



The Legal and Regulatory Framework for CSO Self-Financing in Brazil

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This guide examines the legal and regulatory framework governing the self-financing activities of civil society organizations (CSOs) in Brazil and provides an assessment of the relevant laws and their practical effects in order to identify areas where the law might be improved. Chapter 1 explains the regulatory environment as it relates to self-financing, defines the concept of CSO self-financing, and explains the methodology NESsT used in researching and assessing the current legal framework in Brazil. Chapter 2 outlines a typology initially developed by the International Center for Not-for-Profit Law (ICNL). Chapter 3 describes the current regulatory framework in detail and its application in Brazil. Although CSO self-financing activities are permitted in Brazil, this chapter illustrates that tax laws vary, especially in regard to income tax, depending on the social purpose of the organization and under which governmental jurisdiction it falls under. This chapter also explains the procedures for CSOs to follow. Finally, Chapter 4 discusses the Brazilian legal framework for CSOs carrying out commercial activities and makes recommendations for improvement.

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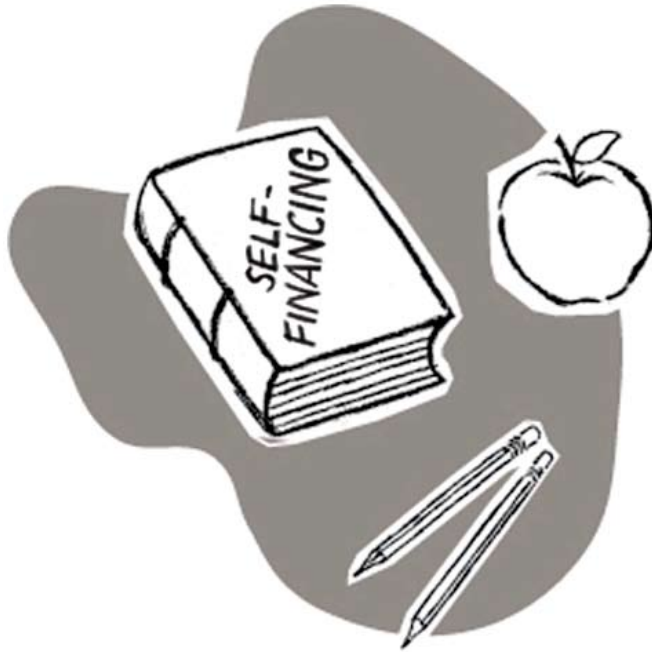
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Setting the Stage: Purpose and Methodology



The term “*civil society organization*” (CSO)¹ encompasses non-profit, non-state organizations as well as community-based associations and groups that fall outside the realm of the government and business sectors. Given limited philanthropic and government assistance, many CSOs undertake self-financing activities² to generate revenues in support of their mission and programs.

NESST has documented over a hundred cases of CSOs in Latin America and Central Europe that engage in these types of activities, and has analyzed the impact of these strategies on the organizations’ performance and sustainability. An important factor that emerged from this research is the need for a clear and supportive legal and regulatory framework to encourage the adoption of self-financing strategies among CSOs. This framework defines whether or not CSOs may engage in self-financing activities and influences the way in which they do so. The tax structure, the level of bureaucracy, and the clarity of existing laws are also factors that have a direct bearing on the development of self-financing activities. Many organizations do not know these rules and

1 NESST uses the term *civil society organization* (CSO) to refer to a wide range of formally registered non-profit, non-state organizations or community-based associations and groups that fall outside the realm of the government and business sectors. In Brazil, this definition includes the legal classifications of association and foundation.

2 NESST uses the term “self-financing” to refer to diverse strategies used by civil society organizations to generate their own revenues (sale of products, service fees, use of hard or soft assets, membership dues, and investment dividends). NESST uses the term “social enterprise” to refer to self-financing activities that are designed by a CSO to significantly strengthen the financial sustainability and the mission impact of the CSO.



believe that they cannot practice self-financing activities or income-generating business activities; others feel that if they do, their reputation or relationship with donors will be adversely affected.

Even when CSOs are aware of the respective legislation, they often do not understand what taxes they need to pay, what forms to file, or what administrative procedures to follow.

The purpose of this guide is to clarify the legal framework for CSOs in Brazil and to assess the degree to which this framework provides an enabling environment for them to pursue self-financing strategies.

