative Instruction RFB # 1.404/2013 (October 23th):**
  - **<u>No</u>** demand of “legal default charge applied” on the extension.

Extension of Temporary Admission Regime for Economic Use

- Normative Instruction RFB # 1.404 extinguished the demand of “legal default charge applied” = SELIC.

- However, the extensions requested between May 21th, 2013 and October 22th, 2013 had to pay it = contractual issue

Recommended to verify agreement and check if it is possible to request reimbursement due to modification of the law from IOC’s.

Extinguishment of **TR form** (so called "Termo de Responsabilidade").

- Some confusion by Customs brokers about this = Customs Authorities clarified that the TR form were only used in Brazil, and the "responsibility" of the importer can continue without a form.
- The new procedure is:
  - On the DI, in the complementary field, the importer will insert a broad text basically saying that the undersigned takes responsibility for the suspended duties, for the duration of the term and any occasional extensions. There is a suggested text provided by Customs.
  - The range of duration for the item will be stated in the RAT, document which supersedes the RCR.
  - The guarantee will also be a separate document, be bond, insurance bond, bank bond, etc.
  - If the regime is extended, nothing needs to be done, since the text on it will already applies for extensions.
  - If the regime is extinguished by re-exportation, the Declaration of Export will be proof of regime extinction. No TR closure will be necessary.
  - The value of the duties suspended does not need to be shown on the DI/TR text. It will be calculated by customs if they ever assess the importer asking for duty credit (execution of TR).

Thank You!

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New Levies and the Tax Impacts of Moving Goods Among Different Customs Regimes

Developments on Repetro and ICMS

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Special Customs Regimes

- **REPETRO:**
  - Special Customs regime applied to goods destined to the exploration and production of Oil & Gas in order to mitigate taxation on supply chain;
  - Ruled by Normative Instruction # 844/2008;
  - Federal Revenue bureaucracy combined with extensive examination of documentation result in usual delay.
- **Temporary Admission Regime:**
  - Suspension of taxes on imports of equipments to be temporarily used on economic activities;
  - Ruled by Normative Instruction # 1.361/2013;
  - Alternatives in case of difficulty to adhere to REPETRO.

Probability of Decline in O&G Revenues for Rio de Janeiro State – Modification of Legislation

2007
- Announcement of discovery of pre-salt by Petrobras.

2009
- Begin of discussion in Congress to modify sharing of O&G royalties – "Ibsen amendment" .

2012
- Enactment of Law # 12.734/2012 – New sharing of O&G royalties causes loss of resources to the producing states.

2013
- Discussion of Law #12.734/2012 in Supreme Court.

2013
- Resolution SEFAZ RJ # 631/2013 – Change of Decree #41.142/08 - ICMS due at a tax rate of 1,5% on the import of goods to be used on exploration phase under REPETRO regime

Taxation on the Transfer of Goods Between Special Customs Regimes / Change of Beneficiary

- **Imposition of ICMS by Rio de Janeiro State:**
  - Resolution SEFAZ RJ # 631/2013 – ICMS was exempt on import of goods to be used under REPETRO on exploration phase, this Resolution change this – applied new rate of 1,5%;
  - Alleged taxable event occurs in the moment of the transfer between Special Customs Regimes (Temporary Admission Regime to REPETRO, and vice-versa) or when changing beneficiary;
  - Tax assessments when taxpayers try to obtain before Treasury Office statement attesting non-levy of ICMS on the operation.

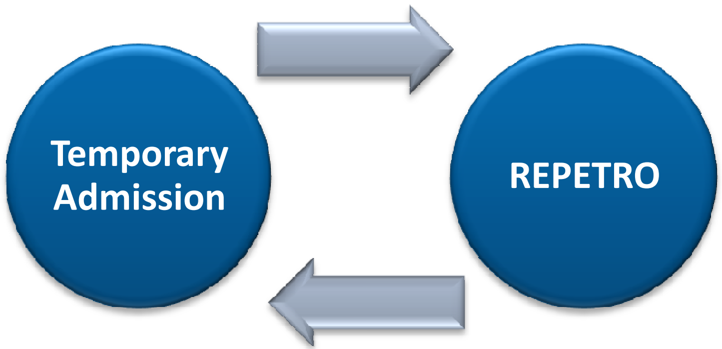
Does the ICMS tax event occur upon the transfer between Special Customs Regimes or Change of Beneficiary?

ICMS on Import Transactions

- **ICMS on import transactions**
  - **Constitutional Analysis:**
    - Interpretation of Brazilian Constitution (Art. 155, item II) indicates that levy of ICMS depends on transfer of ownership of goods;
    - Supreme Court former decisions (AI 286970) stating non occurrence of tax event in leasing operations due to absence of transference of property;
    - REPETRO and Temporay Admission Regime **do not entail transfer of property (goods continues under the property of the foreign entity);**
  - **Taxable Event of ICMS Levied on Imports:**
    - Entrance of goods or equipment imported from abroad in Brazilian Territory (Brazilian Constitution - Art. 155, paragraph 2, item IX);
    - Moment of entrance of goods is defined in legislation – is the “Customs Clearance” / “Customs Check”.

ICMS on Transfer Between Special Customs Regimes and Change of Beneficiary

- **Transfer between special customs regimes or Change of Beneficiary – <u>Absence of Taxable Event</u>**



  - Not described as taxable event in legislation;
  - Even though requires amendment of Import Declaration, does not represent an actual import;
  - Non occurrence of new “Customs Clearance” / “Customs Check”.

