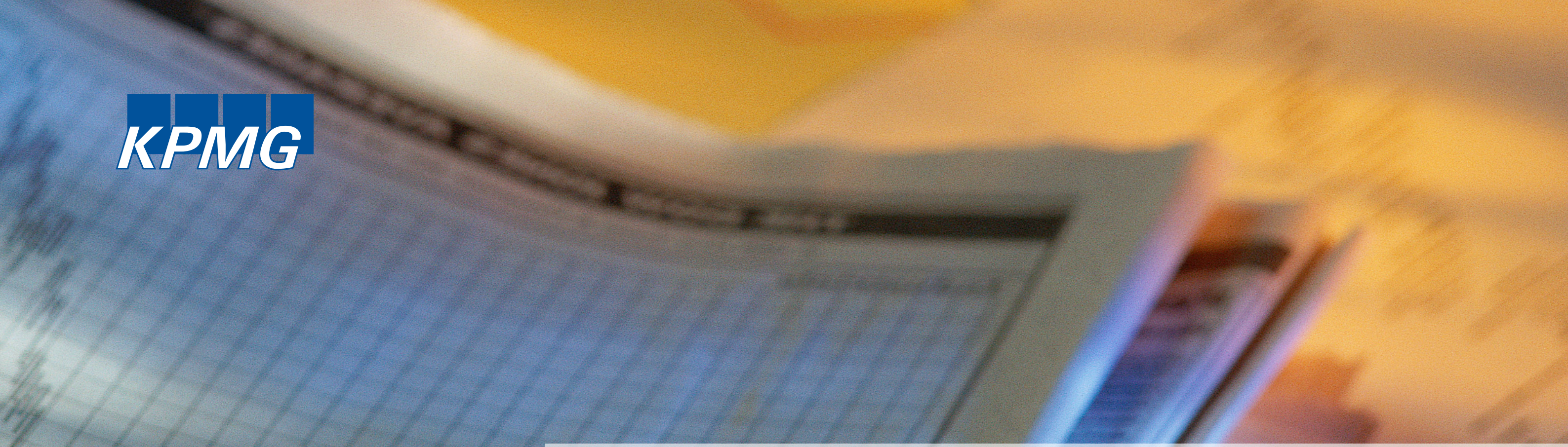


Indirect Tax in Brazil

An approach of Tax risk management and value creation in businesses by creating tax awarenesss

TAX

The importance of indirect tax management for risk-benefits opportunities and a successful Tax Governance policy.

Did you know that the tax burden in Brazil has reached 35.80% of Brazil's GPD in 2008? In 2008 the government collected R$ 1.034 trillion on tax revenues. R$ 500 billion of this amount was effectively raised by **Taxes on Goods and Services ("indirect taxes")**, representing a significant participation of 48.40% on the total tax revenue.

Indirect taxes are raised with companies in the entire production/services chain. In a non-cumulative system a company can offset the indirect taxes paid on its purchases against the indirect taxes levied on its sales. Therefore, it should be considered that the amount of R$ 500 billion is the net amount that was effectively raised by indirect taxes, taking the tax credit on purchases into consideration.

The annual cash flow of indirect taxes that run through a company's administration therefore represents an amount much larger than the net amount of R$ 500 billion (roughly 266 billion US dollar). After all, companies are confronted with indirect taxes when they purchase goods/services, and when they supply goods/services.

Tax Burden by Tax Base and Government Level

Tax Base	Tax Collection	%	Federal	State	Municipal
Income	212,056	20.50%	212,056	0	0
Payroll	233,023	22.53%	209,595	17,810	5,618
Property	35,679	3.45%	417	18,763	16,499
Goods and Services	500,637	48.40%	258,582	220,083	21,972
Financial Transactions	21,146	2.04%	21,146	0	0
Others	31,856	3.08%	18,339	10,075	3,442
Total	**1,034,397**	100.00%	720,134	266,731	47,531

Based on a recent study by the Brazilian Federal Revenue Service, the Brazilian taxes levied on goods and services are the following:

Taxes	Federal	State	Municipal
ICMS (State Value Added Tax)		x	
COFINS (Social Contribution)	x		
PIS (Social Contribution)	x		
IPI (Excise Tax)	x		
ISS (Tax on Services)			x
Import Duties (Customs Duties)	x		

ICMS, the State VAT, plays an important role within the tax landscape. From analysis of the 2008 Tax Revenue data, that considered the tax collection among 26 States and 1 Federal District, ICMS represents more than 82% of the total State tax collections. In addition, ICMS contributes to 21% in the Brazilian national tax revenue budget. At a federal level, the other four indirect taxes (COFINS, Customs Duties, IPI and PIS) represent more than 35% of national tax collection and 25% of total tax collections.

