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IOF/Exchange: are the benefits only for short-term capital?

October 19 – 25, 2008

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Faced with the deep financial crisis worldwide and among the measures adopted to increase liquidity in the Brazilian financial system, the Federal Government reduced the IOF tax rate on certain foreign exchange transactions, aiming to stimulate the inflow of foreign funds required to finance economic activities in Brazil.

The changes in IOF legislation were introduced by Decree No. 6613, effective as of October 23, 2008, which reduces to zero the IOF assessed on foreign exchange transactions (for both inflow and outflow of funds) related to:

(i) all transactions on the financial and capital markets carried out under Resolution 2689/00 - foreign investments in fixed-income securities and in Equity Investment Funds – FIP, previously subject to IOF/Exchange at the rate of 1.5%, will now be taxed at the zero rate for both inflow of funds as well as their repatriation abroad. Dividends and interest on equity derived from “Investments 2689” are also subject to IOF/Exchange at the zero rate;

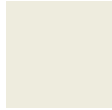
(ii) Foreign loans with maturity over 90 days – the zero rate for IOF/Exchange is applicable to both inflow of funds to Brazil and their repatriation abroad. Loans with a term of up to 90 days remain subject to IOF/Exchange at the 5.38% rate.

Foreign direct investments in Brazilian companies under Law 4131/64 are still subject to IOF/Exchange at the rate of 0.38% for both inflow and repatriation of funds. Dividends and interest on equity derived from “Investments 4131” are also subject to IOF/Exchange at the rate of 0.38%.

In view of the demand for foreign funds within a global credit crunch scenario, the position taken by the Federal Government to reduce the IOF/Exchange rate to zero on financial and loan transactions is clearly commendable. However, it does not seem consistent to us that

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this IOF reduction will not be extended to “Investments 4131”, especially those in the long term, which are also fundamental instruments for economic development.

São Paulo, October 24, 2008.