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Consequences of Transfer Between Special Customs Regimes

- **Transfer between special customs regimes – Tax Consequences:**
  - **Analysis considering General Principles of Tax Law:**
    - Contributive Capacity;
    - Taxpayers Good faith behavior;
    - Tax avoidance.
  - **Transfers from a <u>higher</u> tax burden circumstance to a lower one:**
    - Taxpayer already faced the proper and reasonable tax burden;
  - **Transfers from a <u>lower</u> tax burden circumstance to a higher one:**
    - Possibility to collect remaining ICMS;
    - Exception: original import initially treated as a tax exempted transaction.

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Bad Debt (Loss) Deduction

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I. Bad Debt – Deduction Criteria

- Section 340 to 343 of Brazilian Income Tax Regulations (Decree No. 3.000/1999 – "RIR") establish the parameters for recording and deducting bad debt losses.
- Loss may be recorded at any time, but deductibility is subject to conditions set forth by the legislation.
- In addition, depending on the bad debt's amount, the deductibility is only granted if the creditor keeps the amounts recorded as provision for bad debts for at least 5 years from the debt's expire date.

I. Bad Debt – Deduction Criteria

- The deductibility criteria can be summarized as follows:
  - Debts inferior to **BRL 5,000.00** may be deducted as losses at any time;
  - Debts that vary from **BRL 5,000.00** to **BRL 30,000.00** may be deducted after expired for more than 1 year, but creditor shall keep administrative procedures for collect the credits;
  - Debts exceeding **BRL 30,000.00** may be deducted after expired for more than 1 year, but creditor shall initiate and keep judicial procedures for collect the credits;
  - **Secured debts** may be deducted after expired for more than 2 years, but creditor shall initiate and keep judicial procedures for collect the credits or the seizure of collateral;

I. Bad Debt –Deduction Criteria

- The deductibility criteria can be summarized as follows (cont.):
  - Debts held against debtors for which the insolvency or bankruptcy was judicially declared, including the cases of judicial restructures ("recuperação judicial") may be deducted at any time, up to the amounts that exceed the value that the debtor has committed to pay.
  - In this case, the deduction is allowed from the date in which the judicial decision is issued. Creditor shall also adopts all necessary judicial procedures for the collection of the credits.

II. Bad Debt – Accounting Record Criteria

- According to the tax legislation (Section 341 of RIR), the losses shall be recorded as a debit entry against P&L and a credit entry against:
  - The account that recorded that bad debt itself, in the case of debts inferior to **BRL 5,000.00**;
  - Provision for Bad Debts' account, in Assets accounts, in all other cases.
- In order to grant the deductibility of the losses, creditor shall maintain the debt recorded in Provision for Bad Debt's account for at least 5 years from the date in which the debt expired.

III. Bad Debt – Recovering of Credits

- According to Section 343 of RIR, bad debts deducted as losses which are, at any moment, recovered by the creditor, shall be considered taxable income and, therefore, be included in the Corporate Income Taxes ("IRPJ" and "CSLL") calculation basis in the moment of the recovery.
- In this case, Corporate Income Taxes are considered due only in the moment of the recovery (no penalties are applicable).

III. Bad Debt – Recovering of Credits

- On the other hand, irrespectively of the recovery of the credit, bad debts deducted as losses will be considered taxable income whenever the creditor discontinues administrative or judicial collect procedures without observe tax legislation requirements.
- In this case, the deduction of the bad debt will be considered as a deferral of taxation and, accordingly, be subject to interest and penalty for the late payment.

IV. Bad Debt – Capitalization of Debts

- According to Brazilian law, during the judicial restructuring of the company (debtor), creditors may receive company's shares/stock as payment. For instance, it is possible to agree that creditor will receive 30% of its credit in cash and 70% in shares/stock.
- In this case, no premium would be generated, given that the investment is made in the exact amount of the credit.
- In addition, if payment is made 100% in shares/stock of the company (debtor), which means that the debt is 100% capitalized, creditor will not be allowed to deduct any amount as loss.

IV. Bad Debt – Capitalization of Debts

- If the value of the shares/stock received as payment is lower than the value of the debt, creditor may claim the difference as loss.
- Given that the debtor its in a judicial restructuring program, the correspondent loss may be deducted immediately, but, depending on the debt's value, a Provision for Bad Debt shall be recorded.
- On the other hand, if the value of the shares/stock received exceeds the value of the debt, creditor shall recognize a premium in the payment of the debt, subject to Corporate Income Taxes.

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Corporate Tax and Transfer Pricing updates and trends

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Brazil Transfer Pricing – General Comments

- Applies to import and export transactions of goods, services and rights with related parties resident overseas and/or parties, whether related or not, located in blacklisted countries.
  - Brazil TP does not apply to domestic transactions with related parties
- Deviates substantially from the OECD Transfer Pricing Guidelines. Instead of adopting the arm's length principle, the transfer pricing methods are driven by predetermined profit margins that allows the taxpayer to mathematically determine and prove its pricing benchmark without having to go through a search for comparables.
- The Brazilian provisions do not foresee Advanced Pricing Agreement.
- Brazilian entities subject to transfer pricing have to prepare the relevant analysis on an annual basis and general information must be disclosed in the annual income tax return. The detailed calculation must be kept by the taxpayer to be presented to the tax auditor when required during an audit.

