

## **THE BRAZILIAN LEGAL SYSTEM**

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### General overview

Brazil is the largest country in Latin America, considering either its area, economy or population. Brazil mainland extends for an area of 3.3 million square miles, which makes it the fifth largest country in the world. Brazil's 2005 Gross Domestic Product of R\$ 2,147 billion (US\$ 1 billion in the 2007 current exchange rate) and would be in the 10 most largest economies of the world according to data of 2005.

The following overview shall take into consideration the legal aspects of such huge economy that might interest the venture capital investor, especially in those areas where technology or other intellectual property considerations have a particular importance in the investing decision.

## The Brazilian Constitution

Brazil is organized as Federal Republic, as a union of States, the Federal District and - which is a particularity of Brazilian system - of Municipalities. The legal system adopted in Brazil is largely codified on the Roman tradition, and the Federal Government, the States and the Municipalities enact laws.

Under its 1988 Constitution, therefore, Brazil has three instances of power. Each Federate public entity has its own jurisdiction to prescribe (legislative power) and jurisdiction to enforce (executive power); the Union and the States (not the municipalities) have also their court systems. The States are organized and governed by their own Constitutions and laws and the municipalities are organized and governed by their own Organic Laws, having also legislative authority to get down to matters of local interest. The President of Brazil is empowered to issue statutory-like executive orders of a provisional character, which must be confirmed by Congress.

In this way, when the Federal Constitution establishes the legislative authority of the Federal Government, the States and the Municipalities, the most important concern is to avoid the issuance of laws that are redundant or conflicting with those in other spheres. What is really important to know about the Brazilian system is that, although the Federal Constitution determines a hierarchy between Federal Government, states and municipalities, none of them - even the Federal Government - is allowed to interfere in the matters that belong to the prescriptive or enforcing power of another public entity.

Actually, the Federal Constitution is the cornerstone of the Brazilian legislative system, and provides for the fundamental rights and guarantees of the citizen; governs the political and administrative organization of the Republic as a whole; defines the singular roles of the Executive, Legislative and Judicial Branches; provides extensive regulation of the tax system; and deals on the broad basis of the socioeconomic and financial policy.

Civil and commercial law, labor relations, criminal law and most economic regulation are under Federal prescriptive jurisdiction. Courts either at the state or Federal level follow the same civil and criminal procedure, and there is neither civil jury system nor punitive damage concepts.

### Brazil and the international legal community

Many treaties exist to avoid double taxation between Brazil and the foreign investor's country. Brazil is a long-standing member of all major International economic treaties, including the WTO and WIPO Intellectual Property agreements. MERCOSUR, the regional economic market including Argentina, Uruguay and Paraguay, besides Chile and Bolivia as associate members, has caused extensive changes in the domestic legislation. The bilateral tax treaty signed with Spain is analyzed hereunder.

Foreign judgments are given full enforcement through the Superior Federal Court (formerly through the Supreme Court), and no review on the merits is required. Foreign arbitration is also given full credit.

### Intellectual property considerations. The New Patent law.

Brazil was always well provided with patent laws of complex technical and legal consequence. Fourth country in the world to enact a patent law (in 1809), it was a founding member of the Paris Convention in 1882 and remained a full-fledged party to such treaty since then. Patents received Constitutional acceptance in the first Imperial Charter of 1824, and further Republican Constitutions provided for patent protection (and eventually, trademarks) in their Bill of Rights.

Multilateral considerations were of course present during all the lengthy Congressional proceedings leading to the new law, in force since May 15, 1997. Harmonization procedures held by the World Intellectual Property Organization in Geneva and, especially, the negotiation of the Uruguay Round of GATT had brought to the field of intellectual property the concept of *international minimum standards*, substantive requirements on the content of national laws.

The 1994 successful end of the Uruguay Round and the new (TRIPs) Agreement under World Trade Organization established the minimum standards requirement as the applicable legal criterion. Law 9.279 is obviously intended to fulfill TRIPs required levels.

Normal patent term expires in 20 years counting from filing date, or 15 years in case of utility models; but it is assured a minimum of 10 or 7 years respectively, counted from issuance of letters patent, except if INPI (the Brazilian Patent and Trademark Office) was prevented from examining the application by court order.

In the prior law, design creations were treated as patents and subjected to the same procedures. The new Code grants registration as required for design patents, but substantive examination may be requested at any time thereafter, by owner or by any third party. Designs are subjected to a 5-year fee requirement on a 10 year term (plus three extensions of 5 years, if required). No working or compulsory licensing requirement is imposed.

#### Other intellectual property rights

No sound, scent or touch trademarks in Brazil. Only visually perceptible signs are allowed, in trade or service flavors. The new law also provides for certification and collective marks.

