KPMG

Brazilian Oil&Gas Update

This publication aims to assist investors with gaining an understanding of the latest tax changes amid a bewildering economic and political scenario

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Oil & Gas industry updates

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The barrel low price has a negative impact on production, which requires high-cost operations; however, this scenario is likely to improve and investments tend to resume

Both economic instability and significant cutbacks in Petrobras' investment forecasts, which culminated in a broad revision of the contracts entered into with leading construction companies and equipment suppliers in Brazil, are some of the significant challenges that the Oil & Gas industry has to weather. In addition, another challenge posed to the industry is the price of crude oil barrel, which casts doubts on the pre-salt economic feasibility, as the production relies largely on high-cost deep water operations.

Despite the fact that short-term investment perspectives are limited as a result of this scenario, industry experts believe in the market recovery, even if such recovery occurs slowly, on account of existing installed capacity of key industries and the country's own natural resources potential. "It is important to bear in mind the number of pre-salt reservoirs located within Brazil and certified by international bodies. Additionally, the country already has the whole supply chain installed in its territory and it relies on the legal stability that protects concession agreements. Nationalization, terrorist activity or war risks that could spook investors are considered very low", says Anderson Dutra, Head of Oil & Gas Industry at KPMG in Brazil.

This guide is updated on a regular basis in accordance with the tax requirements impacting the Oil & Gas industry chain.

Dutra believes that two measures recently taken by the government can favor the resumption of investments. One of them is senator José Serra's bill, which should go through vote still this semester. This bill aims at terminating Petrobras' monopoly as the only pre-salt operator. This change would create opportunities for companies which have already participated in operations with Petrobras to further develop their activities in these reservoirs, thus enabling the former to win new partners and increase investments. The second measure taken is the flexibility of the rule concerning local content in the oil and gas chain.
As a result of the barrel low price, government signed in January a decree aimed at amending the policy for local content and assisting oil companies in meeting goals regarding the acquisition of goods and services in the domestic market. "These two measures may boost the Brazilian Oil & Gas industry and investors' confidence", he points out.

Practical measures

KPMG's industry Head stresses the vigorous process of corporate governance improvements taking place in companies' structures, in tandem with economic and political aspects that promote changes in the sector, thus providing the ones who invest in the country with a more favorable environment. "We are having hard times right now, but we are beginning to see the light at the end of the tunnel, and that is how we have been working with the industry", he says. This improvement is also contingent upon the efforts made by the companies to comply with the country's tax aspects, which are complex and undergo constant transformation. Last year,

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for example, was marked by the end of the Transition Tax Regime (Regime Transitório de Tributação - RTT), which granted companies tax neutrality for the period during they were adapting to the International Accounting Standards.

As a result of the new rules in legislation that lead to a number of adjustments in tax determination, KPMG releases the third edition of "A Guide to Brazilian Oil & Gas Taxation". This publication includes a description of the main taxes levied on the industry chain with the latest tax updates in the country. One of them addresses the change in taxation of income earned abroad. "An important particularity for the industry is the fact that companies with income earned abroad deriving from time or bareboat charter activities, operating lease, rent, asset loan or service directly related to the oil and gas prospecting and exploration, within the Brazilian territory, do not submit the income earned here in Brazil to taxation, states Julio Cepeda, Tax Partner at KPMG in Brazil.

The other change presented in the Guide is an additional measure impacting capital gains taxation. "A priori, this measure affects only Brazilian individuals; however, due to a technical matter, non-residents who currently make certain investments in Brazil may also be affected by such tax", explains Cepeda.

The publication also addresses eSocial (Sped), which basically consists of replacing physical bookkeeping with digital accounting bookkeeping. This guide is aimed at foreigner investors who intend to invest in the whole industry chain. This is why this publication also informs how the current legislation works. It also mentions the significance of the local content rules for companies that participate in the bidding rounds, as well as the general provisions for transactions performed in the country.

According to Cepeda, in addition to the aspects addressed in the guide, it is worth highlighting the fact that the market players stay alert to changes that may affect the industry in the near future; taking account of the usual and constant changing scenario to which Brazilian tax system subject.

KPMG's Tax partner also alerts to the possible impacts arising from the Declaratory Act signed by the government, which grants the status of privileged tax regime to the Netherlands, taking into account that many players operating in the industry hold companies located in such country. "The Netherlands have always been a very attractive country for investments due to its historical agreements entered into with other countries, both from the legal and tax perspectives, and to its already installed infrastructure, which ranges from its location within Central Europe, to its impeccable transportation logistics and easy adaptability, as the majority of its population masters the English language. Not to mention the country's educational system, which attracts various expatriates and their families. This change in status may prejudice some structures that have been ensuring an interesting return on investments made in the industry", adds Dutra, who worked for two years at KPMG's office in the Netherlands.

For a better visualization of the latest measures and possible changes that may occur, as well as the emergency implementation status of each one of them, check out the following infographic.

Implementation status

IN PROGRESS

*** Taxation on capital gains**
Pages 8 and 9 of the Guide

eSocial (Sped)
Page 45 of the Guide

ALREADY A REALITY

RTT
Page 13 of the Guide

Income taxation abroad
Pages 35 and 36 of the Guide

Goodwill
Page 38 of the Guide

The Netherlands' reclassification
Not yet included in the Guide

FULL ALERT TO FUTURE CHANGES

Repetro
Page 23 of the Guide

PIS/COFINS Unification
Not yet included in the Guide

CPMF
Not yet included in the Guide

Regulation

*Law 13259 has already been published; however, the date it will be in force is still being discussed.