Brazil Transfer Pricing – General Comments (cont)

- The option for the transfer pricing method is mandatory/irreversible if the tax authorities commence a tax audit against the taxpayer, except when, during the tax audit, the tax authorities disqualify the method adopted by the taxpayer, case in which it will be required to present, within 30 days, new transfer pricing calculations based on a different method.
- Except for commodity transactions , under Brazilian legislation, which contains a detailed description of the methods, the taxpayer may choose the most favorable method in the case of acquisitions, imports, and exports subject to transfer pricing control.
- Brazil transfer pricing rules explicitly exclude inter-company royalties and technical, scientific, administrative or similar assistance fees, which remain subject to previously established deductibility limits and other specific regulations .

Recent amendments to Transfer Pricing Regulations

Laws 12.715/12 and 12.766/12 have introduced changes in the existing transfer pricing regulations mainly related to:

- Minimum statutory gross profit margins from 20% to 40%, depending on the company's industry, required for the Resale Price Method (PRL), including the exploration and production of oil & gas
- Transfer pricing methods for commodities (Quotation on Imports - PCI and Quotation on Exports - PECEX)
- Transfer pricing analysis for back to back transactions
- Interest

Transfer Pricing – Interest Deductibility

- Up to December 31, 2012, (i) interest paid by Brazilian taxpayers under loan agreements registered with the Brazil Central Bank and (ii) interest received by Brazilian taxpayers from overseas were not subject to Transfer Pricing.
- Presently, the calculation of the maximum amount of deductible expenses and minimal revenue arising from interest subject to transfer pricing regulations should observe the following:
- • In case of transactions in US dollars (USD) at a fixed rate, the parameter rate is the market rate of the sovereign bonds issued by the Government on the external market, indexed in USD
- • In case of transactions in Brazilian real (BRL) at a fixed rate, the parameter rate is the market rate of the sovereign bonds issued by the Government on the external market, indexed in BRL
- • In case of transactions concluded abroad in BRL at a floating rate, the Ministry of Finance will determine the parameter rate; and for all other cases, the parameter rate is the London Interbank Offered Rate (LIBOR)

Transfer Pricing – Interest Deductibility (Cont)

- The agreement contracting date must be observed in order to determine the applicability of the new rules. In this sense, agreements contracted prior to 1 January 2013 would fall out of the scope, even if interest payments are made in 2013
- Regulation expressly provides for the application of the new rules for agreements as of 1 January 2013. The renewal or re-negotiation of existing agreements should be considered as a new transaction and, therefore, subject to the new regulations.

Resale Price Method (PRL), for the import of goods, services or right, depending on the company's industry

- The Resale Price Method was significantly affected by the changes. Before Law 12.715/12, this method had two versions: one for simple resale of imported goods, services or rights – PRL20% - and another for goods imported and applied in production – PRL60%. Each version had its own calculation methodology and minimum profit margin (20% on the gross resale price for finished goods and 60% on the net resale price for raw materials/components/parts).
- Presently, minimum statutory profit margins vary according to the company's industry sector, as follows:
  - Forty percent (40%): pharmaceutical/pharma-chemical products; tobacco products; optical, photographic and cinematographic equipment and instruments; dental, medical and hospital equipment and instruments; **extraction of petroleum and natural gas; and petroleum-related products**
  - Thirty percent (30%): chemical products; glass and glass products; pulp, paper and paper products; and metallurgy; and
  - Twenty percent (20%): for all the other businesses.

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Transfer pricing method for import/export of commodities traded publicly

- According to the current regulations, intercompany imports and exports of commodities, including crude, must be tested using PCI (quotation on imports) and PECEX (quotation on exports) methods, respectively.
- Regulations expressly listed the commodities and stock exchange markets for PECEX and PCI purposes. Therefore, both methodologies will rely on internationally accepted commodity quotations from international commodity exchanges.
- PECEX and PCI are both defined as the quotation of daily average values of assets or rights in internationally known futures or commodity markets, and the prices used will be adjusted to more or less the market average premium, on the date of the transaction or the latest known transaction. It is allowed adjustments on prices based on variation of quality, characteristics of products, content of products, among others.

Back-to-back operations subject to transfer pricing analysis

- As from January, 2013 back-to-back operations must comply with Brazilian transfer pricing rules.
- Back-to-back operations are those in which the purchasing and selling of goods occurs without their physical departure or entry in Brazil. The good may be purchased from a foreign country and sold to another country without the physical entry in Brazil.
- It is necessary to demonstrate that the margin of profit of the entire transaction between related parties is consistent with the margin practiced in operations between independent parties.

Corporate Tax - Treatment of Goodwill in connection with corporate reorganization

- Provisional Measure N. 627/2013 established changes in the tax treatment of the premium paid by Brazilian entities for the acquisition of investments in other legal entities.

- According to the Explanatory Memorandum attached to the Provisional Measure, the changes were implemented aiming the alignment of the tax rules with the new accounting rules set forth by Brazilian legislation, which are converging the BRGAAP to IFRS.

- Among the changes implemented by Provisional Measure N. 627/2013, we can highlight the following:

  - The rules related to the acquisition of relevant investments, which shall be evaluated by the equity method, are those provided by accounting legislation. Therefore, not only investments in subsidiaries or affiliates in which the investor has control, or holds 20% or more of the equity, shall be evaluated by equity method for tax purposes, but investments in any subsidiaries and affiliates and also in other companies of the same economic group.

