MARSH

ADVISOR

CUSTOMS BONDS – BRAZILIAN LEGISLATION CHANGE

BACKGROUND

The special customs regime for goods to be used in the research and production of oil and natural gas fields (REPETRO) was introduced in 1999, and is currently agreed to be in force until December 31, 2020.

The REPETRO regime reduces the tax burden on companies involved in exploring and extracting oil and natural gas via the total suspension of federal taxes ordinarily due on the purchase, or importation of selected equipment and spare parts used in the research and production of oil and natural gas fields.

The three main features of this regime are:

1. The suspension of taxes on the import under "temporary admission" of goods, which are to be leased, borrowed, or rented from a foreign owner.
2. The suspension of taxes on local and foreign acquisitions of raw material, parts, and pieces for manufacture in Brazil, normally in a bonded warehouse.
3. Goods purchased by a foreign company from Brazilian manufacturers and which are deemed to be exports.

The Annex to Normative Instruction RFB 844/2008 establishes an example list of the goods eligible for tax suspension:

- Vessels supporting research, production, and storage activities of oil or natural gas.
- Machines, apparatus, instruments, tools, and equipment destined for the research and production activities of oil or natural gas.
- Drilling and production platforms, and those destined to support the research and production activities of oil and natural gas.
- Motor vehicles assembled with machines, equipment, instruments, and tools destined for research and production activities of oil and natural gas.
- Specially made platform structures.

If goods become ineligible for tax suspension (for example, if a vessel sinks and becomes a wreck so it can no longer be considered to be exportable), the full amount of suspended tax must be repaid.

As such, the suspended taxes represent an exposure to Receita Federal do Brasil. In order to mitigate against the risk of non-payment in the event that an item loses its temporary admission status (REPETRO), Receita Federal do Brasil required issuance of a "customs bond" before they would allow entrance of the goods into the temporary admission regime (REPETRO). This could be issued by any judicial person with a net worth of at least five times that of the total suspended taxed amount or greater than BRL1,000,000, whichever the less.

However, after the new Normative nº. 1361, the position has changed and instead of the above-mentioned "customs bond," the Importer must now present one of the following options equal to the total amount of suspended taxes, in order to be granted entrance under the REPETRO/Temporary Admission Regime:

- A cash deposit equivalent to the total suspended tax amount for all equipment.
- A bank guarantee.
- A surety (customs) bond.

The change is a result of studies carried out in partnership with the private sector (Instituto Aliança Procomex), Brazilian Customs entities and, foreign customs, and is also applicable to temporary exports. As the temporary admission regime handles over US$30 billion per year (representing about 50,000 individual customs submissions), the new regime is intended to bring modernity, speed, and simplicity to the customs procedure. It has been produced in agreement with the World Customs Organization under the Istanbul Convention and the procedures are compatible with the demands of the International Exchange.

IMPACT

Clearly, those importing high-value assets under the REPETRO regime are going to feel keenly the impact of this change. The change impacts not only new entrants to Brazil, but also currently established companies, who from time to time must renew their temporary admittance status (REPETRO) with Receita Federal do Brasil (local customs).

Under the previous rules, any company was able to satisfy the temporary admittance mode by virtue of simply giving an internal company "customs bond," or by having in-country assets, of at least BRL1,000,000 in value. As such, the discrepancy between the amount of suspended taxes and the customs bond was significant, as large suspended tax amounts (for example, high-value drilling and floating production, and storage and offloading (FPSO) units, where the amount of suspended taxes normally exceeds US$100,000,000) could be "guaranteed" by issuing a simple company customs bond of BRL1,000,000.

Now, the three alternatives offered by Receita Federal do Brasil can be considered as follows:

TYPE OF GUARANTEE*	PROS	CONS
CASH	Known amount for taxes already allocated, therefore, perhaps no need to rely on other insurances for insurable incidents, which may result in temporary admission status being revoked (i.e. no longer any need to insure suspended tax amount on a total loss-only basis).	Reduces available cash flow and credit flexibility.
BANK GUARANTEE		Reduces available cash flow and credit flexibility. Requires indemnity from local or parent company. Expensive form of credit.
SURETY BONDS	Usually lower cost than a bank guarantee. Usually does not require cash back-up. Provides additional line of credit that is ring-fenced from other lines.	Requires indemnity from local or parent company (depending on financials).

*Marsh is able to assist in the arrangement of surety bonds only.