1.1 What is self-financing and why is it important?

Self-financing strategies are used by CSOs to generate revenues in support of their missions. The use of these strategies is a response to the current funding paradigm in which CSOs compete for a limited pie of existing government and philanthropic funding from both national and international sources. This reality makes many CSOs heavily dependent on short-term, project-based funding and prevents them from focusing their attention on long-term, strategic development. Through self-financing, CSOs may be able to increase their long-term viability and independence by generating some of their own resources to supplement support from public and private donors.

Self-financing does not necessarily lead to the commercialization of CSOs. Rather, it can provide these organizations with a greater level of independence and sustainability without compromising their mission, purpose or values. Income from self-financing can be one alternative for CSOs to support work that is often more difficult to finance through traditional sources of funding, such as core operating expenses, new programs, advocacy efforts, and others.

NESST does not believe that self-financing should entirely replace traditional sources of financing, but instead proposes that self-financing can provide a powerful complement to government and philanthropic support. Through self-financing, many CSOs are not only financially strengthened, but also institutionally empowered by their own ability to generate new revenues and to determine the course of their work with fewer constraints from donors.

Furthermore, when pursued in a socially and environmentally responsible manner, the enterprise activities of CSOs can help create an alternative economy more responsive to the needs of local communities, small producers, and low-income people. By purchasing products and services sold by CSOs, consumers are contributing to a more equitable and sustainable world.

Types of self-financing activities include the following:

- **Membership dues:** raising income through dues from members or constituents in exchange for some kind of product, service, or other benefit (for example: a newsletter or magazine for its members, or discounts on products or services³). If the fee is not paid in exchange for a product or service, it is considered a donation.
- **Fees for services:** capitalizing on some existing skill or expertise of the organization by contracting work to paying clients in the public or private sector (for example, a CSO provides consultation services to businesses or local government agencies).
- **Product sales:** Selling, rather than giving away, the products of projects (for example, books or other publications); reselling products (for example, in-kind donations) with a mark-up; or producing and selling new products (such as T-shirts or mugs).

3 The term membership dues (“mensalidade” in portuguese) in Brazil can refer to two different types of activities (1) a monthly payment such as a gym membership or access to cable television and (2) a monthly payment such as being a member of a social

movement or organization, the latter of which is not considered, under the current Brazilian legal framework, as a business activity and therefore is treated differently from a legal and fiscal point of view.



- **Use of hard assets:** renting out real estate, space/facilities, equipment and other assets, when not in use for mission-related activities.
- **Use of soft assets:** generating income from patent licenses or other intellectual property or by endorsing products with the CSO's name or reputation.
- **Investment dividends:** passive investments such as share accounts, savings accounts and mutual funds, or other more active and sophisticated financial transactions: active trading on the stock market or engaging in debt swaps, etc..

As previously mentioned, CSOs engage in self-financing activities primarily to strengthen their financial resources or to advance their social purpose. Some of these may be solely interested in generating profits that they can use to fund core mission programs. In these instances, the organization is not concerned with advancing its social mission *directly* through self-financing, but rather *indirectly* by applying the profits earned through this activity to further its social mission. An example of this is a health education organization that starts a printing business and uses the revenues to fund research projects. This activity would be considered non-mission-related.

Other CSOs may be primarily interested in using a self-financing strategy to advance their social mission. For example, a CSO whose social mission is to offer carpentry training and job placement to recovering substance abusers may begin selling the furniture that the trainees produce in order to pay for the costs of the materials and the salaries of the trainees. This activity would be considered mission-related.

These two examples are not mutually exclusive, and neither are the financial and social goals that motivate CSOs engaging in self-financing activities. Many times, CSOs aim to achieve financial and social goals simultaneously through self-financing. The health organization may be better positioned to disseminate the findings from its research by publishing its own materials, and the job training organization may be able to apply surpluses from its furniture sales to fund other programs of the organization or

its core operating expenses. In each of these scenarios, the objectives of CSO self-financing activities and the relationship between these activities and the organization's primary mission are fundamental in determining the legal treatment of these activities, as this guide will illustrate.

