

Tax as Competitive Edge in Brazil



SdM
Canadian & International Tax

Agenda

- Overview of Taxation
- Taxation: A Pricing Factor

Overview

- Developed treaty network
- Relatively sophisticated tax systems
- Application of treaty benefits
- Proposed recoverability of WHT if no presence

Overview

Challenges for Canadians

- High tax rates
- Withholding taxes (WHT) applied at large
- Value-Added Tax (VAT) may be non-conventional
- Multiple indirect tax regimes
- Costly transfers of employees to local subsidiary

Overview

Challenges for Canadians (continued)

- Barriers to entry, customs on services
- Central bank restrictions
- Difficult to repatriate capital
- High social security

Overview- Tax Data

Country	<u>Tax Rate (1)</u>	<u>WHT Applicable on Dividends (2)</u>	<u>WHT Applicable on Services (2)</u>	<u>Tax Treaty with Canada</u>	<u>Dividend WHT per Treaty (3)</u>	<u>Services WHT per Treaty (2)</u>
Brazil	34%	0%	15%-25%	Yes	0%	15%

(1) Composed of combination of three level of taxation

(2) Withholding Taxes applicable to services

(3) Lower of domestic and treaty rates. Rate shown assumes a wholly -owned subsidiary owned by a corporation

Overview

Withholding Taxes (WHT)

- WHT on services can be significant
- Request for proof of payment
- Ensure understanding and application of treaty
- Black list for tax havens
- Canadian Foreign Tax Credit (FTC) Regime
 - Competitiveness through use of FTC
 - Clients' request to share the FTC

Business Culture and Tax

- Significant presence of international players
- Significant import
- Brazilian are used to deal with WHT tax issues
- Large number of professionals advising Brazilian companies
- Grouping all non-residents under a common umbrella

Alternatives for WHT Recovery

- Exclude from the price
- Include cost in the price
- Use FTC as a cost reduction

FTC- Illustration

• Service Revenue Earned Offshore	\$100,000
• Plus Mark-Up	<u>\$17,647</u>
• Total Expense to the Payer	\$117,647
• WHT Tax (15%)	(\$17,647)
• Net Payment Made	\$100,000

FTC- Numerical Illustration

Without FTC	
Services Portion of Contract	\$100,000
Gross-up for WHT	\$17,647
Deduction(May not be permitted)	(\$17,647)
Total Revenues	\$100,000
Profit (=30%)	\$30,000
Tax in Canada (= 25%)	\$7,500
After-tax Cash	\$22,500
Taxes paid by You	\$7,500
Taxes paid by client	\$17,647

FTC- Numerical Illustration

With FTC	
Services Portion of Contract	\$100,000
Gross-up for WHT	\$17,647
Total Revenues	\$117,647
Profit (=30%) + WHT	\$47,647
Tax in Canada (= 25%)	\$11,900
Less: FTC	(\$11,900)
After-tax Cash	\$30,000
Taxes paid by You	\$0
Taxes paid by client	\$17,650

Factors impacting the FTC

- Local tax rate
 - High tax jurisdictions are favored
- Local FTC regime
 - Worldwide or Source
- Profit margin
 - No profit = No tax = No FTC
- Timing issue impact on cash flow

Conclusion

- FTC sharing part of Brazilian checklist
 - Be ready for the discussion
- A matter of principle
 - Lack of technical expertise
 - May jeopardize business relationships
- Pricing strategy
 - Predict FTC sharing in the pricing

Questions?

SdM

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