



Subsidiary Financing
Funding options and tax regulations

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Financial committee
Swedcham
April 15, 2010

PROFIT MIGRATION STRATEGY

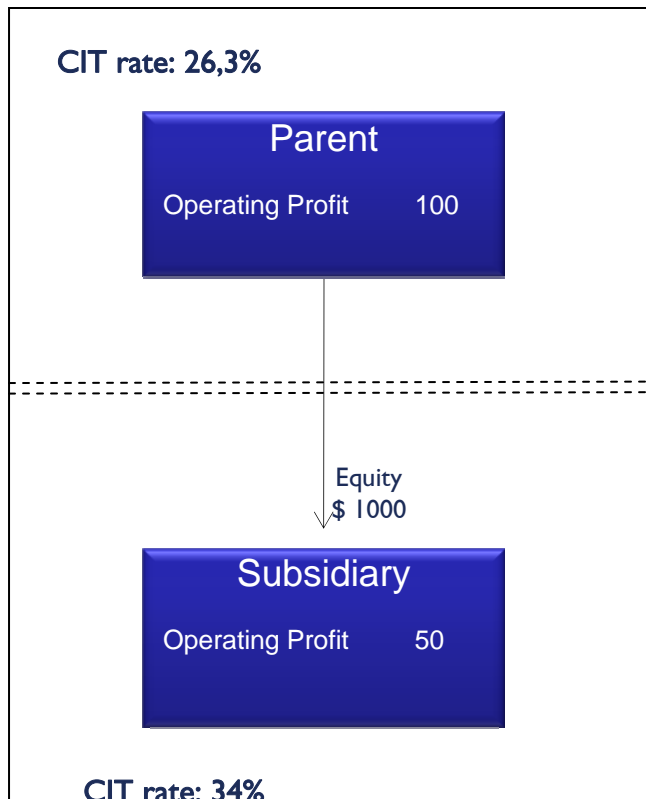
Transfer of profits generated in high-taxation jurisdiction to a lower-taxation jurisdiction



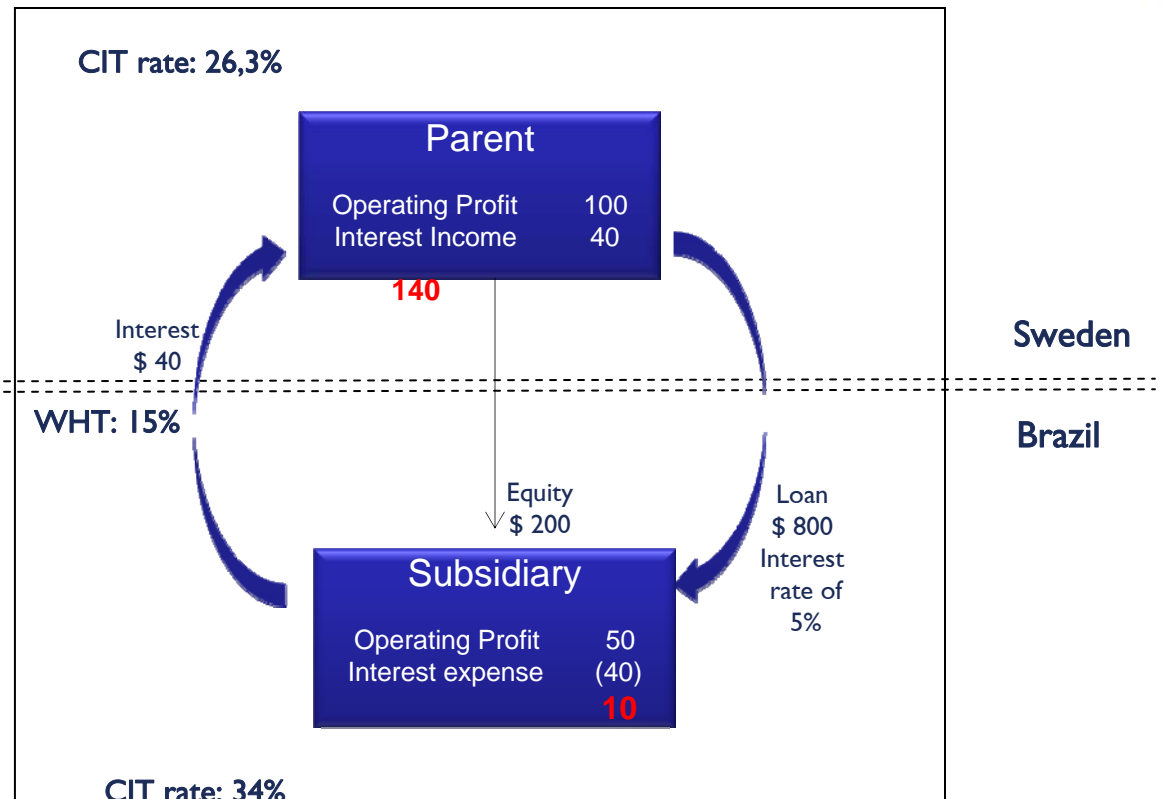
INTERCOMPANY LOANS

Intercompany loans as instruments for international tax planning

EQUITY



DEBT



CIT: Corporate Income Tax
WHT: Withholding Tax

EQUITY

Sweden	
Operating Profit	100
Taxable Income	100
Tax (CIT rate 26,3%)	26,3
Total tax revenue	26,3
Brazil	
Operating Profit	50
Tax (CIT rate 34%)	17
Total tax revenue	17