Tax Treatment of Goodwill

- The cost related to the acquisition of the investment shall be divided into two categories, in the following order: (1) appreciation or less appreciation of assets - identifiable assets acquired and liabilities assumed at fair value; and (2) goodwill - future profitability (goodwill) or negative goodwill.
- Both amounts must be recognized in a separate account and be supported by an independent appraisal registered with the federal revenue service or the registry of deeds and documents. The registration shall be made until the last business day of 13th month following the acquisition.
- This requirement means that the tax treatment of the premium should be consistent with the accounting purchase price allocation (PPA).
- As opposed to the rumors spread in the last years, Provisional Measure N. 627/2013 maintained the possibility of amortize the premium paid for tax purposes, but the amortization of the premium (added-value of assets of goodwill), as provided by the former legislation, can only be deducted in the event of merger or demerger.

Tax Treatment of Goodwill (cont)

Provisional Measure N. 627/2013 created new requirements for the amortization of the premium, which are:

a) The premium paid for the appreciation of assets shall be recorded in the same account in which the asset is recorded. Therefore, the premium will hit P&L as a result of the depreciation, amortization or depletion of the asset.

b) Taxpayers are allowed to amortize, for tax purposes, the premium paid as goodwill, by performing an exclusion in the tax book, observing a minimum 5 years period for amortization. Therefore, even though not longer amortizable for tax purposes, the goodwill can be deducted for tax purposes.

c) However, the following restrictions shall be observed for both the depreciation/amortization/depletion of the appraisal of assets and for the amortization of goodwill:

(i) the deduction is only allowed when the entities involved in the transaction are considered "independent parties";

(ii) the appraisal report shall be registered within the term established by the legislation;

(iii) the values that originated the premium must be identifiable in the accounting books;

(iv) the appraisal report may be disregarded by Tax Authorities in case the data included in the report is incorrect or cannot be dully supported.

Tax Treatment of Goodwill (cont)

d) The premium can be deducted even in the cases where the merged entity is the one that acquired the investment with the premium.

- Less appreciation of assets shall be recorded, in merger and spin-off events, in the same account that recorded the correspondent asset. The asset with the adjusted cost value shall be depreciated, amortized or depleted in accordance with tax legislation.
- Negative goodwill, on the other hand, shall be taxed, after merger or spin-off, in a maximum 5 years period. Taxpayers shall perform add-backs in the corporate income taxes calculation basis with this purpose.
- According to Provisional Measure 627/2013, former rules related to the tax treatment of the premium paid in the case of merger or spin-off remain applicable to the events (merger or spin-off) occurred until December 31st, 2015, for which the investments were acquired until December 31st, 2014.
- Alternatively, taxpayers may opt to adopt the new rules set forth in the Provisional Measure as of January 1st, 2014. In this case, the option is final and applicable to all rules set forth in the Provisional Measure.

ENERGY TAX WORKSHOP: US Companies Doing Business in Colombia

Juan Pablo Godoy

November 20, 2013

CUSTOMS SPECIAL REGIMES

Highly Exporting Users (ALTEX):

Companies recognized as ALTEX enjoy a series of tax and administrative benefits. To be recognized as ALTEX, certain requirements are to be met.

Main benefits are:

a. No inspections by the time of the exporting operation
b. One single guarantee for the whole foreign trade operation
c. VAT exemption for the import of industrial machinery that is not produced in the country and is used to transform raw materials.
d. Possibility of obtaining authorization from the Customs Authority to operate an **industrial processing warehouse** that allows the import of raw materials with suspension of customs duties and VAT, as long as such supplies and materials are used in the production of export products.

CUSTOMS SPECIAL REGIMES

Permanent Customs Users (UAP):

Companies recognized as UAP enjoy a series of tax and administrative benefits. To be recognized as UAP, certain requirements are to be met.

Main benefits are:

a. Automatic imported merchandise release.
b. Possibility of importing raw materials or inputs as temporary imports for industrial processing regimes without paying custom duties when those raw materials or inputs are used to manufacture goods to be exported.
c. One single guarantee for the whole foreign trade operation
d. Customs taxes payment in a monthly basis

CUSTOMS SPECIAL REGIMES

Authorized Economic Operators (OEA): Equivalent to U.S CTPAT

Apply to legal entities with a safe international supply chain.

Main benefits:

a. Initially only for exporters.
b. Reduction in physical and documentary inspections for foreign trade operations.
c. Simplified logistic procedures.
d. Exporters may directly conduct exportation operations without customs brokers assistance.
e. Reduction in the cost (20%) of guarantees covering foreign trade operations.

CUSTOMS SPECIAL REGIMES

Temporary Imports:

Short-term

Applicable when goods are imported to meet specific needs. The maximum import term will be of six (6) months, extendable for up to three (3) additional months and, in exceptional situations for up to six (6) additional months. VAT and/or customs duties are not accrued.

Long-term

Apply to **capital goods** and any accessory or spare parts import, as long as they constitute one single shipment. The maximum term for these imports is of five (5) years. Customs duties and VAT will be payable in bi-annual installments, which must be paid only while the goods are within the national customs territory.

CUSTOMS SPECIAL REGIMES

Plan Vallejo: Special Import-Export regime

By these program, capital goods, raw materials, inputs and parts may be imported enjoying tax benefits. These benefits are subject to compliance with certain export undertaking of finished goods or services to be performed by the beneficiary of the special program.

Plan Vallejo for Raw Materials: Grants total or partial suspension of customs duties (VAT and custom duties), of raw materials, to be totally or partially exported after having undergone a transformation or manufacture process.

CUSTOMS SPECIAL REGIMES

Plan Vallejo: Special Import-Export regime

Plan Vallejo for Services: Allows the temporary import of capital goods and spare parts (only for air transport services), with full or partial suspension of tariffs and deferment of the VAT payment. Beneficiaries must export services listed within the applicable regulations, for an amount equivalent to 1.5 times the FOB value of the imported capital goods.

