

THE INVESTOR'S HANDBOOK FOR RENEWABLE ENERGY IN BRAZIL

AN INSIDER'S GUIDE



REA CONSULT

Preface

Favorable geographic conditions, growing electricity demand, progressive regulatory reform, and maturing supply chains, have made Brazil one of the most exciting countries in the world for renewable energy investment.

According to Bloomberg's **2019 Climatescope report**, Brazil ranks third most attractive in the world for clean energy investments. Brazil also ranks third globally in terms of installed capacity from renewable energy sources, after only China and the United States, according to **IRENA** analysis. Despite this, Brazil only ranks 7th in the world for installed wind power capacity and 22nd for solar.

The real renewable power in Brazil comes from hydroelectric, where it is only second to China. Large hydropower plants account for around 80% of domestic electricity generation, providing flexible and low-emission base power supply. However, further expansion is constrained by the remoteness and environmental sensitivity of remaining hydropower resources.

As a result, reforms in the Brazilian energy market over the last decade have focused on diversifying the country's energy mix. While natural gas plays a role in this new power landscape, the key focus has been to promote the development of wind and solar power generation by creating the technical, socio-economic, and political conditions required to encourage investment.

Transmission capacity and technology have improved to account for intermittent supply, new financing mechanisms have been put in place to suit a wide range of projects, and more supportive regulation has been established. From 2017 to 2020 (ytd) the average annual installed capacity growth of centralized solar power was approximately 35%. In the same period, distributed solar power grew by more than 120% on average, benefiting from the world's most progressive net metering regulation. The more mature wind sector saw an average increase in

the generation capacity of 8% per year, while total wind capacity is expected to double between 2017 and 2024.

There is a famous saying here, we say that "Brazil is not for beginners". Despite reform, Brazil is still an emerging market with many of the inefficiencies and cultural hurdles

you would expect of a populous Latin American country. However, those who can navigate Brazil's dense legal and regulatory jungle will discover a renewable energy market that is brimming with potential. Since I began working in the renewable energy sector, I have seen markets peak and stall. The conditions are right, now is the time for Brazil.

The Investor's Handbook for Renewable Energy in Brazil has been developed by REA Consult to support that journey. It serves as an insider's guide for those developing projects renewable energy in Brazil and anyone curious about the inner-workings of this lucrative market. A new chapter will be released every week, all free to read and share. See all the chapters published so far and **follow the evolving story here**



Rachel E. Andalaft

Founding Partner at REA Consult

REA Consult is a management and consulting firm committed to building bridges for international sustainable investments. Born in Brazil with offices in Europe, Asia, and South America, REA Consult has a global track record of supporting successful projects.

4

TAXATION FOR RENEWABLE ENERGY VENTURES IN BRAZIL

BRAZILIAN TAXATION IS COMPLEX. INVESTORS MUST SELECT THE RIGHT TAXATION SYSTEM & BEWARE OF CUMMUALTIVE BURDENS WHEN PLANNING PROJECT EXPENDITURES

△ Actual & Presumed Profit

△ Tax System Comparison

△ Additioanal Taxes

△ Dividends & Foreign Captial



Taxation for Renewable Energy Ventures in Brazil

As discussed in more detail in Chapter 3, project companies and investment vehicles for renewable energy assets are commonly incorporated in the form of a Specific Purpose Entity (SPE) – the equivalent of a Special Purpose Vehicle (SPV).

These autonomous partnerships can adopt the same taxation system as any other corporation, including the compliance with all accessory obligations established by law. Thus, the SPE can adopt the systematics of Actual Profit or Presumed Profit, as discussed below.

However, the special system of *Simples Nacional* – Brazil's simplified taxation system for small and medium enterprises – which is widely used by Brazilian companies, presents

two impeditive factors that renewable energy ventures must adjust to:

- △ Firstly, according to the Federal Complementary Law 123/2006, which instituted the *Simples Nacional* does not apply to a subsidiary, branch, agency, or representative of a foreign corporation.
- △ Secondly, in the National Register of Economic Activity (CNAE), the option for the *Simples Nacional* is not allowed for activities related to the generation or transmission of electric energy, including solar energy.

