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FRAGA, BEKIERMAN E PACHECO NETO - ATTORNEYS AT LAW

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The Contribution for Intervention in the Economic Domain to Finance the Program to Support the Interaction Company-University (“CIDE”) – Modifications on this Tax levied on Remittals for paying services and royalties.

By Roberto Bekierman *

Since its inception pursuant to Law NR 10168, of 29 December 2000, CIDE has experienced several changes. Firstly it was assessed on payments made to persons or entities domiciled abroad in connection with technology transfer agreements executed with them, i.e., contracts involving the exploration of patents, use of trademarks, supply of technology and technical assistance.

When CIDE was implemented, the withholding income tax rate on such currency remittances had been just increased from 15% to 25%, and would be cut back to 15% when CIDE became effective. Considering that the CIDE rate is 10%, the tax burden apparently would be unchanged. This did not come true, however, for the beneficiaries resident abroad.

Persons or entities domiciled abroad – whether in countries which are parties to Double Taxation Avoidance Treaties with Brazil (“Treaties”) or in countries that allow the credit of income tax paid in the income source country – were forbidden to take credit of the amount of CIDE paid in Brazil. Firstly, because the Treaties and the international reciprocity provisions only include the income tax, and, secondly, because Brazilian legislation established that the CIDE taxpayer is the sender and not the beneficiary of the remittance. The tax burden of the beneficiary thus became substantially higher.

With Law 10332, of 19 December 2001, in force since 01 January 2002, the lists of taxable events and taxpayers of CIDE were extended. In fact, Article 6 of that Law gave a new wording for §§ 2 and 3 of Article 2 of Law 10168/00, as follows:

“§ 2. After 01 January 2002, the contribution mentioned in the caption of this Article becomes due also by the legal entities that executed technical assistance agreements, administrative assistance agreements, and service agreements with a similar purpose to be rendered by residents or domiciled abroad, and is due also by the legal entities that pay, take credit, deliver, employ or remit royalties, in any instance, to beneficiaries who are resident or domiciled abroad.

§ 3. The contribution shall be charged on amounts paid, credited, delivered, employed or remitted each month to residents or domiciled abroad as remuneration arising from obligations set forth in the Caption and in Paragraph 2 of this Article.”

This wording elicits some legitimate questions. We can foresee that the tax authorities will try to assess CIDE on every remittance abroad referring to payments of royalties and services of any kind. The former wording only imposed CIDE on payments resulting from agreements that must be filed at the National Institute of Industrial Property – INPI, but, currently, in the absence of a legal definition of “technical and administrative assistance services” that do not involve transfer of technology, it becomes almost impossible to distinguish these services from others which are not subject to CIDE assessment.

Would financial services be included in “technical and administrative assistance”? What about legal services? And royalties? The International Conventions to Avoid Double Taxation consider copyrights payments as royalties. However, the domestic income tax legislation clearly distinguishes the concepts: in Brazil, for instance, payments for literary, software and film licenses have all copyright nature. It seems that the taxable event of CIDE does not include these licenses, and therefore CIDE is not owed in payments abroad concerning what the domestic legislation considers “copyrights”, even if the beneficiary is domiciled in a country which is a party to any of the Conventions. As noted, CIDE is not subject to regulation by a Convention, but rather by domestic legislation.

Some taxpayers are challenging the constitutionality of CIDE based on the failure of the Brazilian Congress to introduce it by a “Complementary Law”. There is at least a case decided to the benefit of the taxpayers by the Federal Appellate Court of the 3rd. Region (States of São Paulo and Mato Grosso do Sul). Nevertheless, the Federal Supreme Court, when judging the Additional Tax to the Ports Prices (“Adicional da Tarifa Portuária – ATP”) and the Additional Tax of Freight Prices for the Refurbishment of the Merchant Navy (“Adicional de Frete para a Renovação da Marinha Mercante – AFRRM”) ruled that these taxes had the nature of a contribution of intervention in the economy but did not need to be introduced by a “Complementary Law”. It must be clear though that these decisions of the Supreme Court did not analyze the issue in its full spectrum and one of the judges mentioned his understanding in favor of the taxpayers.

For these reasons, any challenge of CIDE might be fully analyzed in a case-by-case basis. There are strong reasons to understand that some remittals are not taxable, due to the fact that the taxpayer or the taxable event is not expressly established. On the other hand, even though there are juridical reasons to challenge CIDE in a broader basis, there is still no solid jurisprudence to support it.