1.2 Purpose and contents of this guide

In an attempt to diversify their funding base, many Brazilian CSOs have already initiated self-financing strategies. For the most part, however, many of these have done so with little expertise, capital, or other forms of support. NESST's research on the use of self-financing among CSOs in Latin America in general and in Brazil in particular, demonstrates that many do not have the internal capacity (skills, human resources, adequate financial systems, stakeholder support, business plans) or the external support (financing, consulting support, favorable legal and regulatory environment) to engage in self-financing activities. When such organizations nevertheless attempt to pursue self-financing strategies, a great deal of stress is put on their staff and indirectly on their other programs and the underlying mission. When a CSO decides to pursue self-financing activities, it is important that it do so with the appropriate levels of technical and financial assistance and within an external framework that makes such activities possible.

The pressures and demands faced by CSOs engaging in self-financing activities in Brazil highlight the need to understand the legal framework affecting them.

In this context, the purpose of this guide is to address the following areas:

1. Outline the key laws, regulations, and procedures governing the use of self-financing by CSOs in Brazil. Chapter 3 explains what Brazilian law, specifically the Civil Code and tax law, says about the use of self-financing or *commercial activities* (*business activities* is also used in Brazil). It provides an analysis of the administrative registries and tax regulations that apply to CSOs engaging in such commercial activities. The chapter also offers



a general overview of these laws and regulations, so that Brazilian CSOs have a clear idea of where they fit within the legal system and the tax implications of the commercial activities they operate for self-financing.

2. Assess the relevant laws governing CSO self-financing activities in Brazil, evaluate their practical effects, and identify areas where the law might be improved. The guide identifies the strengths and weaknesses of Brazilian laws — whether they are a help or a hindrance to self-financing, whether they allow for transparent use of self-financing, and whether they foster the development of the CSO sector as a whole. The legislation is analyzed within a tax treatment typology that makes it easy to understand and assess.

This typology was first developed by the International Center for Not-for-Profit Law (ICNL) to examine the legal treatment of CSO economic and commercial activities in Central and Eastern European countries⁴. It has now become a widely accepted typology for understanding and assessing the tax treatments of such activities.

The ICNL typology is presented in Chapter 2; Brazilian legislation is analyzed in the context of this typology in Chapter 3; and the criteria presented are used as a basis for the assessments and recommendations offered in Chapter 4.

1.3 Background and Methodology

This guide is a component of NESsT's efforts to foster self-financing among CSOs in Central Europe and Latin America. Since 1997, NESsT has conducted applied research on CSO self-financing in order to identify common challenges and needs. The objectives of the applied research were as follows:

- Assess the current use of self-financing activities among CSOs. NESsT has developed national assessments of CSO self-financing in nine countries to determine CSO needs and to prepare the capacity-building tools and support for non-profit organizations seeking to implement or expand their self-financing activities.
- Document success stories and obstacles in self-financing activities among CSOs. NESsT has completed over 100 case studies of CSO self-financing activities to gain insights into their development.
- Examine the legal environment for CSO self-financing in 12 countries⁵, including the regulatory and tax framework in place at local and national levels that affects these activities.
- Disseminate lessons from the research – by organizing conferences, seminars, and workshops – for stakeholders from all sectors in an effort to develop strategies for assisting CSOs in the use of self-financing.

The research methodology for this guide was developed by NESsT to assess the legal framework for CSO self-financing activities in a given country. This methodology strives to help answer the following core concerns and questions:

1. *What the law states.* What is the current legal treatment of CSO self-financing activities, including current legislation, legal provisions, history of the law, revisions of the law, regulatory approach, tax rates, reporting requirements, other laws or regulations, legal cases, and organizations or lawyers providing advice or assistance?

2. *How is the law understood?* Are the regulations of CSO self-financing activities understood by CSOs?

4 ICNL is an international organization whose mission is to facilitate and support the development of civil society and the freedom of association on a global basis. ICNL, in cooperation with other international, national, and local organizations, provides technical assistance for the creation and improvement of laws and regulatory systems that permit, encourage, and regulate the not-for-profit, non-governmental sector in several countries around the world. ICNL maintains a documentation center for

laws, regulations, self-regulatory materials, and other relevant documents; provides training and education; and conducts research relevant to strengthening and improving laws affecting the NGO sector. For more information on ICNL, see www.icnl.org.

5 The countries in Latin America and Central Europe where NESsT has analyzed the legal and regulatory framework for CSOs are: Argentina, Chile, Colombia, Croatia, Czech Republic, Ecuador, Hungary, Peru, Romania, Slovakia, Slovenia, and the Ukraine.



3. *Effects of the law.* What is the effect of current regulations on CSO self-financing activities?

4. *Recommendations for the law.* What are the most important recommendations for addressing current regulatory problems?