Junior Plan Vallejo : Grants the exporter of any kind of goods the right to replace, through a new import, with the suspension of custom duties, the raw materials or inputs that have been used in the production of such exported goods, when all customs duties were originally paid (tariffs and VAT) upon the initial import. This right must be requested within a term of 12 months after the shipment of the exported goods.

CUSTOMS SPECIAL REGIMES

Free Trade Zones

Special areas of the Colombian territory in which industrial (goods and/or services) or commercial activities are developed under a special customs, tax and foreign trade regime.

Main benefits:

- Special income tax rate of 15% for industrial users. The income tax for equality “CREE” is not applicable to companies declared as FTZ zones or FTZ users before December 31, 2012. If this is not the case, CREE is 9% until 2015 and 8% afterwards.
- Customs taxes are not accrued on goods entering the FTZ.
- VAT exemption for sales from the national customs territory to the FTZ.
- Exportation from a FTZ benefits from the FTA signed by Colombia.

FREE TRADE AGREEMENTS -FTA

FTA´s in force:

1. Colombia – United States Free Trade Agreement: in force since May 2013

- More than 80% of American exports related to industrial and purchase products are considered to be duty free.*

- 99% of the exportable Colombian portafolio is considered to be at zero duty under this agreement. This free trade agreement also includes chapters of investments, financial services, communications, public purchases and e-commerce, among others.

2. Colombia – European Union Free Trade Agreement
3. Colombia – Mexico Free Trade Agreement
4. Economic Complementary Agreement CAN –MERCOSUR
5. Colombia – Chile Free Trade Agreement
6. Colombia – European Free Trade Association (“EFTA”) Free Trade Agreement
7. Colombia – Canada Free Trade Agreement
8. Colombia – Northern Triangle Free Trade Agreement
9. Colombia – Venezuela Economic Complementary Agreement

* Data: Colombia Ministry of Commerce

BILATERAL INVESTMENT TREATIES

Main protections: (i) National Treatment, (ii) Most Favored Nation Treatment, (iii) Fair and Equitable Treatment, (iv) Prohibition of Unlawful Expropriation

BIT´s in force:

- Chapter X of the FTA Colombia - United States
- BIT Colombia - India
- BIT Colombia - China
- BIT Colombia - Perú
- Chapter VIII of the FTA Colombia - Canada
- Chapter V of the EFTA FTA: in force with Liechtenstein and Switzerland
- BIT Colombia - Switzerland
- BIT Colombia - Spain
- Chapter XII of the FTA Guatemala, El Salvador and Honduras - Colombia
- Chapter IX of the FTA Chile - Colombia
- Chapter XVII of the FTA Mexico - Colombia

CUSTOMS REFORM

Main topics:

- Colombian customs reform will follow Kyoto Treaty foundations
- Some special customs regimes like UAP´s and ALTEX will be abolished and its benefits will be shifted to OEA´s
- Short term imports finalization in a FTZ will be limited (only once, then export abroad)
- OEA new benefits are going to be provided for
- Crude Oil export through pipelines crossing country boundaries will be ruled thoroughly
- Full restructuring of the penalty system
- Customs Broker figure will be alternative not mandatory as it is nowadays

CORPORATE REORGS, ASSETS AND STOCK ACQUISITION

Law 1607 of 2012 introduced new regulations regarding the tax effects of corporate reorganizations:

Tax-free reorgs:

- Mergers and spin-offs, whether for acquisition (non-related entities involved) or reorganization (related entities involved) purposes, comprising national and foreign entities as long as the acquiring or resulting entity is national.
- Transfer of assets among the merged or spined-off entities is not deemed as an alienation, thus no taxable income is derived therefrom.
- The fiscal cost of the assets accounted for by the transferring company will be kept by the acquiring company.
- The useful life of the assets and its cost for depreciation or amortization purposes remain the same.

CORPORATE REORGS, ASSETS AND STOCK ACQUISITION

- Assets transferred to the acquiring company keep their fixed or movable nature.
- If the acquiring company transfers the assets within the two (2) years following that in which the transfer took place, fiscal losses and excess of presumptive income over ordinary income may not be offset against the earnings so derived.
- For the shareholders, it will be deemed that no alienation of shares has occurred if all of the following are met:
  - Shareholders or partners holding at least 75% (acquisitive reorgs) or 85% (restructuring reorgs) of the entities involved receive an equivalent participation and rights in the resulting company.
  - The equity participation received by the shareholders may not be less than 90% (acquisitive reorgs) or 99% (restructuring reorgs) of its total compensation.
- The cost of the shares or securities representing the capital in the former company will be kept as the cost of those received.

CORPORATE REORGS, ASSETS AND STOCK ACQUISITION

  - If the shares so acquired are sold or assigned in any way within the two (2) years following that in which the merger or spin-off took place, such transaction will be treated as a taxable transfer but the tax so determined will be added in a 30%, and in any case it may not be lower than a 10% of the price attributed to said shares or securities representing the capital in accordance to the valuation method applied for purposes of the merger or spin-off.

- Mergers and spin-offs between foreign entities resulting in transfer of assets located in Colombia:
  - Taxable transfer falling under the general income tax rules
  - Tax-free transfer if the total assets owned in Colombia by the group of companies taking part in the transaction do not exceed 20% of the total assets of the group to which the companies belong, per the consolidated balance sheet of the ultimate parent company. Rules mentioned to acquisitive and restructuring mergers and spin-offs apply in this case.

