Brazil’s New Tax Rules for Oil and Gas Activities

January, 2018

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I. Provisional Measure No. 795/2017 and Law No. 13,586/2017

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- Provisional Measure No. 795 ("MP 795/2017") from August 18, 2017:
  - Provides changes in the tax treatment applicable to oil and natural gas exploration and development activities, as well establishing a special tax regime for the oil and gas industry.

- On December 29, 2017 the MP 795/20017 was converted into Law No. 13,586/2017:
  - The Law confirmed the main aspects of MP 795/2017.

I. Provisional Measure No. 795/2017 and Law No. 13,586/2017

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I. Corporate Income Tax ("IRPJ") and Social Contribution on Net Profit ("CSLL"):

- Full deduction, in the relevant calendar year, of expenditures in the activities of exploration and production of oil and natural gas, for purposes of calculation of real profit (taxable income) and calculation basis of CSLL.
  - Previously the full expense was set forth in Article 416 of RIR (Income Tax Regulations) nominally only for Petróleo Brasileiro S.A. ("Petrobras").

- Deduction of depletion expenses connected with development activities, and, especially, the possibility of accelerating depletion of assets by applying the rate determined by the unit-of-production method ("MUP") multiplied by 2.5.

- New Normative Instruction No. 1,778/2017 contain the ruling related to such modifications.

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II. Withholding Income Tax ("IRRF") on revenues related to charter or leasing of maritime vessels when the charter/lease and service agreements are executed simultaneously:

- New maximum percentages for each type of vessel, for purposes of applying zero tax rate, as of January 1st, 2018, which are:
  - 70% for vessels with floating systems of production and/or storage and offloading;
  - 65% for vessels with rig systems for drilling, completion, wells maintenance; and
  - 50% for other types of vessels .
- Charter or lease agreements of vessels related to activities of transportation, handling, transfer, storage and regasification of liquefied natural gas shall represent 60% of the total value of the agreements for purposes of IRRF at zero tax rate.

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- **Concept of related legal entities for the application of such percentages.**

- The legal entity that charters, leases or rentals maritime vessels based abroad and the legal entity providing the service are considered related legal entities in the following hypothesis:

I. When the legal entity that charters, leases or rentals of maritime vessels based abroad is the parent, subsidiary or branch of the legal entity providing the service;

II. When the capital share of one in relation to the other characterize it as its parent company or affiliate, as defined in paragraphs 1 and 2 of section 243 of Law 6,404/1976*;

III. When both legal entities are under common corporate or administrative control or when at least ten percent of the capital stock of each one belongs to the same individual or legal entity;

IV. When the legal entity that charters, leases or rentals of maritime vessels based abroad together with the legal entity domiciled in Brazil, has a corporate share in the capital stock of a third legal entity, provided that the sum of the shares characterizes them as controlling companies or affiliates thereof, as defined in paragraphs 1 and 2 of section 243 of Law 6,404/1976; or

V. When the legal entity that charters, leases or rentals of maritime vessels based abroad is associate of the legal entity providing the service, in the form of a consortium or condominium, as defined in the legislation in force, in any business.

* Ten percent of capital share of each one belongs to the same individual or legal entity.

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- **Previous concept according to paragraph 7th of section 1st of Law No. 9,481/1997**: the companies are considered as related legal entities in case the owner of the maritime vessel located abroad and the legal entity supplier of services are direct or indirect shareholders of a legal entity owner of assets leased or rented).
- **Definition of common corporate or administrative control :**
  - It is not sufficiently clear at Brazilian corporate and tax legislation whether the indirect control or the indirect corporate share should also be considered into the definition of "common corporate control"
  - Literal interpretation x extensive of the concept of common control – possibility of inclusion of indirect control;
  - CARF, CVM and CPC precedents
- Considering that there is no legal definition or precedents about the matter and literally interpreting the provisions it is possible to conclude that the participation of 10% on the capital shall be direct.