Trade and service marks are protected by 10 year terms, always renewable. They may be transferred and licensed, but a transfer must include all similar signs, which could not originally be registered in the name of third parties. Licenses and transfers must be registered with INPI in order to affect third parties.

Registration is denied in all the cases where other foreign law standards apply: basically, a) where a prior registration or application is found; b) where the claimed words or images are in public domain; c) where the rights of third parties could be infringed by the registration, or d) where the words or images or combination thereof are misleading to the public or otherwise contrary to the rules of fair competition. An extensive list of cases is included in art. 124 of the law, with all the exceptions and details ruled.

Copyright is fully protected under a new law, published in February 1998, and software

protection is all covered by a new specific statute. Both laws considerably enhanced the protection of owners and creators. Brazil is a member of the Washington Convention on Semiconductor Chip Protection. Plant patents are protected by a law published in 1997.

Since 1986 improved anti-piracy provisions and programs were enforced in the video, recording and software markets. Albeit the counterfeiting industry has not been altogether abolished, it is far less significant than in most third world countries.

### Transfer Pricing

Transfer pricing is a transfer or inter-company price set by a taxpayer when selling to, buying from, or sharing resources with a related person.<sup>1</sup> A transfer price is usually

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<sup>1</sup> Related Persons (art. 23 of Rule 9.340/96) includes any legal entity or person resident or domiciled outside Brazil whose capital stock characterizes its controller or affiliate as defined pursuant the Brazilian corporation law among others Law 6.404/76 – Brazilian Corporation Law – art. 243 §1º Affiliates are companies that one participates with 10% (ten percent) or more without having control of the company in the other; § 2º Controlled companies are companies in which another company detains the direct or indirect control of the first company that permanently grant the majority in the corporate decisions and the power to elect the majority of the management.

Also, the federal receipt in a extensive list of what would be considered related persons (combining Rule 9.340 and IN 243, as so establishes:

“Será considerada vinculada à pessoa jurídica domiciliada no Brasil:

- 1) a matriz desta, quando domiciliada no exterior;
  - 2) a sua filial ou sucursal, domiciliada no exterior;
  - 3) a pessoa física ou jurídica, residente ou domiciliada no exterior, cuja participação societária no seu capital social a caracterize como sua controladora ou coligada, na forma definida nos §§ 1º e 2º, art. 243 da Lei nº 6.404, de 15 de dezembro de 1976;
  - 4) a pessoa jurídica domiciliada no exterior que seja caracterizada como sua controlada ou coligada, na forma definida nos §§ 1º e 2º, art. 243 da Lei nº 6.404, de 15 de dezembro de 1976;
  - 5) a pessoa jurídica domiciliada no exterior, quando esta e a empresa domiciliada no Brasil estiverem sob controle societário ou administrativo comum ou quando pelo menos dez por cento do capital social de cada uma pertencer a uma mesma pessoa física ou jurídica;
  - 6) a pessoa física ou jurídica, residente ou domiciliada no exterior, que, em conjunto com a pessoa jurídica domiciliada no Brasil, tiver participação societária no capital social de uma terceira pessoa jurídica, cuja soma as caracterizem como controladoras ou coligadas desta, na forma definida nos §§ 1º e 2º, art. 243 da Lei nº 6.404, de 15 de dezembro de 1976;
  - 7) a pessoa física ou jurídica, residente ou domiciliada no exterior, que seja sua associada, na forma de consórcio ou condomínio, conforme definido na legislação brasileira, em qualquer empreendimento;
  - 8) a pessoa física residente no exterior que for parente ou afim até o terceiro grau, cônjuge ou companheiro de qualquer de seus diretores ou de seu sócio ou acionista controlador em participação direta ou indireta;
  - 9) a pessoa física ou jurídica, residente ou domiciliada no exterior, que goze de exclusividade, como seu agente, distribuidor ou concessionário, para a compra e venda de bens, serviços ou direitos;
  - 10) a pessoa física ou jurídica, residente ou domiciliada no exterior, em relação à qual a pessoa jurídica domiciliada no Brasil goze de exclusividade, como agente, distribuidora ou concessionária, para a compra e venda de bens, serviços ou direitos.
- Para efeito do item 5, considera-se que a empresa domiciliada no exterior estão sob controle:
- societário comum, quando uma mesma pessoa física ou jurídica, independentemente da localidade de sua residência ou domicílio, seja titular de direitos de sócio em cada uma das referidas empresas, que lhe assegurem, de modo permanente, preponderância nas deliberações sociais daquelas e o poder de eleger a maioria dos seus administradores;
  - administrativo comum, quando:
    - 1) cargo de presidente do conselho de administração ou de diretor-presidente de ambas tenha por titular a mesma pessoa;
    - 2) cargo de presidente do conselho de administração de uma e o de diretor-presidente de outra sejam

contrasted with a market price, which is the price set in the marketplace for transfers of goods and services between unrelated persons. Unless prevented from doing so, related persons engaged in cross-border transactions can avoid the income taxes of a country through their manipulation of transfer prices (due to tax havens and/or affiliates).