Eduardo Szazi and Ricardo de Oliveira Campelo, both partners of Brazilian law firm Szazi, Bechara Advogados, carried out the research specific to the Brazilian legal environment.

Mr. Szazi is a practicing lawyer in Brazil and senior partner of Szazi & Bechara Law Offices, a law firm specializing in not-for-profit organizations and corporate social responsibility. He has been a legal Consultant for GIFE, the Brazilian grant-makers association, since 1997 and its only Emeritus Member since 2000.

To carry out the research necessary to develop this publication, Mr. Szazi relied upon his experience as a professor of NGO Law in post-graduate level courses at the two leading business schools in Brazil (FGV (Getulio Vargas Foundation)- and – FIA Business School) as well as research conducted for various books, including a well-known work on NGO Law (*Third Sector: Regulation in Brazil*) and a series of books addressing relevant aspects on the subject (*Third Sector: Polemical Issues*).

Since 1997, Mr. Szazi has been engaged in efforts to reform the legislation related to non-profits in Brazil and is a member of a small team developed by the Brazilian Government to study and draft a new law on non-profits. He is also engaged in developing additional legislative bills on the national, state and local levels, and has testified before Congress in several hearings on NGO and civil society issues.

Two cases studies are included in Chapter 4 to illustrate the legal framework developed in Chapters 3 and 4 and to provide an understanding of the experience of CSOs in this area. The organizations selected were: Atlantic Forest Foundation and Ayrton Senna Institute.





A Typology for Assessing the Legal and Regulatory Framework



This chapter presents a typology for analyzing the regulations that govern CSO self-financing activities. The typology was developed by ICNL⁶ and NESST expanded and modified it to be more applicable to the Brazilian legal system. The following section presents four key areas that are vital for understanding the legal structure for CSO self-financing before assessing the specifics of Brazil: 1) the legal characteristics of CSOs; 2) the legal definition of self-financing; 3) the criteria for permitting self-financing; and 4) the taxation of self-financing activities.

In its texts, ICNL uses the term *non-profit organizations* (NPOs) or *NGOs* which refers to a subgroup of the broader classification of *CSOs*, the term used by NESST. This guide uses the term *CSO*, except in parts that specifically draw upon the ICNL typology, where it maintains the original ICNL terminology.

The broad scope of organizations encompassed by the term *CSO* is consistent with existing Brazilian law in the Civil Code with regard to non-profit legal entities: associations and foundations. The terms most commonly used in Brazil by CSOs are

⁶ The overall typology presented in this chapter was adapted, with permission, from the paper "Regulating Economic Activities of Not-for-Profit Organizations" that was first prepared by ICNL for the "Regulating Civil Society" Conference in Budapest, Hungary,

in May 1996 (copyright ICNL, 1997) and from the Handbook on Good Practices Relating to Non-Governmental Organizations, Appendix I: Economic Activities and Taxation (copyright ICNL, 2000).



association and foundation, and therefore, this guide primarily considers the case of CSOs that are legally organized as such.

2.1 Legal Characteristics of Non-Profit Organizations

The characteristics listed below highlight the key differences between non-profit and for-profit organizations and therefore provide a context for understanding how non-profit organizations (NPOs) engage in self-financing activities. The discussion that evolves in this chapter and the rest of the guide addresses a subgroup of all NPOs: those whose philanthropic purposes are intended to promote public benefit. There is no agreed-upon definition of what constitutes public benefit, which is why most of Chapters 3 and 4 address this issue in terms of Brazilian law.

It is important to recognize that some NPOs such as cooperatives, mutual benefit societies, social work organizations and labor unions are also considered to be NPOs and in general the regulatory norms for associations and foundations apply to them, although they are usually governed by a separate set of laws and regulatory bodies. Therefore they are not included in this study.

Organizations are considered NPOs as long as they provide a public benefit and uphold the principle of non-distribution.

ICNL, however, does make this distinction between NPOs, and its typology accordingly identifies two basic legal assumptions that distinguish public benefit NPOs from for-profit entities:

1. Non-distribution constraint. Although NPOs are not prohibited from generating profits, these profits may not be distributed to private parties who might be in a position to control them for personal gain, such as founders, members, officers, directors, agents, employees, or any related party.