I. Provisional Measure No. 795/2017 and Law No. 13,586/2017

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- Levy of IRRF on the entire payment to foreign charter company benefiting from privileged fiscal regime or domiciled in a low tax jurisdiction;
- Application of those percentages does not encompass the reclassification of charter or lease agreement for purposes of CIDE and PIS/Cofins-imports;
- Inclusion in paragraph 10 of Article 1 of Law No. 9,481/1991 prohibiting retroactive use of the limits for the application of 0% WHT (Withholding Tax) rate to vessels used in maritime support navigation, regarding events that occurred prior to the enactment of Law 13,043/2014;
- Article 3, paragraph 7 establishes that the tax transaction applicable to events that occurred up to December 31, 2014, do not apply to vessels/rigs used in maritime support navigation since they are expressly excluded according to item above;
- Inclusion of a new paragraph in Article 5 (new paragraph 2) that expressly prohibits the granting of special regime with the suspension of payment of federal taxes on goods whose permanence in the country relates to the importation of vessels destined for cabotage (coasting navigation), inland waterways navigation, maritime support navigation, and port maritime navigation;
- Retroactive application of percentages previously fixed by Law No. 13.043/2014 to taxable events that occurred until December 31, 2014 and allowed the payment, in up to 12 installments, of the difference of IRRF due, with total reduction of *ex officio* and late payment penalties – Rules for the amnesty program set forth in Normative Instruction No. 1,780/2017.

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III. Taxation of profits of foreign controlled companies:

- Amendment of Article 77 of Law No. 12,973/2014, limiting to December 31, 2019, the non inclusion upon the real profit and calculation basis of CSLL of the holding company domiciled in Brazil portion of profits sourced abroad by direct or indirect controlled company or related company, corresponding to activities related to the oil and gas industry in Brazil.

IV. Import of goods used in the oil and gas industry:

- Special regime for imports with the suspension of federal taxes related to tax events occurring **until December 31, 2040**, relating to goods destined to activities of exploration, development and production of oil and natural gas and other hydrocarbons, as long as such goods remain in Brazil on **a permanent basis**.
- Such regime will also apply to the import or acquisition in the local market of raw materials, intermediate products and packaging material to be used in these activities. The qualification for the benefits under the special regime is applicable **as of January 1, 2018**.

II. Decree No. 9,128/2017

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- Published on August 18, 2017 Decree No. 9,128 ("Decree"), which **extended REPETRO up to December 31, 2040**.

- By means of such Decree, new rules applied to REPETRO were introduced as well as the express possibility of migration of goods imported under this regime until December 31, 2017, to the new system from the year 2018.

- Such rules are set forth in Normative Instruction No. 1,781/2017.

III. Normative Instruction No. 1,781/2017

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- **Normative Instruction (IN) RFB No. 1,781/2017:**
  - Regulates the new system instituted by the Provisional Measure No. 795/2017 and Law No. 13,586/2017;
  - New system = Repetro – SPED;
  - Applicable as of January 1, 2018;
  - **Substitutes the Normative Instruction No. 1,415/2013– "old Repetro" – for events occurred as of January the 1, 2018.**
  - **Substitutes Normative Instruction No. 1,743/2017.**

III. Normative Instruction No. 1,781/2017

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- **Definitive importation**:
  - Importation of goods that will stay in a permanent basis in Brazil with suspension of federal taxes that would apply on the importation of goods used on exploration, development and production of oil and natural gas;
  - Available until December 31, 2040;
  - The usage of the goods is conditioned, exclusively, to the activities of exploration, development and production of oil and natural gas;
  - Is applicable to goods described in Annex I and II of the Normative Instruction, as well as to :
    - parts and pieces that are needed to guarantee the operation of main assets; and
    - tools used in the maintenance of the main assets.
  - **Controversial aspects: (i) term of 5 years as of the registration date of the Import Declaration and (ii) need to transfer the ownership**

    (*) However, the assets should be used on exploration activities, development and production of oil & gas within 3 years, under penalty of being subjected to the levy of the taxes applicable to regular imports with payment of interest and fine, calculated as of the date of the triggering event.