A significant amount of a company's financial resources is spent on indirect taxes. For example, indirect taxes streaming through an organization account for approximately 40% to 55% of its operational revenue. As a result, indirect taxes take the 3rd largest financial value within an organization, following the amount spent on sales and purchases. Due to their dynamic character, indirect taxes have a significant impact on companies' cash flow, and should therefore be managed adequately.

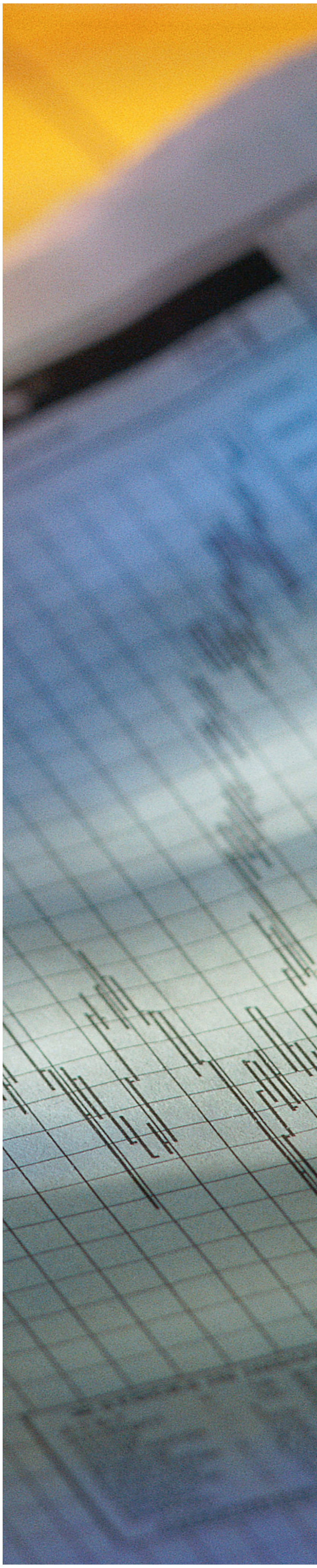
Highlight of Indirect Taxes on Cash Flow

	R$	Effective Tax Rate	Indirect Taxes
Sales	10,000	32.25%	3,225
Purchases	(7,000)	32.25%	(2,257)
Salaries	(1,000)		
EBITDA	2,000		
Total of Indirect Tax Cash Flow			5,482

Indirect taxes are levied with the companies in the entire production chain, but ultimately paid by the final consumers. Some of these taxes are not directly noticed by the final consumers as they are charged to the consumers as an increase of the sales price of goods and services. Indirect taxes influence business competition as they cause a raise of the final sales price offered to a customer.

In a non-cumulative taxation system, the companies in the production chain have the right to offset taxes paid on its purchases against the indirect taxes due on their sales. In the situation that an indirect tax has a cumulative character, a supplier in the production chain may not be able to offset the indirect taxes paid on purchases against the taxes due on its sales. This leads to a "cascade effect" and accumulation of taxes (i.e. taxes on taxes) which in its turn affects the market prices even more.

The impact of indirect taxes on prices depends on the ability to effectively apply the non-cumulative concept. Due to legislative complexities, operational peculiarities, but also due to administrational flaws, indirect taxes may cause significant risks and also have a cumulative character (accumulation of taxes). This ultimately increases market prices, pressure on profit margins, competitive disadvantages, and a reduction of the net result available to shareholders.



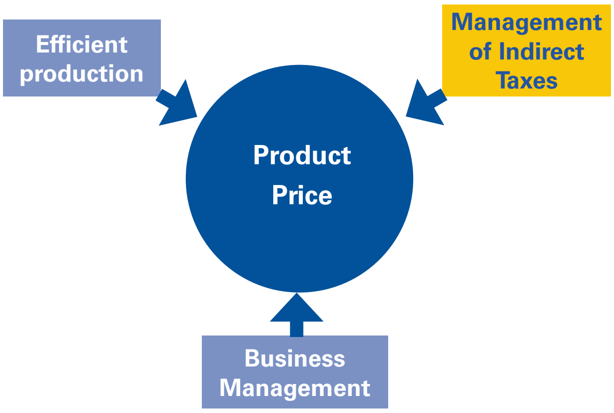
Sub-Categories of Indirect Taxes (R$ billions)

Tax Base	Total	%	Federal	State	Municipal
Non-cumulative	361,958	72.30%	141,875	220,083	0
Cumulative	138,679	27.70%	116,707		21,972
Total	**500,637**	100.00%	258,582	220,083	21,972

In order to avoid these potential negative impacts, and tofocus on the value adding potential of tax management, it is important to build awareness, excellence and high standards of indirect tax management within a company, taking the (type of) business into close consideration.