CORPORATE REORGS, ASSETS AND STOCK ACQUISITION

Transfers of assets:

– The contribution made to national companies in money or in kind will not give rise to taxable income for the receiving company and will not qualify as a taxable alienation for the contributor if the following are met:
  - Issuance of new shares by the receiving company in exchange, no profit or loss derived by the receiving company
  - Assets transferred will keep the fiscal cost registered by the contributor at the moment of transfer as well as their nature as fixed or movable in the hands of the receiving company.
  - Shares or securities received will keep as fiscal cost the same cost of the assets transferred.
  - For the shareholder the tax will be triggered until the shares are sold.
  - If the receiving company sells the fixed assets within the 2 years following that in which the transfer took place, fiscal losses and excess of presumptive income over ordinary income may not be offset against the earnings so derived

CORPORATE REORGS, ASSETS AND STOCK ACQUISITION

Transfers of assets (cont):

- The contribution made by national individuals, companies or entities to foreign companies or other entities in kind or industry will be subject to tax under the general rules.
- In addition, those contributions will be subject to the transfer pricing regime and if the transaction involves intangibles, the reporting obligation under said regime must be fulfilled regardless of the amount contributed.

VAT AND INDIRECT TAX ISSUES

VAT:

General rule: Triggered by the sale of movable tangible assets, import of goods and rendering of services in the national territory.

Special industry issues:

- Export of goods including hydrocarbons is exempted (subject to 0% rate) and allows VAT credits and refund of balances in favor. This covers crude directly exported and crude sold to international trade companies (*sociedad de comercialización internacional*)
- Biofuels to mix with gasoline and Diesel Oil are VAT exempt.
- Sale of oil to be refined in Colombia is VAT excluded, therefore, VAT paid to suppliers cannot be credited and must be accounted for as a higher cost or expense.

VAT AND INDIRECT TAX ISSUES

VAT (cont..):

- VAT paid on the import of heavy machinery for basic industries, including oil & gas, can be used as a tax credit for income tax purposes. If the CIF value of the goods imported exceed US $ 500.000, the VAT may be paid (i) 40% at the moment of filing the import return, (ii) and the balance in two (2) equal installments within the following two (2) years.

National tax on gasoline and Diesel Oil:

As from 2013, imports, self consumptions and sales of gasoline and diesel oil are subject to this tax as a fixed amount per gallon, ranging for 2013 between COP $1.050 and COP $1.555 per gallon for 2013.

DOUBLE TAXATION RELIEF

Unilateral tax credit

- National and foreigners, residents in Colombia
- Foreign sourced income
- Credit not exceeding Colombian tax
- Elimination of juridical and economic double taxation

Treaties to avoid international double taxation

- Decision 578 of the Andean Community (Peru, Bolivia, Ecuador)
- Tax treaties currently in force: Spain, Chile, Switzerland, Canada, Mexico
- Treaties signed: India, Korea (Rep.), Portugal, Czech Republic
- Negotiations: United States, Germany, The Netherlands, Belgium, France, Japan

2012 TAX REFORM

New tax rules introduced by Law 1607 of 2012

Residence – Place of effective management:

Resident companies are defined as those that: (i) the have their place of effective management in Colombian territory during the taxable year, understanding as such the place where the company's daily management decisions are taken, regardless of the place where the shareholders of the company are resident or where the shareholder or board of directors' meetings take place; (ii) have their principal domicile in Colombian territory; or (iii) are incorporated under Colombian law.

The tax authorities construed the "during the taxable year" requirement as fulfilled if occurred at any moment during the taxable year with no need of computing terms.

2012 TAX REFORM

New tax rules introduced by Law 1607 of 2012

Permanent establishment concept

Physical PE: Fixed place of business within the country whereby a foreign entity or a non-resident individual, wholly or partly carries on its business. It includes, amongst others, branches of foreign corporations, agencies, offices, factories, workshops, mines, quarries, oil and gas wells or any other site for extraction or exploitation of natural resources.

Agency PE: person, other than an independent agent, acting on behalf of a foreign enterprise, and having or habitually exercising an authority to conclude acts or contracts that are binding for the enterprise, except if those activities are limited to preparatory or auxiliary ones.

2012 TAX REFORM

New tax rules introduced by Law 1607 of 2012

<u>Thin capitalization rules</u>

Interest generated by debt may be deducted only up to the average not exceeding a 3 to 1 debt to equity ratio, taking into account the net worth as from December 31st of the previous year. Interest derived from debt exceeding this proportion is not deductible.

The law does not include the recharacterization of interest as equity.

Only interest-bearing debt is taken into account.

Financing for infrastructure for public services projects is not covered.

2012 TAX REFORM

New tax rules introduced by Law 1607 of 2012

<u>Anti-avoidance rule</u>

A general anti-avoidance rule was introduced defining “abuse or abusive conduct for tax purposes” as the use or implementation, through one or several transactions and through any type of entity, legal agreement or proceeding, aiming to modify or alter the tax effects that would apply to the taxpayer or its related parties, shareholders or beneficial owners, in order to eliminate, reduce or defer the tax or increase a balance in favor, without having a legitimate commercial or business purpose.

After a special procedure, the effects of the transactions may be disregarded and recharacterized, and the corresponding taxes, interest and penalties charged.

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ENERGY TAX WORKSHOP: Venezuela - Energy and Tax

Leonardo Palacios Márquez

November 20, 2013

EVOLUTION OF PARTICIPATION FASHIONS OF PRIVATE CAPITAL IN THE VENEZUELAN OIL INDUSTRY

I	II	III
Oil Nationalization (1970) LORECH	Oil Opening (1995) Strategic Alliances and Operating Agreements	Migration to Mixed Companies (2005)

OIL OPENING

Strategic Association Agreements (Belt)

- Joint ventures (except PZ)
- Integrated operation including exploration, extraction, transportation and management of heavy crude oils.