Therefore, the best option for taxation systems for renewable energy projects often lies between Actual Profit and Presumed Profit.



Actual Profit

The comparison between the Actual Profit and the Presumed Profit systems is guided by the incidence of the following taxes:

- △ Corporate Income Tax (IRPJ)
- △ Social Contribution on Net Income (CSLL)
- △ Contribution to the Social Integration Program (PIS)
- △ Social Contribution on Billing (COFINS)

For the Actual Profit arrangement, in which there is no turnover ceiling, the IRPJ and the CSLL are calculated over the profit effectively earned, i.e. the Actual Profit, which is the net profit of the averaging period adjusted by additions, exclusions, or compensations prescribed or authorized by tax legislation.

This way, if the company verifies losses along the year, it will be exempt from the collection of these taxes.

For the PIS and the COFINS, as a rule, the non-accrual rule predicted by Law 10,637/2002 is adopted, in which the applicable aliquots are 1.65% for the PIS and 7.6% for the COFINS, both concerning revenue rather than profit.

Presumed Profit

The calculation of IRPJ and CSLL in the Presumed Profit system, as the names suggest, is done over a percentage stipulated by tax legislation and which has different values according to the company's activity. Hence, the profit verification does not interfere in the calculation of taxes.

In commercial activities, for instance, the Presumed Profit margin is 8% of the gross revenue. In service providing, the margin is 32%. Therefore, even if the company has obtained a higher profit margin, taxation will only reflect on the pre-fixed margin.

On the other hand, if the effective profit margin is lower than the pre-fixed one, the taxes mentioned above will also be calculated over the presumed margin.

In the cases of PIS and COFINS, the accrual rule is adopted, which means it is not possible to credit them in other operations. According to the current legislation, the applicable aliquots are 0.65% for PIS and 3% for COFINS, reflecting also on the revenues.

In this system, there is a turnover ceiling of R\$78 million a year. Moreover, the tax norm lists situations which prevent the adhesion to the Presumed Profit system, as in the case for commercial banks and investment banks, or when companies have profits, yields, or capital gains coming from abroad.

Comparison between the available systems: Actual Profit and Presumed Profit

As a general rule, the Brazilian taxation systematics does not make it easy to change the taxation arrangement. For that reason, the option for which taxation model the company should adopt is somewhat immutable in the country.

This way, once the taxation option is chosen, in order to change to a different system in the same calendar year, legislation ascribes the payment of a fine and interests on arrears to the company.

This means that, as a rule, the company must follow the taxation rules of the model which it adopted for at least one year. Because of that, analyzing and comparing the available systems is especially important for the company's planning.

To the companies that fit in the Presumed Profit's turnover ceiling and have high profits, the Actual Profit is not recommended (profit margin above the presumed). On the other hand, in case the prediction of profit is minimal, Actual Profit is the best option.

Another advantage of the Presumed Profit system is its simplicity, especially in what concerns obligations before Taxation Offices, decreasing expenses with accounting management.

In addition, as has been detailed, the aliquots of PIS and COFINS are lower in the Presumed Profit system, even though they adopt the accrual rule.

Now, in the Actual Profit system, one can benefit from the PIS and COFINS credits. Also, a great advantage that can be pointed out for this system is the possibility of compensating taxation losses in future fiscal years in which there is profit.

And, to finish, in both systems the additional collection of Income Tax (IRPJ, or simply IR) may happen through an aliquot of 10% over the profit part that exceeds the value of multiplying R\$20,000 by the number of months in the averaging period.