Indirect tax should be "on the radar" not only in the financial department, but also in the Purchase Department, Accounts Payable Department, IT Department, Sales Department, Logistics Department, and obviously also in the Board Room. This awareness would result in a optimized indirect tax management covering the entire business process that begins with the processes of registering indirect taxes paid on the acquisition of goods and/or services (i.e. tax credit) followed by the subsequent sale, enabling the offset of indirect taxes due against the tax credits.

Therefore, a better indirect tax management contributes to a better risk management, tax planning, and operational efficiency. Furthermore, it contributes to reducing the overall tax burden in the production chain, creating value for a company by bringing more competitive advantage.

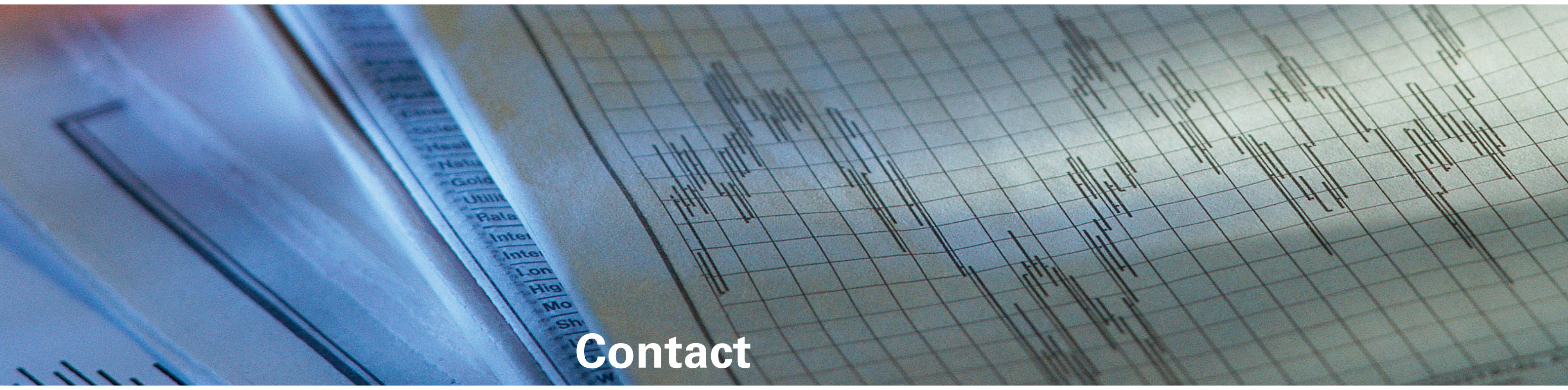


Considering the potential adverse tax effects and the potential benefit of tax management, it is recommended having a consistent and adequate corporate and tax governance in order to ensure that internal processes are focused on:

- monitoring the complex and dynamic Brazilian indirect tax legislation;
- monitoring the tax treatment of (envisaged) supplies and supply chains;
- analyzing performance indicators aligned with terms of payment to suppliers and collection of accounts receivable, discounts and rebate procedures, average term of production and days in inventory;
- applying the proper tax burden in the formation of prices in order to maintain profitability indexes;
- evaluating risks when granting credit, in the sense that it carries a significant portion of indirect taxes;
- analyze the "pros and cons" of local tax incentives.

kpmg.com.br

These measures contribute to preventing flaws in indirect tax management in Brazil. Should you desire to discuss the indirect tax management in your company, please do not hesitate to contact us.



Contact

Roberto Cunha
Partner, Indirect Taxes & Customs
(11) 2183-3118
rcunha@kpmg.com.br

Elson Eduardo Bueno
Director
(11) 2183-3281
ebueno@kpmg.com.br

Maira Manna Rigoni Behrndt
Director
(11) 2183-3218
mrigoni@kpmg.com.br