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# ***New Brazilian Provisional Measure revokes the Transitional Tax Regime and amends rules on goodwill amortization***

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## ***In brief***

On November 12, 2013, the Executive Branch of the Brazilian government published Provisional Measure No. 627 (PM 627/2013), which, among other provisions, revokes the Transitional Tax Regime (RTT) and provides new rules regarding dividends, interest on net equity (INE) and the amortization of goodwill arising in connection with share acquisitions. We summarize below the primary items that merit focus by multinationals with investments in Brazil.

In addition to these changes, we are currently evaluating the possible impact of certain other modifications that are included in PM 627/2013, particularly as they relate to the Brazilian government's efforts to align local tax rules with the Brazilian IFRS accounting standards and others regarding the taxation in Brazil of profits from foreign controlled or affiliated companies (CFC rules). We will publish separate Newsalerts on these topics as appropriate.

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## ***In detail***

### ***Background: Normative Instruction No. 1,397 (NI 1,397/2013) versus PM 627/2013***

In September 2013, the Brazilian Revenue Service (RFB) issued NI 1,397/2013, which provided new regulations relating to the RTT. NI 1,397 broadly provided that, among other items, calculations of tax-exempt distributable dividends and tax-deductible INE expenses should be based on balance sheet equity balances determined using accounting principles that were in force

until December 31, 2007 (Tax Balance Sheet). In this regard, the portion of a dividend paid to a non-resident beneficiary that exceeds the dividend amount calculated in accordance with the Tax Balance Sheet approach would be subject to a 15% income tax withholding (25% if the beneficiary were located in a tax haven jurisdiction). Furthermore, the portion of INE paid that exceeds the INE amount calculated in accordance with the Tax Balance Sheet approach would no longer be deductible for Brazilian income tax purposes.

NI 1,397/2013, which reinforced the Brazilian tax authorities' position on the use of a Tax Balance Sheet for these purposes, has generated extensive debate locally.

PM 627/2013 provides that dividends paid by November 12, 2013 out of earnings that accrued between January 1, 2008 and December 31, 2013, and that exceeded the amount of dividends that would have been distributed using the Tax Balance Sheet approach, will not be subject to Brazilian income tax. Similarly, INE that was paid with respect to the same 2008-

2013 period and that exceeds the Tax Balance Sheet amount would be fully deductible for Brazilian income tax purposes. Note that PM No. 627 only applies to earnings that have been distributed prior to November 13, 2013. As such, this may not resolve the ongoing debate regarding the applicability of the NI's provisions to future distributions.

While these new rules included in PM No. 627 apply as of January 1, 2015, these two measures are only valid for legal entities that opt to apply the rules under PM 627/2013 for the 2014 calendar year.

#### ***Goodwill determination and amortization***

Pursuant to current legislation, upon a share acquisition, if the cost of the investment is higher than the net equity value of the acquired company, the difference must be booked as goodwill, the nature/economic reason of which must be properly documented in an appraisal report. As a general rule, the full amount of goodwill is typically allocated to future

profitability and amortized over a period of not less than five years.

PM 627/2013 provides new rules for the determination of the goodwill amount for Brazilian income tax purposes. In this regard, and in line with IFRS principles, the share purchase price must be allocated to: (i) the net equity of the acquired company; (ii) the fair market value of the net assets; and (iii) the goodwill attributable to future profitability, which is determined based on the difference between the purchase price and the sum of items (i) and (ii). As under current law, the goodwill amount may be amortized for Brazilian income tax purposes over a five-year period if the acquired company merges with the acquiring company.

Certain new requirements apply, including the preparation of an independent appraisal report supporting the value referred in the item (ii) above, which must be filed with the RFB or the Register of Deeds and Documents, and the maintenance

of documentation which demonstrates that the goodwill did not arise in connection with a transaction involving an exchange of shares.

These new goodwill amortization rules will become effective on January 1, 2015, although taxpayers may elect (irrevocably) to follow the new rules beginning on January 1, 2014. Taxpayers continuing to rely on the former goodwill amortization rules for acquisition transactions taking place on or before December 31, 2014 will have until December 31, 2015 to complete the merger of the target and acquisition entities.

#### ***The takeaway***

US multinational companies doing business in Brazil should evaluate these new rules carefully, especially if they have or will be engaging in share transactions that may generate goodwill, and that involve payments of dividends and interest on net equity.

### ***Let's talk***

For a deeper discussion, please contact:

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