*** partner at the Rio de Janeiro offices**

News

Politics

The President-elect reiterates that no international agreements will be broken and that the institutional order will be maintained.

The election of leftist candidate Luiz Inácio Lula da Silva means that, for the first time, Brazil will be governed by a traditional leftist party– the Partido dos Trabalhadores PT (Workers' Party). Lula was elected after having unsuccessfully run for office three consecutive times over a period of 13 years.

His trajectory is reminiscent of that of the late French socialist president, François Mitterrand, who was elected in 1981, during his third presidential campaign. The flagrant difference is that Lula has only come into power by forging alliances with sectors that range from the most radical leftist elements within PT itself to conservative parties like the Partido Liberal – PL (Liberal Party), to which the Senator, José Alencar, the Vice President-elect, is affiliated.

In a political change of course similar to the modernization of the British Labour Party five years ago, Lula and PT leaders have abandoned the old dogmas of the left. They have adopted a conciliatory approach, established alliances with liberal and conservative sectors, and promised to maintain agreements made by the current government and economic stability, thus earning the voters' trust.

The most visible concern on the part of the market and investors in general is about the influence that the PT's most radical sectors may have on the new government. These fears, however, should not be blown out of proportion, given that Lula has been choosing the PT's moderate elements for his transition team and future ministerial positions, besides technical experts and members of other center parties that lent him support. In his first speech Lula already reiterated his campaign commitments concerning austerity, fiscal responsibility, observance of the current government's agreements, inflation control and the fight against corruption.

Lula also announced the implementation of import substitution programs. That's good news for national entrepreneurs and for the foreigners who settle here. The goal is to generate jobs and to improve the trade balance, which should reach significant surplus this year already.

The moderate tone of the PT government will also be set by its relationships with the opposition. Lula must not expect much cooperation from the states – the PT only managed to get 3 governors elected, all of them in states of weak national expression (Acre, Piauí and Mato Grosso do Sul). Important states such as São Paulo and Rio de Janeiro voted for continuity in their local governments – São Paulo reelected the PSDB candidate Geraldo Alckmin, from the same party as the current president Fernando Henrique Cardoso, and Rosinha Garotinho, wife of the last elected governor, was elected in Rio de Janeiro.

In Congress, the PT is far from obtaining the majority, even when the alliances with other leftist parties are taken into account. For that reason, it will only manage to get the reforms it has been preaching approved if it forges alliances with more traditional center parties like the PMDB, PFL and PSDB.

The task is even more complex due to the extension of the Brazilian Constitution, which covers such widely different themes as the environment, tax and social security systems, labor rights, urban policy and the organization of the Powers. The Constitution is systematically blamed for restricting

governmental policy and can only be amended with 3/5 of the votes from of each of the Houses – Congress (House of representatives and the Senate), in two terms each. As the budget is already assigned to some compulsory expenses, the new President has less than 20% maneuvering space for handling expenditures. If he immediately fulfills his promise to increase minimum wages and retirement pensions, there will not even be 10% left of the budget to invest.

No doubt, the Brazilian constitutional structure and the fragmentation of political representation resulting from these elections will restrict the new president's field of activity. On the other hand, there is the relief of knowing that our democratic institutions will be respected and that changes will be filtered by a pluralistic Congress and an independent Judiciary System.

TV and Radio Broadcasting

The Government announces the bidding for TV and Radio Broadcasting under the new rules

The Brazilian government announced the public tendering procedure for the concession of seven television channels and fourteen radio stations in frequency modulation (FM). It is the first concrete step towards a constitutional amendment that would allow the introduction of foreign capital into the country's media sector, with up to 30% interest. The procedure is being conducted by the Ministério das Comunicações (Ministry of Communications) and the announcement of the bidding process was published on October 18th in the Federal Official Gazette. Before the constitutional amendment's approval, only Brazilian-born citizens and Brazilian citizens who have been naturalized for more than ten years could own newspapers, magazines and TV and Radio Stations.

Oil & Gas

The Banco Nacional de Desenvolvimento Social – BNDES (National Bank for Social Development) and the Agência Nacional de Petróleo - ANP (National Oil Agency) sign agreement

On 10.03.2002, the BNDES and the ANP signed an agreement for the purpose of encouraging joint actions for developing the oil and natural gas sector, and to increase its ability to compete internationally. The sector covers the whole domestic production chain, which includes the extraction, production, refining, distribution and resale of oil and natural gas, and related suppliers of machinery, equipment, materials and services.

