

MEMORANDUM TO CLIENTS

TAX

January 6, 2016

New fee is established for environmental control and inspection in connection with oil and gas research, exploration and production; new ICMS tax rate is set for oil extraction

On January 30, 2015, the State of Rio de Janeiro published in the Official Gazette, Law No. 7,182/2015, establishing a fee for Environmental Control and Inspection in connection with Oil and Gas Research, Exploration and Production ("Oil&Gas Fee") and Law No. 7,183/2015, reinforcing the rules on the State's VAT ("ICMS") for oil extraction.

Both laws are in line with other strategies adopted by the State of Rio de Janeiro to boost tax collection in that state and stabilize its budget.

OIL&GAS FEE

The main features of the Oil&Gas Fee are as follows:

- i. the taxable event for applying this tax is the normal exercise of environmental protective power ("*Poder de Polícia*"), exercised by the State Environmental Institute, in relation to the research, exploration and production of oil and gas carried out in the State of Rio de Janeiro;
- ii. the environmental protective powers include specific activities to be undertaken for the benefit of the general public to avoid irreversible environmental damage; these activities include the control and evaluation of the use of oil and gas resources; development of systems to produce, manufacture, expand and distribute assets related to oil and gas; control and inspection of permits, licenses and concessions for research, exploration and production of oil and gas resources;
- iii. the resources resulting from the collection of the Oil&Gas Fee will be used to carry out the above activities;

The purpose of this memorandum is to inform our clients about important changes and developments in the area of law. We remain at the reader's disposal for any additional information that may be desired regarding the subject matter herein.

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- iv. the taxpayer is the entity which is authorized to conduct research, exploration and production of oil and gas resources in the State of Rio de Janeiro;
- v. the Oil&Gas Fee is set at BRL 2.71 (two reais and seventy one centavos) per oil barrel extracted or natural gas equivalent, which must be paid monthly, by no later than the 10th day of each month immediately subsequent to the extraction. The Oil&Gas Fee will be adjusted as of 1st January each year, in accordance with the State's Reference Unit. Pursuant to the Rio de Janeiro tax authority's Resolution No. 952/2015, which stipulates the State's Reference Unit for 2016, the Oil&Gas Fee for the 2016 year will correspond to BRL 3.0023 (three point zero zero two three reais);
- vi. taxpayers who pay the Oil&Gas Fee are released from having to pay the Rio de Janeiro State Fee on Control and Environmental Inspection ("*Taxa de Controle e Fiscalização Ambiental do Estado do Rio de Janeiro or TCFARJ*"); up to 60% of the amount paid as Oil&Gas Fees can be credited against the Federal Fee on Control and Environmental Inspection ("*Taxa de Controle e Fiscalização Ambiental - TCFA*");
- vii. the Executive Branch will further regulate Law No. 7,182/2015;
- viii. Law No. 7,182/2015 came into force on the date of its publication, but its effects are subject to a 90-day grace period, which will end on March 29, 2016.

Please note that in the past the Rio de Janeiro Legislative Congress approved a bill of law which established a fee similar to the Oil&Gas Fee, but that bill of law was later rejected by the former Governor who declared it unconstitutional and illegal.

The Oil&Gas Fee was approved by the Rio de Janeiro Congress on December 10, 2015 and it was heavily criticized by the oil and gas sector even before it was enacted. Notwithstanding an apparent concern by the State Governor to adjust the final draft of the Oil&Gas Fee legislation in order to minimize possible unconstitutionality claims, we believe there are grounds on which the application of this law as approved may be challenged in court.

ICMS TAX ON OIL EXTRACTION

The highlights of Law No. 7,183/2015 are as follows:

- i. ICMS is levied on the transference (“*circulação*”) of oil from the extraction wells to the concessionaire company;
- ii. the triggering event occurs when the oil goes through the production measurement points (“*Pontos de Medição da Produção*”) immediately after it is extracted; the production measurement points are defined in the development plan for each oil field, in accordance with the applicable legislation;
- iii. the taxpayer is the oil trader, manufacturer, producer or extractor, whether or not it is a direct concessionaire;
- iv. the basis for calculation of this tax is the oil reference price, which is established by the weighted average oil sale price charged by the concessionaire during normal market conditions, or its minimum price established by the National Agency of Petroleum, Natural Gas and Biofuels (ANP), whichever is higher;
- v. the ICMS tax rate is set at 18%;
- vi. the place of taxation is determined by where the oil production is subject to the measurement procedure which occurs after the oil extraction;
- vii. Law No. 7,183/2015 came into force on the date of its publication, but its effects are subject to a 90-day grace period, which will end on March, 29, 2016.

The language of Law No. 7,183/2015 is similar to that of Law No. 4,117/2003 (known as “Lei Noel”), which is currently being challenged on constitutional grounds in a direct action of unconstitutionality (“*Ação Direta de Inconstitucionalidade*”) filed in 2003 with the Brazilian Supreme Court. In this lawsuit, both the Attorney General and the Public Prosecutor’s Office filed a motion seeking that Law No. 4,117/2003 be declared unconstitutional.

In our preliminary analysis of Law No. 7,183/2015, we believe that it violates constitutional provisions for the same reasons Law No. 4,117/2003 does. Please note that it is possible, based on Supreme Court precedents, that the direct action of unconstitutionality filed in 2003 be amended to also include a review of the constitutionality of Law No. 7,183/2015.

Attorneys in the Tax Practice

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