Operating Agreements

- Agreements where companies rendered services for PDVSA (3 rounds).
- Companies did not become owners of crude oil.
- Stipend(fee) + costs

OIL OPENING

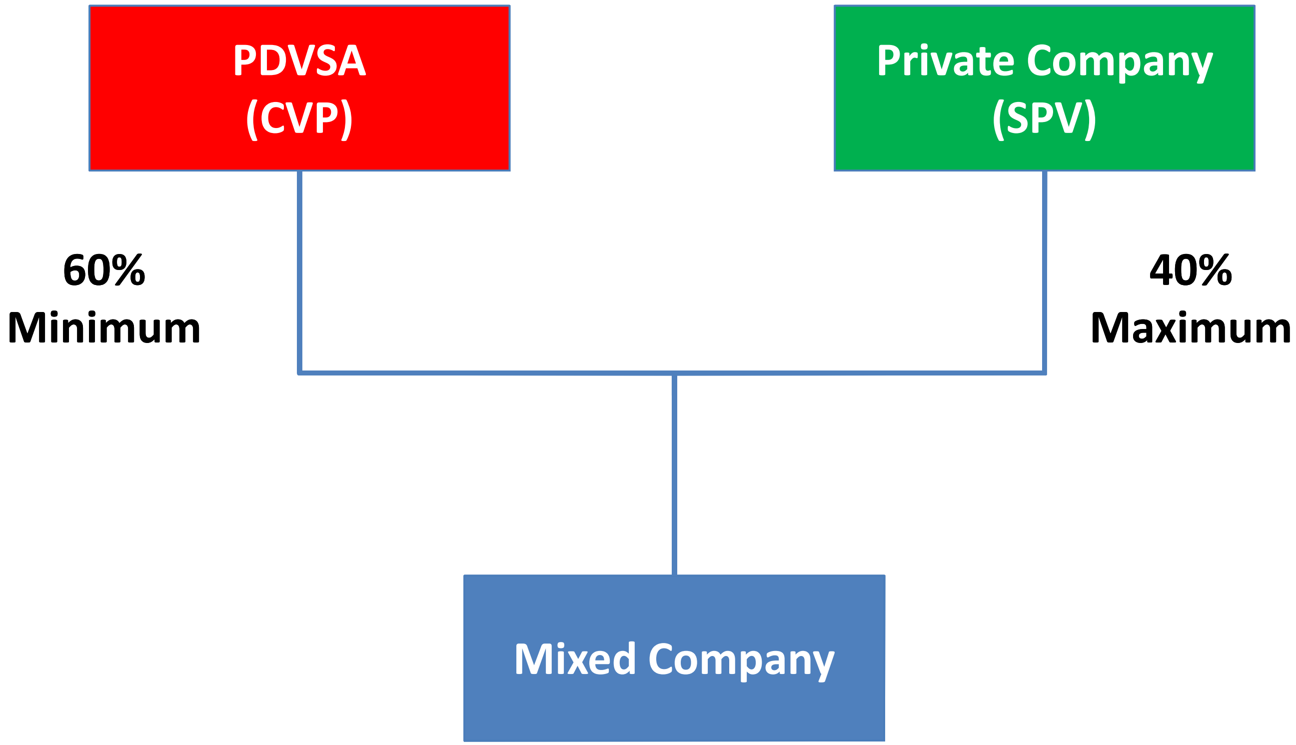
Strategic Association Agreements (Belt)

- Conoco
- Exxon Mobil
- BP
- Total
- Statoil

Operating Agreements

- Eni
- Perenco
- Teikoku
- Polar
- Harvest

MIXED COMPANIES



CONSTITUTIONAL FRAMEWORK

Article 12. ***Public domain*** of hydrocarbon wells.

Article 156.16. The ***regimen and administration*** of mines and hydrocarbons reserved to the National Power.

Article 156.12. The ***creation, organization, collection, administration and tax control*** to hydrocarbons reserved to the National Power.

Article 302. The State ***reserves for itself*** the oil activity and that of other industries.

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TYPES OF ACTIVITIES

Sentence No. 00710, ruled on 06/19/2012 by the Administrative-Political Chamber of the Supreme Tribunal of Justice

PRIMARY

Refining

Industrialization

Marketing

SECONDARY

Any activity related to the field and different from primary activities

PRIMARY ACTIVITIES

Organic Hydrocarbon Law

Extraction Tax

1/3 of the value of all extracted liquid hydrocarbons

General Consumption Tax

Between the 30% and 30% of teh price paid for each liter of sold hydrocarbon

Surface Tax

100 TU for each km2 or fraction of land that is not under exploitation

Export Registration Tax

0.1% of the value of hydrocarbons exported from the national territory

Own Consumption Tax

10% of each m3 of products produced and consumed in own operations

PRIMARY ACTIVITIES

Organic Hydrocarbon Law

Royalties?

Law creating value official Contribution for Extraordinary and Exorbitant Prices in the International Market

>80$ and <100$=80% on the difference

>100$ and <110$=90% on the difference

>110$=95% on the difference

PRIMARY ACTIVITIES

Organic Gas Hydrocarbon Law

Royalties?

Article34. The State is entitled to twenty per cent (20%) participation as royalty out of the volume of gas hydrocarbons extracted from any well, not re-injected.