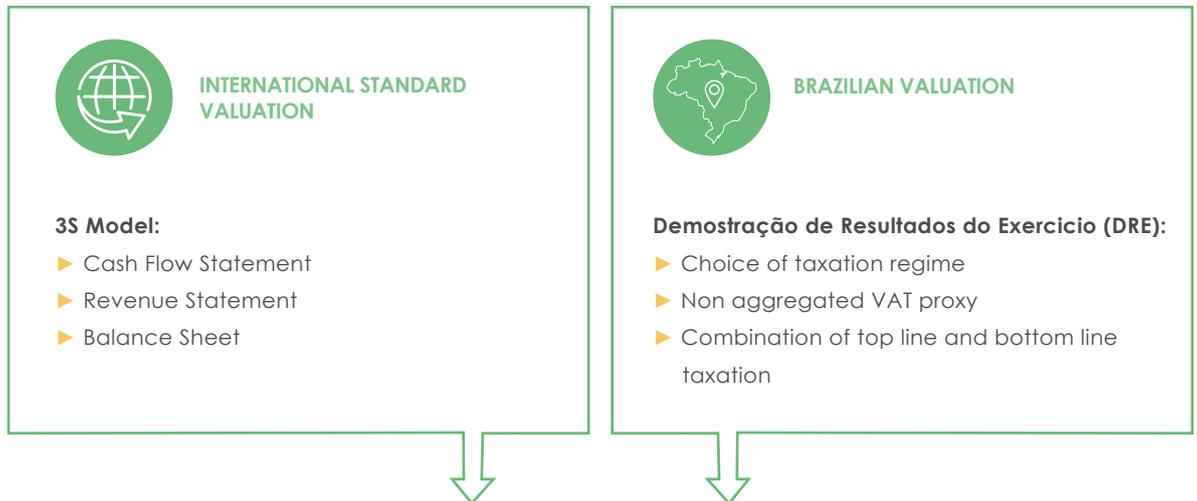
Comparison Table Between Taxation Systems: Actual Profit And Presumed Profit

	ACTUAL PROFIT	PRESUMED PROFIT
Turnover Ceiling	Non-existent	R\$78 million/year
Main Feature	The verification is based on actual profit ¹	The verification is made according to a legally predicted percentage over the revenues
Examples of Deterrents	Non-existent	Are not allowed to adopt Presumed Profit the companies ² : <ul style="list-style-type: none"> △ Whose activities include commercial banks, investment banks, etc.; △ Which had profits, yields, or capital gains coming from abroad
IRPJ and CSLL Aliquots	IRPJ: 15% IR additional: 10% over the actual profit part that exceeds the value of multiplying R\$20,000 by the number of months in the averaging period CSLL: 9%	IRPJ: 15% IR additional: 10% over the presumed profit part that exceeds the value of multiplying R\$20,000 by the number of months in the averaging period. CSLL: 9%
Calculation Base for the IRPJ and the CSLL	Actual Profit or Tax Profit	Profit percentage estimated over the revenues: Industry and Commerce: 8% for the IRPJ and 12% for the CSLL; Services: 32% for both the IRPJ and the CSLL
Verification of PIS/ COFINS	Non-accrual modality PIS: 1.65% over the revenues COFINS: 7.6% over the revenues	Accrual modality PIS: 0.65% over the revenues COFINS: 3% over the revenues
Advantages	Compensation for tax loss; Since it considers the company's actual profit, it has a fairer taxation system; Takes advantage of PIS and CONFINS credits; The profit verification can be done monthly, quarterly, or annually, whichever is more appropriate for the business strategies; In case of tax loss, tax contribution is not mandatory.	It is a simpler, less bureaucratic taxation system than the Actual Profit; When the company's actual profit is higher than the presumed profit, the calculation of taxes considers the latter; Tax obligations are less complex, so accounting management does not require as much detailing; PIS and COFINS have lower aliquots than for Actual Profit.
Disadvantages	Very bureaucratic in document management; High volume of accessory obligations; Strict accounting control; PIS and COFINS with higher aliquots.	There is no credit compensation for PIS and COFINS; If there is a decrease in the company's profitability along the year, it is not possible to adjust the calculation base; When there is profit above what was presumed, the profit distribution among partners demands a more thorough balance.

¹ *Actual Profit* is the net profit of the verification period adjusted by additions, exclusions, or compensations prescribed or authorized by tax legislation.

² All the possibilities are predicted in the Income Tax Regulations (RIR, 2018), in article 257. Since they cannot adopt the Presumed Profit system, they are mandatorily framed as Actual Profit.