2. Public-benefit purpose. By definition, this class of NPO is organized and operated primarily to provide a public benefit. These characteristics are not dependent on the particular legal form of the NPO. Accordingly, this discussion addresses NPOs of various legal forms as long as they provide a public benefit and uphold the principle of non-distribution (non-profit purpose).

However, as explained in Chapter 3, the Civil Code of Brazil, which regulates non-profit legal entities, considers the following legal types:

a) The civil association is the typology most used by NPOs. It is broadly defined as an organization of people, who pursue a non-profit purpose, without establishing rights and responsibilities among themselves (Article 53). As can be seen, this definition is very broad and flexible and is not necessarily related to the fulfillment of a “public or social interest” purpose.

b) The foundation is created by a group of individuals to support religious, moral, cultural or social interest purposes, and who define how the foundation will be managed. (Article 62 of the Civil Code).

2.2 Legal Definition of Self-Financing

There are many terms and definitions, both legal and non-legal, currently in use to describe activities that generate revenues for CSOs (e.g., commercial activity, economic activity, philanthropic enterprise, social enterprise, social-purpose business, earned income, income-generating activity). ICNL uses the term “economic activity” to refer to self-financing activities. ICNL defines economic activities as “regularly pursued trade or business activities,” with the exception of those that have traditionally been excluded (such as ticket sales for cultural events, tuition fees at educational institutions, and patient fees at non-profit hospitals). NESST, on the other hand, uses the term “self-financing” to refer to activities that generate revenues for CSOs, including the six types of activities described in the previous chapter.



This guide refers to the general term “commercial activities” specifically for the Brazilian context in Chapters 3 and 4, as this term (or “economic activities”) is more commonly used in Brazil to refer to activities or operations that CSOs adopt to generate revenue, whether these are directly related to their social purpose or they contribute to sustainability. Likewise, this guide uses the terms self-financing and economic activities interchangeably when presenting the ICNL typology.

2.3 Criteria for Allowing Self-Financing

According to ICNL, *a threshold issue is the extent to which NPOs should be permitted to engage in economic or commercial activities without losing their philanthropic status*. When viewed from this standpoint, the question is not whether such activities should be tax-exempt, but under what circumstances they will be permitted at all.

There is a global debate about whether or not an NPO that engages in commercial activities retains its essential characteristics. The answer is simple: provided the activity is not interpreted as or related to the generation of profit, and this difference remains clearly established, we can assert that NPOs that carry out commercial activities do not lose their quality as NPOs.

At this stage of the analysis, the question is not whether such activities should be tax-exempt, but under what circumstances they should be permitted at all.

There are two typical tests used by governments around the world for determining whether economic activities are *for-profit* or *non-profit*:

1. **Principal-purpose test.** The *principal-purpose* test provides one legal model for regulating NPO self-financing. It does not prohibit the use of self-financing activities, but rather emphasizes that the NPO is established and operated primarily for

non-profit purposes and not for private gain. This criterion implies that self-financing would be for mission-related purposes and would not be the principal activity of the organization. Common examples of principal-purpose tests found in regulatory frameworks of many countries are: that economic activities are not the principal purpose (i.e., the principal activity) of the NPO; that economic activities are complementary (or additional) to the NPOs programs; or that economic activities are related to institutional objectives.

2. **Destination-of-income test.** Contrary to the principal-purpose test, the *destination-of-income* test, in its pure form, ignores the economic or commercial nature of the activity in question and focuses exclusively on the purposes for which profits from the activity are used. Under this test, an organization must devote all of its income to its not-for-profit purposes in order to qualify as an NPO. Accordingly, an organization that spends 99% of its time pursuing commercial endeavors, spends 1% of its time undertaking public-benefit activities, and devotes all of its profits to these public-benefit activities could still qualify as an NPO. An example of a destination-of-income test is when the profits from economic activities are used to support the organization’s mission and are not distributed as earnings.

Under either test, an NPO is permitted to engage in economic activities that further the mission (non-profit purposes) for which it is organized. It should be noted that governments can — and in some cases do — use a combination of conditions under the principal-purpose test and destination-of-income test to determine whether the economic activities of an NPO are permitted. For example, a government can authorize only those commercial activities which are related to the mission of an NPO (principal-purpose test) and require that the revenues from these be used exclusively for mission-related activities (destination-of-income test). But what justification is there for governments to permit NPOs to conduct self-financing activities? There are two main public policy rationales for permitting NPOs to engage in such activities:



1. **Self-financing applies non-public resources to the public good.** Income from economic activities is a primary source of funds for NPOs (particularly in emerging market countries, where there is an absence of private capital and philanthropic tradition) and enables them to do their public-benefit work with less dependence on governmental support and charitable donations.