PRIMARY ACTIVITIES

Organic Science, Technology and Innovation Law

LOCTI Contribution

1% of gross income in the case of companies carrying out any activity ***provided for*** in the Organic Hydrocarbon Law

Sentence No. 00710 issued on 06/19/2012 by the Political-Administrative Chamber of the Supreme Tribunal of Justice

Refining

Marketing

Industrialization

SECONDARY ACTIVITIES

Organic Law of the Municipal Public Power

Financial Activity Tax

Sentence issued on 10/18/2007 by the Political-Administrative Chamber of the Supreme Tribunal of Justice, case: *Shell Venezuela vs. Mun. José Gregorio Monagas del Edo. Anzoátegui*

The National Power is exclusively entitled to tax the main hydrocarbon activity

Municipal tax legal authority relies on collateral industry service, although they are essential to develop the activity

MIXED COMPANIES

Endogenous Development Tax

Agreement to Approve the Creation of Mixed Companies

1% of income in a social investment plan

Special Advantages as Royalties

Agreements to Approve the Creation of Mixed Companies

Participation as special advantage of 3.33%
2.22% for municipalities in replacement of IAE.
1.11% to the People's Power Special Fund (FOPO for its abbreviation in Spanish) to finance endogenous development projects

Special Advantage 50%

Terms and Conditions to Create Mixed Companies

50% of the value of royalties less the amounts paid for the concept of hydrocarbon taxes

PRIMARY AND SECONDARY ACTIVITIES

Law establishing the Value Added Tax

Exemption

Transportation service of fuel from hydrocarbon.

Aliquot 0%

To sales of natural hydrocarbons carried out by mixed companies regulated in the Organic Hydrocarbon Law to Petróleos de Venezuela, S.A. or any other affiliate.

Exemption

Fuel from hydrocarbon as well as inputs and additives aimed at improving gasoline quality.

PRIMARY AND SECONDARY ACTIVITIES

Income Tax Law

Subjective Aspect

Taxpayers dedicated to hydrocarbon exploitation and related activities, such as: refining and transportation or purchase or acquisition of hydrocarbons and derivatives for exploitation.

Aliquot

Proportional rate of 50%

PRIMARY AND SECONDARY ACTIVITIES

Paratax Contributions

1%
Regular Salary
INCES

2%
Integral Salary
BANAVIH

1%
Operating Income
FONA

½% - 2%
Gross Income
FONACIT

1%
Net Income
Instituto Nacional del Deporte

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ENERGY TAX WORKSHOP: Mexico 2014 – Energy and Tax Reforms

Jose Carlos Silva

November 20, 2013

The Energy Reform

Oil & Gas

- Open exploration and exploitation of oil deposits to private parties through agreements with the Mexican government to work jointly.
- Open other areas of the production and distribution chain, such as transport and transformation (i.e. basic petrochemical industry), to private parties through permits.
- Change the tax regime applicable to PEMEX (State owned oil company) to make it more competitive.

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The Goals of Energy Reform

- Boost economic growth - Increase employment and investment.
- Energy Safety - Uninterrupted and diversified energy supply at competitive costs.
- Sweeping and Inclusive Development – Make energy available in all regions
- Strengthen the Role of the government as oil regulator – Improve management of deposits
- Transparency –Access to oil industry contracts.

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Tax Reform

- Congress approved changes to current legislation
- Major Reform plan abandoned
  - VAT on foods and medicines
- Still, very generous budget….
- Re-directed to Social and Revenue Reform
  - Universal Pension
  - Unemployment Insurance
- System overhaul still pending

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Tax Reform

- 30% Corporate Rate remains in
- Dividend withholding imposed at 10%
  - Treaties may reduce or eliminate
- Rate for individuals increased to 35% for income exceeding $250k
- Preferential VAT rate on border (11%) increased to 16%
- NPV depreciation repealed
- “Desperate” excise taxes
  - High calorie foods and sweetened drinks
- Not enough revenue = Deficit = Debt

What’s Next?

- All eyes on The President´s Energy Bill to ammend the Constitution. The amendment is currently being discussed in Congress.
- Tax Reform used for leverage by PRI
- New Tax Regime for Pemex deffered for 2015

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Taxing the Oil Industry

- No specific rules for obvious reasons
- Recomended Domestic vehicles for JVs
  - Sociedad de Responsabilidad Limitada (SRL)
    - Check the box
  - Sociedad Anonima Promotora de Inversion (SAPI)
    - A modern type of partnership
- Both: Limited Liability
- Major Beware in industry: Permanent Establishment rules
  - Presence in Mexican soil and seas
  - Acting through an agent
  - Same tax, but….

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Tax Aspects to be considered when investing

- Asset deduction structure
  - Renewable energy assets
- Thin capitalization rules
- Trade & customs on import of projects related assets
- Value added tax refunds

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CRZ's Credentials

- Regular participation in public tender offers and transaction structures:
  - Petróleos Mexicanos (PEMEX)
  - Compañía Federal de Electricidad (CFE)

- Involvement with Energy Sectors
  - Wind energy
  - Oil
  - Natural gas
  - Independent Power producers

- Examples of clients and transactions
  - Macquarie/ Mitsubishi wind park Oaxaca
  - Alstom
  - Renovalia
  - Enhol – Financing to NADBANK
  - MITSUI
  - Mitsubishi
  - Sale of shares by Eoliatec to EDF
  - Quantum Reservoir Impact LLC
  - Tejas de Gas (Gas pipeline, 2013)
  - Halliburton
  - Siemens
  - Asset acquisition by MITSUI from Gas Natural

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