Interview

Investment challenges in Brazil

What are the main challenges posed to investments made in Brazil?

Brazil, as any other emerging country, is sensitive to the worldwide volatility, and investment decision-making imply the analysis of suitable returns to such volatility. In addition, investment decision-making take into account the long-term return, and the uncertainty related to the economic environment also poses a challenge. This is so due to the fact that the economic environment, among other aspects, is determined by the tax regime in Brazil, which is constantly changing, thus lessening the certainty that investors have about their future returns. The uncertainty related to the regulatory labor regime also lessens the appetite for investments or expectations of higher returns, thus reducing the aggregate investment level.

What are the main differences between Brazil and other countries?

The main difference that I found between them is related to the high level of regulation on several economic aspects. It begins with a high level of regulation on imports foreign trade and payment installments, in addition to a tax system extremely complex and dynamic in the municipal, state and federal spheres. The regulation of labor laws also hinders flexibility when it refers to foreign changes.

Promotion

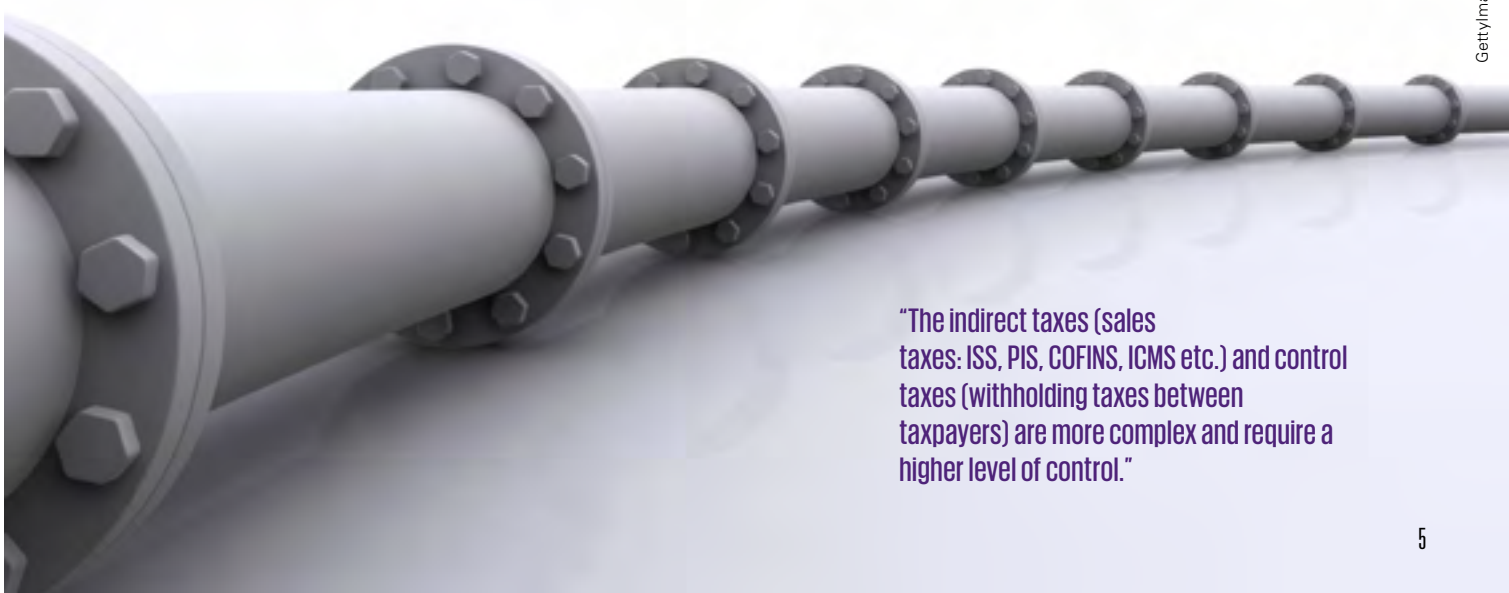
Victor Escalante
CIO at Fugro Brasil

Which aspects in the country require more improvements in terms to tax matters?

Taxes are obviously the matters that are constantly questioned and challenged by different stakeholders, but it is also our duty to understand that they have to enable the State to work properly. An efficient tax regime has to allow that taxpayers comply with the requirement at a minimum cost; otherwise, taxes will be more expensive at the top of explicit tax rate. While direct taxes (income tax) seem to be simple in terms of compliance, indirect taxes (sales taxes: ISS, PIS, COFINS, ICMS etc.) and control taxes (withholding taxes between taxpayers) are more complex and require a higher level of control.
Accordingly, indirect taxes and control taxes offers the opportunity to improve the tax regime.

In addition to the complexity posed by the tax regime, the ongoing changes pose a challenge to compliance with new regulations, which, in turn, results in higher costs. Unfortunately, changes in the tax regime are not always based on sound legal grounds, thus resulting in a high number of disputes between tax authorities and taxpayers, increasing uncertainty among taxpayers and reducing the amount of tax collection expected by the State.

A reduction in the number of modifications in the tax regime would be an opportunity to improve efficiency as a result of the decrease in the cost of changes, thus enabling the taxpayer to comply with requirements.



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