2. **Self-financing accomplishes public-good objectives.** Certain economic and commercial activities directly accomplish public-benefit purposes. For example, although the sale of a book on teaching techniques by an educational organization is an economic activity, the distribution of the book directly serves the public-benefit purpose of promoting education. Preventing NPOs from using such commercial and economic means to attain their goals could directly impair their ability to serve public-benefit purposes.

Governments have typically employed four approaches, alone or in combination, to determine the tax treatment for CSO self-financing activities.

2.4 Taxation of Self-Financing Activities

Although the legal treatment of CSO self-financing varies on a practical level from country to country, most have avoided going to extremes (i.e., a complete prohibition on economic activities or, conversely, allowing economic activities to be the principal activity of the organization). However, the important issue is the tax treatment of such activities. Governments have typically employed four approaches, alone or in combination, to determine the tax treatment for CSO self-financing activities:

1. **Blanket tax.** A *blanket tax* policy is applied to income from all economic activities, regardless of the source or destination of the income. Under this approach, the organization is not limited by level or type of activity, but is taxed on all revenues generated by these activities regardless of how the revenues are used.

2. **Destination-of-income tax.** A *destination-of-income tax* policy exempts income from economic activities that is used for public-benefit purposes. Under this approach, the organization is not limited by level or type of economic activity, but is taxed on all income that is not used to further its public-benefit purposes.⁷

3. **Source-of-income tax.** A *source-of-income tax* policy focuses on the source of the income, granting a tax exemption only when the income is generated by activities that are related to the public-benefit purposes of the organization. Under this approach, the organization is taxed for all income generated from non-mission-related activity even if the income is used to support mission-related programs.

4. **Mechanical tax.** A *mechanical tax* policy makes a rigid distinction based on “mechanical” criteria in order to determine the difference between economic activities that are taxed and those that are not; or it may establish an exemption ceiling (a maximum profit level). Income levels below the ceiling are tax-exempt and above it they are taxable.

Some governments have created hybrid tax policies that are based on one, two or more of these approaches. For example, it is possible to allow net income from economic activity to be tax-exempt below a specified threshold and to apply a mission-relatedness mechanical test to determine whether net income above that threshold should be taxed.

The following chapter analyzes the legal framework in Brazil and the criteria that apply to the taxes for NPOs. These criteria indicate that in order to qua-

7 The destination-of-income tax should not be confused with the destination-of-income test. The test is used to establish that CSOs may conduct economic activities without compromising their non-profit/non-profit legal status as long as any revenues are

destined to the organization’s mission. The destination-of-income tax, on the other hand, focused purely on the tax treatment of non-profit/non-profit organizations.



lity as NPOs, CSOs must put all their profits toward non-profit purposes.

In Brazil, the Constitution grants certain “immunities” which impede the tax authorities from collecting taxes in certain situations. The *patrimony, income and services* of non-profit educational and social service institutions benefit from *constitutional tax immunity*. There also exist tax exemptions - exonerations granted by the appropriate tax authority - which create and revoke tax benefits according to its convictions.

There is no consensus on which of these tax approaches is best, since each entails certain benefits and costs and defines a different public policy objective. NESST uses four of the ICNL criteria to shed light on the practical implications of each approach:

1. Simplicity or complexity of administration. Blanket taxation of all economic activity is the simplest approach to administer. Once economic activities are defined, NPOs are treated the same way as for-profit organizations. The “destination-of-income” rule is slightly more complex to administer. The main difficulty is establishing and enforcing criteria for what constitutes expenditures to support public-benefit purposes. This would require monitoring NPOs and their use of funds, and this “policing” function may prove to be administratively difficult. Moreover, this approach creates a greater potential for abuse by unscrupulous individuals seeking to use NPOs as vehicles for tax evasion.

A *mission-relatedness* test (source-of-income tax) is the most complicated to apply because it is difficult to specify the necessary connection between the economic activity and the public-benefit purpose. However, this test tends to work best when developed over time through administrative practice. This “mission-relatedness” approach is also the most likely to keep NPOs focused on economic activities that also provide public benefit.