The Brazilian economic results statement (DRE) differs consistently from the internationally applied 3 Statements System (3S). REA Consult provides financial modelling and project valuation based upon a proprietary and third party audited tool which integrates DRE and 3S



FINANCIAL MODEL FOR HYBRID RENEWABLE INVESTMENTS

Additional Taxes

Two additional taxes should also be considered; VAT on Sales and Services (ICMS), and the Municipal Service Tax (ISSQN, or simply ISS). While all the taxes listed above are under Federal Union jurisdiction, the ICMS is under state jurisdiction and the ISS is under municipal jurisdiction.

Both have a national regulating law, which outlines general rules that the states and municipalities must follow. In the case of ICMS, this is the Kandir Law (Complementary Law 87/1996) and, for the ISS, this is the Complementary Law 116/2003. It is important to point out that these laws present dispositions about concepts, scope possibilities, taxpayers, collection responsibilities, among others.

The scope possibilities for the ICMS are countless and usually create conflicts between states due to the complexity of state laws, especially regarding the circulation of goods. In this case, what matters is that many states have granted exemption of ICMS for the generation and transmission of renewable energies, and for the import of fixed assets.

In its turn, the ISS is charged over services not comprehended under the ICMS. For that, the national regulating law lists the possible services for which this tax is due.

Sectorial Levies

In addition to the taxes already mentioned, there is a series of sectorial contributions and levies applied to the electricity sector.

The main levies of the sector are:

- △ **P & D** – Accounting of resources directed at the payment/application in Research and Development (P&D), collected in the electric energy supply fee.
- △ **PEE** – Accounting of resources directed at the application in the Energetic Efficiency Program (PPE), collected in the electric energy supply fee, as per current legislation.
- △ **RGR** – Global Reserve of Reversion. Reimbursing the cost of assets connected with utility provision and promoting sectoral expansion.
- △ **CDE** – Energy Development Bill. Promoting alternative energy sources, expanding energy service provision (rural electrification), and providing subsidies for national lignite and low-income households.
- △ **TFSEE** – Electric Energy Service Inspection Fee. Covering the operating cost of ANEEL.
- △ **CFURH** – Financial Compensation for the Use of Water Resources. Providing financial compensation for the use of water and productive land for power generation.

- △ **ESS** – System Service Charge. Subsidizing SIN maintenance to ensure reliability and stability, covering the costs of constrained on and off generation.
- △ **PROINFA** – Program of Incentives for Alternative Electricity Sources. Encouraging the energy generation through alternative sources (wind and biomass) and small hydroelectric plants.

It is worth pointing out that, as a rule, these taxes are collected from the end consumers by their energy distributors. Hence, they are not in the sphere of utility scale projects, but can become relevant in projects of up to 5 MW.

In addition to the aforementioned levies and contributions, generation assets must pay grid usage costs and service fees for the grid operator and other authorities. REA Consult can help you determine the relevant fees for your project feasibility study. Get in touch!

For the wind sector, the government has implemented the Special System for Infrastructure Development (REIDI). In this system, the collection of PIS/COFINS is waived, as long as habilitated in the referred system. It was created with the intention of developing infrastructure in the country, and discharging the PIS/COFINS for direct import and for national purchase of machinery, apparel, and equipment incorporated in infrastructure work directed at fixed assets (Law 11,488/07, Decree 6,144/07, Normative Instruction 758/07).

Dividends

As for sending profits to a foreign holding, the partnership's internal regulation should be observed. As an example, in an SPE that adopts the Limited partnership type, the profit distribution to the partners will follow the dispositions and rules predicted in the SPE's Articles of Association, since the Brazilian Civil Code does not establish a specific rule for destination of the partnership's results.



Hence, if the Articles of Association of an SPE constituted under the form of a Limited Partnership establish that the profits' destination will be decided by the partners, without fixing any minimum percentage for dividends, then the profit distribution will be decided by the majority of partners.