TOTAL TAX BURDEN	43,3
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DEBT

Sweden	
Operating Profit	100
Interest Income	40
Taxable Income	140
Tax (CIT rate 26,3)	36,82
Less credit for WHT	6
Total tax revenue	30,82
Brazil	
Operating Profit	50
Interest expense	40
Taxable Income	10
Tax (CIT rate 34%)	3,4
WHT	6
Total Tax revenue	9,4

TOTAL TAX BURDEN	40,22
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Before MP 472/09, two requirements to enable the deductibility of interest paid abroad:

1. Article 299 of the Brazilian Income Tax Regulations:

- General conditions required to assure the deductibility of expenses
- Expenses paid to “carry out the transactions or operations **required** by the company’s activities”

2. Transfer Pricing Rules:

- Arm’s length interest rate
- Libor + 3%, if the loan is not registered before the Brazilian Central Bank

MP 472/09 introduced a third rule: **Thin capitalization rule**

Thin capitalization rule
vs
Transfer pricing rule

Both are tax rules against evasion
Both affect the interest deduction limit paid to related parties
However,

TRANSFER PRICING

The arm's length interest rate

**Thin capitalization
rule**

Excess of debt in a subsidiary

Definition:

Thin capitalization rule aims to restrict the deduction of interest expenses, when the debt to equity ratio of the debtor exceeds certain **thresholds**.

Situations in which thin capitalization rules apply:

- Interest paid to related parties located abroad;
- Interest paid to entities located in a tax haven.

Thresholds in intercompany transactions:

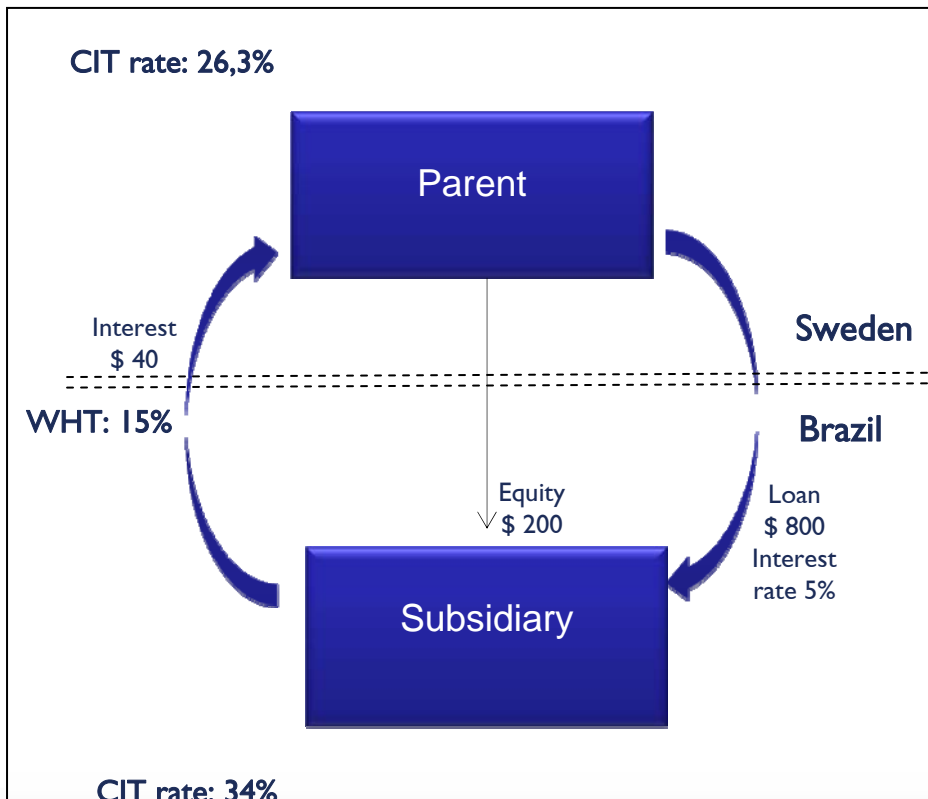
- (i) The debt-to-equity ratio of each related party cannot exceed twice (2:1) the value of the equity investment made in the Brazilian subsidiary; and
- (ii) The overall debt of the Brazilian subsidiary cannot exceed the same proportion (2:1) in relation to the amount of equity held by all related parties in it.

Threshold in transactions with entities located in tax havens:

- (i) The debt that the Brazilian subsidiary has with an entity located in a tax haven cannot exceed 30% of its net worth value.

Debt: All forms and terms of financing, whether the agreement is registered or not with the Central Bank of Brazil *.

*In transactions in which the guarantor (*avalista* or *fiador*), the attorney-in-fact (acting under a power of attorney) or any intervening party is a **related party**.



- Equity: 200 | 2:1 rule → 200 × 2 = 400
- Debt: 800 | 800 - 400 = 400

Interest rate of 5% = 20

The interest calculate over this “excess” shall be deemed as an unnecessary expense and consequently, no deductible for tax purpose.

Threshold

Excess

EQUITY

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TOTAL TAX BURDEN	40,22
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DEBT with TC

Sweden	
Operating Profit	100
Interest Income	40
Taxable Income	140
Tax (CIT rate 26,3)	36,82
Less credit for WHT	6
Total tax revenue	30,82
Brazil	
Operating Profit	50
Interest expense	20
Taxable Income	30
Tax (CIT rate 34%)	10,2
WHT	6
Total Tax revenue	16,2

TOTAL TAX BURDEN	47,02
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THANK YOU!

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