

Brazil Tax Seminar

Tax Developments in Brazil and their effect on the Oil & Gas Industry

Ivan Tauil
Partner

55 21 2127 4210
itauil@mayerbrown.com

Eduardo Telles
Partner

55 21 2127 4210
etelles@mayerbrown.com

June 2015

Summary

1. Brazilian Federal Revenue Service 2015 Audit Program;
2. Topics related to 2014/2015 tax audits;
3. Update on Law No. 13,043/14 (taxation of charter/services split contracts);
4. Market update.

Brazilian Federal Revenue Service 2015 Audit Program

- Main Target:
 - large companies;
 - high net worth individuals.
- Goals:
 - Expectation: tax assessments issued during the year of 2015 must charge taxes in the total amount of BRL 157,9 billions;
 - Fiscal audit regarding major taxpayers - 9,478 legal entities that represent:
 - 0,01% of Brazilian corporate taxpayers;
 - 65% of all federal taxes paid.

Brazilian Federal Revenue Service 2015 Audit Program – cont.

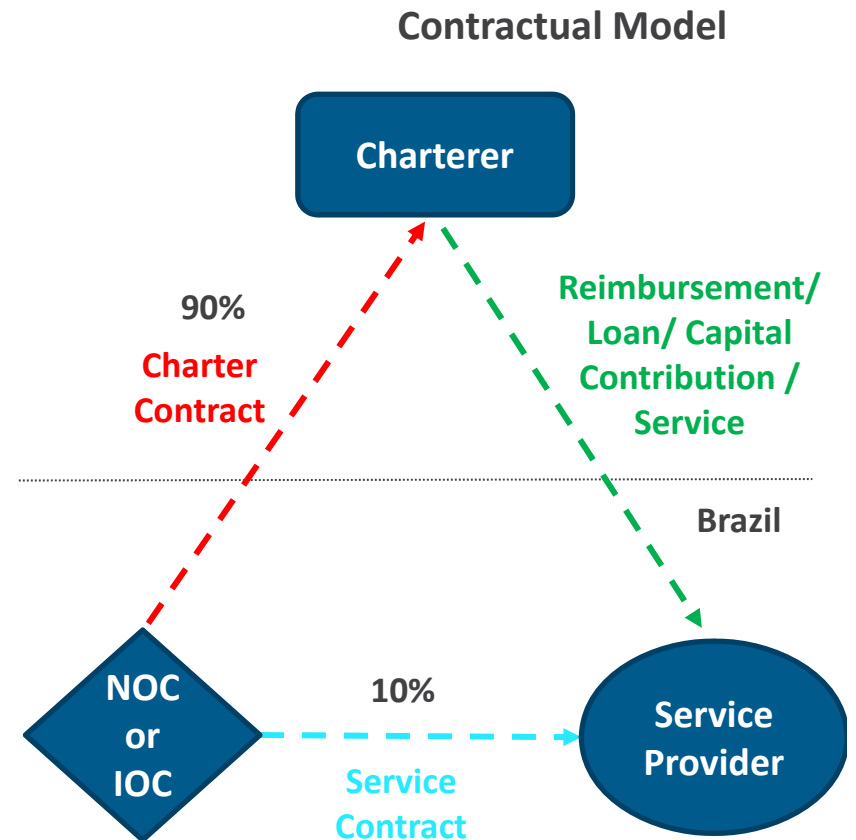
- According to the Program, the main transactions that will be audited by Brazilian Federal Revenue Service during 2015 and may concern the industry are:
 - i. inconsistencies related to adjustment of “RTT” (Transition Tax Regime that introduced tax adjustments resulting from the new accounting methods and criteria);
 - ii. undue amortization of goodwill;
 - iii. foreign investments.

Topics related to 2014/2015 tax audits

- Besides the main target and goals of 2015 Audit Program, other topics are relevant for Brazilian Federal Revenue Service for purposes of tax audit and assessments:
 - Importation of Services:
 - Brazilian Federal Tax Authorities are focused on the taxable events of the taxes levy on importation of services: IRRF, PIS-Import, COFINS-Import and CIDE;
 - Taxable event: accounting credits and/or maturity date vs. settlement.
 - DDA – exploration and development costs:
 - Unit-of-production method of depreciation (“MUP”);
 - Moment to expense capitalized costs – unsuccessful knowledge vs. ANP communication.
 - Farm-in/Farm-out – tax effects of the carrying clause:
 - Ongoing audit / trend to recognize carrying as a capital gain avoidance.
 - Use of withholding taxes on offset of tax liabilities :
 - Issues with advance payments.