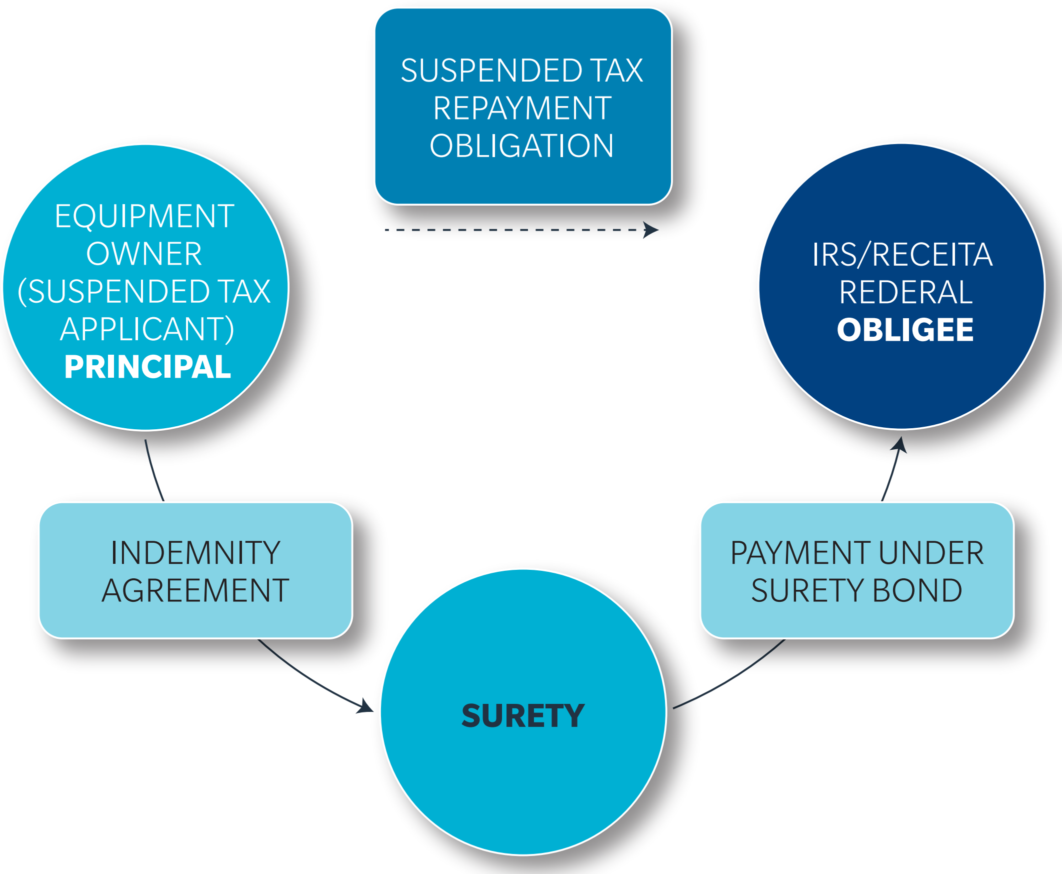
SURETY BOND IMPLEMENTATION PROCESS

The surety bond is issued by an insurer who guarantees the payment of the total suspended tax amount to Receita Federal do Brasil if for any reason it becomes due.

However, the insurer will require indemnity from the local entity or the international parent (as applicable – the decision as to which entity provides this is usually based on the financial strength of the relative companies as this has an impact on eventual rating offered by the insurer).

Therefore, the insurer is, in effect, left with the risk that the equipment owner cannot honor the counter-guarantee for any reason (for the most part one would assume this is insolvency of the entity which signs the indemnity agreement).

The diagram below represents the respective interests of each party involved in the scheme; essentially the insurer steps in to front the equipment owner's obligation for suspended taxes.



To obtain a quotation or have a bond issued the principal/equipment owner (referred to here as "client") is required to submit the following documents for registration with the local insurers:

1. Completed and signed "client registration form."
2. Completed and signed "client shareholder form."
3. Copy of last three financial statements/annual reports.
4. For start-up companies, copy of last two annual reports of parent company.
5. Copy of company articles of incorporation.

The process from registration to issue of completed bond usually takes approximately 10 days and follows these steps:

1. Registration documents (as detailed above) are sent to the local insurer.
2. Risk analysis is made by local insurers – this analysis can be applied to the Brazilian or their offshore parent company.
3. Assuming a favorable analysis, insurers provide limits and rates to the principal/equipment owner.
4. Signature of the indemnity agreement between the principal/equipment owner and insurers.
5. Customs bond is issued.

For more information about customs bonds and other solutions from Marsh, visit marsh.com, or contact your local Marsh representative.

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