The studies will search for credit mechanisms capable of stimulating the formation of Brazilian companies in the sector of oil extraction and production. The importation of machinery and equipment in this sector is estimated at US\$ 3.5 billion a year. However, half these goods could be made in Brazil. A model will also be constructed for a certification system for national machinery, equipment and services related to the oil and natural gas industry, with the goal of meeting the obligation of a minimum percentage of local purchases established in ANP concession agreements. The system will be assembled based on a nationalization index methodology.

Note that the Brazilian Federal Constitution considers foreign companies in Brazil to be national and, therefore, they have equal access to credit lines from the BNDES. With the expected expansion of regulations for import substitution, the competitive advantage of the companies that install themselves here should increase considerably.

Petrobrás finalizes the purchase of Perez Companc

Last October 17th, Petrobrás announced the conclusion of the purchase of a 58.62% stake in the Argentine company Perez Companc S.A., the largest independent oil company in Latin America.

Petrobrás showed a keen sense of opportunity by acquiring valuable assets at a good price due to the crisis in Argentina. The acquisition is likely to create new business opportunities in the neighboring country for companies established in Brazil – especially those that already nurture partnerships with Petrobrás.

The New RJ-SP Pipeline Will Cost US\$1.1 Billion

Petrobrás will invest US\$ 1.1 billion to link the Campos Basin (RJ), Brazil's biggest oil producing region, to São Paulo, the country's largest consumption center. The 725-kilometer pipeline is scheduled to begin operating in mid-2005.

The project includes an offshore platform to pump the oil from the sea to the continent. The company's objective is to reduce the dependency on ships to transport oil to São Paulo, thus reducing environmental risks and problems caused by storms and the excessive number of vessels traveling the routes used to transport production.

The tender for the platform's construction will be released at the end of the month. The company is studying the possibility of having part of the equipment supplied only by Brazilian firms.

Logistics and transport

Ribeirão Preto Airport

The privatization of Ribeirão Preto Airport is likely to progress normally during the next government. Despite the region's economic importance (Ribeirão Preto has approximately 1.5 thousand factories installed) and its location (391 kilometers away from the Port of Santos, the main port in Latin America, and 319 kilometers away from the city of São Paulo), the airport supports domestic flights only and does not have the infrastructure as yet to handle air cargo, having only the airlines' small cargo terminal. The expansion, internationalization and privatization of the airport have been judged feasible by the Secretaria dos Transportes do Estado of São Paulo (São Paulo State Department of Transport), and the project has already been authorized by the Comando da Aeronáutica (Air Force Command). The privatization was also submitted to the State Privatization Program (PED) and was approved. Two factors conspire in its favor – the project has the support of the State Governor (reelected) and the Mayor of Ribeirão Preto **Antonio Palocci**, who belongs to the PT's upper echelons and is currently being considered for an important ministerial position.

São Paulo Railroad Bypass Budgeted at US\$500 Million. Other roads studies are on the way.

Federal Government has authorized studies for the construction of São Paulo's US\$500 million, 112-kilometer railroad bypass.

The group that will conduct the studies is comprised of representatives of the office of the president's chief-of-staff and the transportation, planning, finance and development ministries. They have 90 days to elaborate a study on the project's financial model and structure.

The bypass will improve the operations of the port of Santos, which handles 50% of the country's cargo. The president also signed a decree authorizing the National Department of Transport Infrastructure (DNIT) to initiate the bidding process for the widening of a 30-kilometer stretch of the BR 101 Highway between Rio de Janeiro to Sepetiba. The idea is to ease the flow on the highway, which is congested by tourist traffic, improve the conditions of one of the escape routes from the Angra dos Reis nuclear plant and ease the flow of products leaving or reaching the port.

The DNIT was also authorized to conduct studies on the environmental impact of Rio de Janeiro's Arco Rodoviário (Highway Arch) that will link the BR 101, BR 116 (Dutra) and BR 040 highways. According to the government, the highway arch will improve the transportation of heavy cargo in urban areas and the flow of production to Sepetiba.