III. Normative Instruction No. 1,781/2017

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- Repetro-Sped is not allowed in the following hypothesis:
  - assets with unitary customs value inferior to USD 25,000.00 - This limit is not applicable to tubes foreseen in Annex II.
  - Tubes destined to the transportation of the production; and
  - Under temporary admission rules, the assets that will stay in a permanent basis in Brazil.
- Assets submitted to the regime shall be used EXCLUSIVELY on the blocks or oil fields informed in the agreement provided when the regime was requested.
- The grant of temporary admission, irrespective with or without the proportional payment of federal taxes is prohibited by Article 3, §4º, in the following cases– **Restrictions created by IN not foreseen in the Law**:
  - When the present value of the bareboat charter , lease, assignment, supply/provision or rental contract (calculated using the LIBOR 12 (twelve) months rate as of the date of the signature of the contract) is higher than the fair market value of the vessel;
  - The contracts foresees the sale option;
  - The assets submitted to the lease, assignment, supply/provision or rental or bareboat charter contract is not directly imported by the company engaged for the provision of services or the oil company; or
  - The contract foresees the supply of assets are to be consumed during the provision of services.

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- Transfer of ownership: The import on definitive basis should **only** be applied in case of **transfer of ownership** to the beneficiary in Brazil (**PROBLEM: ICMS – Restrictions created by IN not foreseen in the Law – Convention ICMS 03/2018 – 3% on imports or local acquisitions**).

- The temporary import for economic use of assets without payment of federal taxes proportional to the time that the goods stayed in Brazil can be applied to:
  - production platforms – NCM 8905.20.00; and
  - Floating Production Storage and Offloading (FPSO) – NCM 8905.90.00

- However, **ONE** of the following conditions should be **verified** – **Restrictions created by IN not foreseen in the Law***:
  i. The charter, leasing and rental agreements of the asset have to be associated with the operation services of the platform or of the unity, and have to be held by **non related parties**.
  ii. The asset has to be used **temporally** at production tests or at anticipated production systems, in a exploration field or block (under this hypothesis, the Repetro-Sped concession period is 4 years, without renewal).

* Cumulative with conditions of article 3, §4

III. Normative Instruction No. 1,781/2017

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- Is prohibited the import of ovessels designed to coasting navigation and domestic navigation, as well as for port support navigation and maritime support navigation for permanent stay in the country;
- **Qualification– NEW:**
  - Consortium will be able to be qualified under Repetro as long as in compliance with Normative Instruction No. 1,199/11; and
  - RFB has 30 days to analyze the Repetro request or extension (prior no term was foreseen in the Law and it could take several months);
  - In case of missing documents Taxpayer must be summoned to provide it within 10 days (more flexibility).
- **Guarantee - NEW :**
  - **Not necessary:** for import of vessels and rigs and Assets admitted based on turn-key service agreements, which means that the amounts paid are exclusive and a 100% service agreement's consequence with no other contractual part related to the lease, assignment, availability or capital lease.
  - A Brazilian legal entity can offer guarantee, but its net equity must be superior to R$10.000.000,00 (ten million reais).

III. Normative Instruction No. 1,781/2017

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- Normative Instruction No. 1,781/2017 brought several new Articles containing procedural aspects that were previously provided by Normative Instruction No. 1,415/2013 and 1,600/2015;
- Repetro' s requirements filed before the publication of Normative Instruction No. 1,781/2017 and that are pending for decision will be analyzed in accordance to the Repetro's regulation in force at the time of the request;
- According to current Article 39, paragraph 6, after January 1st, 2019 the remaining goods admitted under Repetro must be transferred to Repetro-Sped;
- **Taxpayers shall pay attention to the amendments in Normative Instruction No. 1,415/2013 provided by this new NR with regard to existing regimes.**

IV. Brazilian Federal Revenue Position - FAQ

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- Brazilian Federal Revenue issued a “FAQ” to answers taxpayers questions related to Repetro Sped;
- Below we have summarized **some** of the positions stated there:
  - Repetro-Sped can be used in unitized fields or in fields that uses the same asset;
  - Operator must import the asset in the split contractual structure (this changes with the actual structure adopted by companies) – there is no “empresa designada”;
  - After December, 31, 2018 the migration procedure (from Old Repetro to Repetro-Sped) is not applicable, being mandatory the transfer between regimes;
  - Part and pieces / accessories to the main asset (for example a rig) must be imported under the Repetro-Sped rules, despite the fact that the main asset is admitted in old Repetro.

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