Tax authorities attempt to adjust the transfer prices set by related persons or due to tax havens so the country collects its fair share of tax revenue from economic activities conducted within its borders and to prevent other countries from obtaining an unfair share of the tax revenue on income derived from cross-border transactions through overly aggressive enforcement of their transfer pricing rules.<sup>2</sup>

Brazil has adopted since 1997 a transfer pricing legislation which requires that any exportation or importation of goods or services to or from related parties are subject to minimum or maximum profit, as the case may be. Brazilian Transfer pricing rules are Income Tax (and certain Income Tax-like) rules and affect such cases (affected cases).<sup>3</sup>

According to the Brazilian Law, the rules regarding transfer pricing must be obeyed:

- (i) By persons or legal entities, resident or domiciled in Brazil that negotiate with related persons or legal entities, resident or domiciled abroad, even if the business is intermediated by a third party<sup>4</sup>; or
- (ii) By persons or legal entities, resident or domiciled in Brazil that negotiate with related or unrelated persons or legal entities, resident or domiciled in a country where the income is taxed in less than 20% and where there is secrecy regarding

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exercidos pela mesma pessoa;

3) uma mesma pessoa exercer cargo de direção, com poder de decisão, em ambas as empresas.

Na hipótese do item 7, as empresas serão consideradas vinculadas somente durante o período de duração do consórcio ou condomínio no qual ocorrer a associação.

Para efeito do item 8, considera-se companheiro de diretor, sócio ou acionista controlador da empresa domiciliada no Brasil, a pessoa que com ele conviva em caráter conjugal, conforme o disposto na Lei nº 9.278, de 10 de maio de 1996.

Nas hipóteses dos incisos 9 e 10:

1) a vinculação somente se aplica em relação às operações com os bens, serviços ou direitos para o quais se constatar a exclusividade;

2) será considerado distribuidor ou concessionário exclusivo, a pessoa física ou jurídica titular desse direito relativamente a uma parte ou a todo o território do país, inclusive do Brasil;

3) a exclusividade será constatada por meio de contrato escrito ou, na inexistência deste, pela prática de operações comerciais, relacionadas a um tipo de bem, serviço ou direito, efetuadas exclusivamente entre as duas empresas ou exclusivamente por intermédio de uma delas.”

<sup>2</sup> Business with related persons or an intermediary resident or domiciled abroad importation and exportation of assets, services and right, interest paid, received or credited in financial operations deriving from an agreement not registered before the Central Bank of Brazil.

<sup>3</sup> Imposto de renda and contribuição social sobre o lucro líquido. (arts. 18, 19, 22, 24 e 28 da Lei nº 9.430/96, e IN SRF nº 243, de 2002).

<sup>4</sup> IN SRF nº 32, 2001, An intermediary is a *trading company* a legal entity domiciled abroad or in Brazil that intermediates business between related persons and that acts exclusively as agent, retail seller or grantee for acquisition and sale of assets, services or rights and will be considered as related to the legal entity domiciled in Brazil according to art. 2º d, IX and X of IN SRF nº 32, 2001.

the individuals that are partners to the legal entities.<sup>5</sup>

If there is a difference between the average of the prices for which the company acquired or sold a certain product or service, or effected financial transactions, during one fiscal year (considered December 31st or the end of the activities of the company) and the average practiced arms length as established by the law, such difference will be added to the amount in which the income tax and the net profit charge will incur, with some exceptions established by the law. Transfer pricing as such does not affect licensing of Intellectual Property items.<sup>6</sup>

Brazil has also separate standard Custom Administration rules on imports of physical goods dealing on tax basis, which will deem the market value for such goods if the disclosed prices are not compatible with the market.

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<sup>5</sup> Ato Declaratório 110 SRF includes the following countries in the list: Liechtenstein, Cyprus, Bahrain, Bermudas, Barbados, Panamá e Costa Rica; (...) and the following places in the UK: Gibraltar, Channel Islands (Jersey and Guernsey) e Turks and Caicos Islands; and Madeira Island (Portugal).

<sup>6</sup> The following operations are analyzed to verify if there is problems of transfer pricing: a) import or export of assets, services or rights, b) interest paid, received or credited in financial operation when deriving from agreements not registered before the Central Bank.