Update on Law No. 13,043/14 (taxation of charter/services split contracts)

- Law No. 13,043, enacted on November/2014:
 - New rules concerning the taxation of the split contracts, regarding the application of 0% IRRF on outbound remittances;
 - Article 106 establishes that in case of split of charter and services contracts with related company:
 - the amount of charter contract of FPSO shall be limited to **85%**;
 - the amount of charter contract of drillships shall be limited to **80%**; and
 - the amount of other charter contract shall be limited to **65%**.
- IRRF will levy on the amounts of the charter contracts that exceeds those limits at a tax rate of 15% (or 25%, in case of low tax jurisdiction country or the so-called privileged tax regime).



Update on Law No. 13,043/14 (taxation of charter/services split contracts) – cont.

- Six months after enactment of Law No. 13,043/14:
 - What are the effects on existing tax assessments?
 - The contract model used by Brazilian oil & gas industry is now foreseen by law;
 - Better chance of defense to taxpayers in the dispute called as “3 round fight”:
 - **Tax assessment 1:** the concept of vessel;
 - **Tax assessment 2:** intercompany remittances;
 - **Tax assessment 3:** requalification of charter contract.
 - Administrative Courts already rendered decisions favorable to taxpayers in all three cases;
 - Administrative Courts already rendered decisions recognizing that the new law accept the contractual model.

Update on Law No. 13,043/14 (taxation of charter/services split contracts) – cont.

– What are the effects on existing and future contracts?

- New rules applied to all outbound payments of charter fees made after January 1st, 2015 (when Law No. 13,043/14 came into force), including payments related to existing contracts;
- Charter companies claim for gross-up or readjustment of prices according to charter contractual clauses (increase of charter company's tax burden);
- New contracts/bids are respecting law thresholds.

Update on Law No. 13,043/14 (taxation of charter/services split contracts) – cont.

- Definition of “related companies” set forth by Law No. 13,043/14 is confusing and appears to suggest that the Brazilian service provider should be the partner of the charterer foreign company:

“the legal entity that is owner of the foreign-based maritime vessel and the legal entity that provides services will be considered as related companies if they are partners, directly or indirectly, in the company owning leased or rented assets”.

- Industry’s understanding is that the real intention of the law is to limit the split of charter/service contracts within the same economic group;
- There is a proposal of amendment of Article 106 of Law No. 13,043/14 in order to include (i) production activities (instead of “prospection”) and (ii) semi-submersible drilling rigs. However, such amendment did not intend to clarify the definition of “related companies”.

Market update

- Brazil Petroleum Agency (ANP) announced Bid Round 13:
 - Round is scheduled to take place on October 7, 2015;
 - Round to be promoted under the rules of the concession regime;
 - No pre-salt areas (2nd round for pre-salt is expected to 2016 or 2017);
 - A total of 269 exploratory blocks will be offered, namely 84 offshore and 185 onshore blocks;
 - ANP expects participation of majors and independent companies;
 - Petrobras manifested the intent to be less participative in this round, which will increase the availability of areas, reduce the value of bids and force the creation of new partnerships, representing a unique opportunity for new players in the country.
- Current local content rules will be reviewed:
 - Simplification of requirements and reduction of percentages;
 - Possible removal of local content as a judgment criteria from the bidding rounds (as already done for the pre-salt bidding round);
 - ANP general director also mentioned, during her participation at the OTC, Houston, that such changes would be implemented at least partially to the Bid Round 13.

Market update – cont.

- Taxpayers Council of Administrative Appeals (CARF):
 - CARF is a second level of federal administrative court, whose members are representatives of Brazilian Federal Revenue Service and of taxpayers;
 - Trials suspended since April, 2015, due to internal audit and restructuring proceeding;
 - New internal regulation is being prepared and will be published soon
 - Brazilian Bar Association (OAB) recently rendered decision prohibiting the taxpayers' representative to practice law. They are prohibited to act as a lawyer even in cases that not involves federal taxes. This decision will result in a substantial change in the representatives profile.

Questions ?

Thank you.