Electric Energy

More Lines Included in the National Privatization Program

President Fernando Henrique Cardoso authorized the inclusion of 16 new power transmission lines in the National Privatization Program (PND). The lines are part of the Interconnected Electric System. The National Electric Energy Agency (Aneel) will be responsible for auctioning the concessions. Most of the projects are concentrated in southern Brazil, but there are also lines in most of the other Regions of the Country ranging from 230 kV to 500 kV

Water and Waste Water

Insufficient water supply and sewage disposal is attracting private investment.

Of Brazil's 5,500-plus municipalities, in 3,700 the water and basic sanitation services are provided by state companies operating under a concession from the municipality. In the remaining 1,800 municipalities, these services are the responsibility of municipal authorities or municipally owned companies, some of which are up for privatization. Around 91% of the country's total population has access to treated water, 53% to sewage disposal and only 13% to sewage treatment. Improvement requires investments around US\$30 billion in coming years. Annual sector billings are projected at US\$4.5 billion.

Get to Know Brazilian Institutions

The National Electrical Energy Agency - ANEEL

Background

The national electric power agency (Agência Nacional de Energia Elétrica - Aneel) was created in 1996 as the first regulatory agency to be set up under the government's new role in privatized public services.

After absorbing the functions of the national department of waters and power (Departamento Nacional de Águas e Energia - DNAEE) in the same year, Aneel embarked on its principal mission of transforming a government energy monopoly into a free market by the year 2005.

As a result of the privatization program, by the year 2000 more than 60% of the country's distribution network and around 13% of its generating power were in hands of the private economy.

Aneel decides the fate of hydroelectric generating plants, using the following basic rule for potential installed capacity of any site:

- Over 30MW – A public auction in which both construction and operation will be the subject of single long-term concession package.
- Under 30MW – Aneel can grant a simple authorization.

Plans call for a free spot market to be in operation by 2003, under the control of an independent, privately run, wholesale energy exchange (Mercado Atacadista de Energia – MAE). This body will include the most representative members of the sector, including generating and distribution concessionaires, major consumers, independent power generators and brokers. MAE will be the principal exchange for the selling and buying of electric power and responsible for registering contracts as well as providing real time information on the spot market.

Operational control over the electric power system has been given to the national system operator (Operadora Nacional de Sistemas – ONS) a private control organ which a membership structure similar

to that of MAE and the authority to determine – according to predefined rules – which generating plants shall run at any given moment.

The ONS will also recommend regulations and goals for study and implementation by Aneel.

Aneel is structured fundamentally to evaluate service goals. It has a staff of 325 employees with specialists in various areas. The organization has four directors, a customer relations department, a legal representative and 20 superintendents. José Mario Miranda Abode is the director-general

The head office is in Brasilia and there are Delegate Agencies in the states of Bahia, Ceará, Pará, Rio Grande do Norte, Rio Grande do Sul and São Paulo responsible for monitoring the sector.

Functions

- Implement government policy and directives on electric power development and the use of hydraulic resources, and issue the appropriate regulations;
- Regulate and monitor the production, transmission, distribution and sale of electric power;
- Authorize the use of hydraulic resources for power generation; also the purchase, sale, importation and exportation of electric power;
- Ensure the quality of services offered;
- Maintain fair trade practices and reasonable tariffs while ensuring that suppliers can receive a proper return;
- Monitor power plant construction by distributors to ensure that they provide at least 30% of their own expected increase in demand;
- Ensure that the concessionaires, and new projects, comply with environmental legislation.

Important legislative steps

- **Law N° 8,987 of 13/12/1995** - Defines basic service requirements, rights and obligations of consumers, tariff policy, auction requirements, concession contracts and the rights and obligations of those who provide a public service.
- **Law N° 9,074 of 07/07/1995** - Establishes guidelines to grant public service concessions and the conditions to become an independent power producer (Produtor Independente de Energia - IPP).
- **Law N° 9,427 of 26/12/1996** - Creates the regulatory agency, defines its organization, financing and goals and establishes the fiscal responsibility of public power services.
- **Decree N° 2,655 of 02/07/1998** - Stipulates the rules and methods to be followed by the electric power exchange (Mercado Atacadista de Energia - MAE) for the relocation of power supply.
- **Decree N° 2,655 of 02/07/1998** - Creates a private entity (Operador Nacional de Sistemas - ONS) to coordinate and control electric power production and distribution within an intergrated system.

Targets

Distribution companies must produce 30% of the power that they sell;

- São Paulo State distribution concession contracts require improvements in the distribution lines, transformers and the quality of services offered, and
- The generating plant concession contracts set investment targets for plant and other improvements.