The same way, the partners may deliberate on the frequency of patrimonial balance inventory for profit distribution, which also, in the lack of specific ruling, may be conducted in periods shorter than a year, at the partners' discretion.

The opposite happens in the Anonymous Partnership's Law (Law 6,404/1976), which predicts the payment of dividends in the terms of articles 201 to 205. In these articles, among other dispositions, mandatory minimum dividends are stipulated, which will be fixed at 50% of the adjusted net profit if the By-laws are not clear.

In this case, in an S.A. type company, if the By-law is not clear and the partners decide to change it subsequently to establish a profit percentage for mandatory dividends, this cannot be lower than 25% of the adjusted net profit. But the By-law may predict, from the beginning, an even lower percentage, for this rule is only applied in the case of By-law omission and subsequent prevision.

Furthermore, share capital participation is proportional to profit participation, which is not necessarily the case in a Limited Partnership.

Deploying Foreign Capital

Under analysis of this report is the constitution of an SPE with participation of a foreign investor. Thus, there are a few means of entering foreign capital in the country, among which the currency investment stands out.

For this sort of transaction, when subscribing capital or acquiring participation in an existing Brazilian company, the resources shall be

sent to Brazil through a banking establishment authorized to work with exchange.

A previous authorization is not necessary, and there must be a record on SISBACEN–EDE-IED module, as mentioned previously.

Currently, dividends and profits distributed to the shareholders or partners according to participation, paid or credited by the corporations taxed and based on the actual or presumed profit, are not subject to collection of Income Tax at the source, nor will they integrate the calculation base for the beneficiary's Income Tax, whether an individual or corporation, resident in Brazil or abroad. By the time of the preparation of this report, a taxation reform bill, that could introduce taxation on dividend, is under discussion in congress.

In addition to the above, investors must consider that financial transactions between a foreign holding and the Brazilian SPE might be subject to other financial levies and taxes, not specific to the electricity sector. This may be the case, for instance, when the foreign holding executes a development agreement with the Brazilian SPE.

REA Consult advises investors to always seek expert tax advisory for your business cases.

In a nutshell, corporate forms and taxation systems should be chosen in accordance with a previous plan, depending on the company's management characteristics, profits and dividends, tax load, as well as advantages and disadvantages for the company's accounting management.

As for sending profit to the foreign investor, Brazilian legislation does not place greater obstacles than the bureaucratic ones, such as registration with the Central Bank. The profit and/or dividend distribution rules follow the governing laws of the allowed partnership types: Limited or Anonymous Partnership.

Copyright

Copyright © REA Consult 2020.

All rights reserved. No part of this work may be reproduced, stored in a retrieval system of any nature, or transmitted, in any form or by any means including photocopying and recording, without the prior written permission by REA Consult, the copyright owner. If any unauthorised acts are carried out in relation to this copyright work, a claim for damages may be made and/or a criminal prosecution may result.

Disclaimer

This is a general reference document and should not be relied upon as legal or financial advice. REA Consult makes no warranty or representation about the accuracy or completeness of this publication. The application and effect of any law or regulation upon a particular situation can vary depending upon the specific facts and circumstances, and so you should consult with a specialist regarding the impact and use of any of this information in any particular instance.

REA Consult does not accept, and hereby disclaims to the extent permitted by law, all liability arising from any loss and damage sustained from the reliance of the information contained herein. Additionally, REA Consult accepts no liability at all for the content provided by the other contributing firms.

Please note that the energy field is dynamic, and the material and data presented herein could change.

Sources

ABDI	BlueSol	CNJ	Iberdrola
ABEEólica	Brazil Government	CTGAS-ER	Instituto Acende
ABSOLAR	Canal Energia	EPE	MME
ANEEL	CBFT	EXAME	ONS
BDNES	CCEE	IBD Group	Valor Sectorial Energia

www.rea-consult.com

Email: info@rea-consult.com

Sao Paulo, Brazil: +55 16 99203 1714 (+WhatsApp)

Cologne, Germany: +49 221 9865 8918

Prague, Czech Republic: +86 132 6908 3763

Beijing, China: +86 132 6908 3763



REA CONSULT