2. Effects on revenue collection. Assuming the tax rates under the various treatments are equal, the greatest tax revenue is generated under the blanket taxation approach, since it subjects the

largest number of NPO self-financing activities to taxation. However, it is empirically unclear how much tax would in fact be collected, because, all things being equal, the level of commercial activities by NPOs will presumably be lower under this rule than under the others (because taxation provides a disincentive for CSOs to initiate commercial activities).

In its purest form, the *destination-of-income* rule has the lowest potential to produce tax revenue because all income, regardless of the source, is free from taxation if it is applied toward public-benefit purposes. In practice, many countries impose limits on the amount of income that is exempt under the “destination-of-income” rule, thereby limiting potential losses to the state’s revenue base. The *mission-relatedness* test also potentially reduces the size of the tax base, but probably less so than the “destination-of-income” test, because it only provides tax benefits for mission-related activities. However, it has the additional benefit of channeling NPO economic activity into specific areas that produce public benefit.

3. Effects on the commercial sector. The *blanket taxation* approach to NPO income from economic activities is most favorable for the commercial sector, since there is no possibility of *unfair* or prejudicial competition (i.e., NPOs do not receive preferential tax treatment when compared to for-profit entities). The *destination-of-income* rule does nothing to prevent claims of unfair competition, since the nature of the use of income may give NPOs a tax advantage that their for-profit competitors do not share. However, a limit on this benefit reduces the comparative advantage for NPOs. The *mission-relatedness* test minimizes unfair competition by encouraging NPOs to focus on activities that produce a public benefit and by applying the standard tax treatment used for for-profit enterprises when NPO activities are conducted purely for profit. The difficulty in implementing this *mission-relatedness* rule lies in establishing which economic activities advance the public benefit and which do not (or which do not advance it enough).

4. Effects on the development of the NPO sector. The *blanket taxation* approach reduces



resources for the non-profit sector, essentially transferring money from NPOs to the public sector. It is generally accepted that NPOs devoted to public-benefit purposes should at the very least not be required to transfer resources to the state if they are not eligible for state subsidies (similar to for-profit enterprises). Blanket taxation of all NPO income from economic activities eliminates the incentive to engage in income-generating, public-benefit activities and is the most unfavorable to the non-profit sector. NPO proponents claim that such taxes should be at a lower, more preferential rate than taxes for for-profit enterprises.

The destination-of-income rule provides the greatest potential revenue to NPOs, since virtually any income

can be made tax-exempt if channeled into public-benefit activities. The “mission-relatedness” test is less favorable to NPOs because activities that are undertaken purely to obtain revenue enjoy no tax exemption. However, the “mission-relatedness” test still provides significant tax benefits for NPOs, particularly when they focus on activities associated with public-benefit

purposes. Moreover, this approach channels NPO economic activities into more socially beneficial directions than the “destination-of-income” test, which encourages NPOs to engage in economic activities that can earn the greatest potential financial return but not necessarily the greatest social return.





Brazilian Legal and Regulatory Framework



This chapter presents the legal aspects related to the commercial activities of CSOs. As a general rule, there is no specific legislation for the commercial activity of non-profit entities, which are usually included under the authorization, registration, and regulation procedures for businesses. Because of this, Brazilian CSOs can self-finance as described in section 3.2 of this guide. In terms of taxes, there are differences in tax code for nonprofit entities, which may be immune to or exempt from taxation. Therefore, it is important to analyze all the ramifications of the practice of commercial activities by non-profit entities on a case-by-case basis.

3.1 General Norms Applicable to CSOs

In Brazil, the term “CSO – Civil Society Organization” is technically correct, although it is rarely used. More often, terms like “NGO – Non-Governmental Organization” are used for entities more strictly dedicated to the formulation of public policy or defense of rights; “Philanthropic” is used for those that offer free educational, health, or social assistance services; finally, “Institute” designates those dedicated to financial support for third-party social projects. Other names include OSCIP—Civil Society Organization in the Public Interest—for those included under Law 9.790



(3/23/1999) (see Section 3.2.1), or the names that correspond to their legal status: Association or Foundation. Therefore, in Brazil, many different names can be applied to non-profit entities dedicated to carrying out a social goal. In any case, to facilitate the reading of this guide, we will refer to all as “CSOs”, since they all are non-profit entities.

This concept—“non-profit” entity—is expressly legal,⁸ defined as groups which have no monetary gains, or, when they do, they funnel those gains back into the completion of their social objectives, since it is prohibited for them to distribute their surplus income or wealth in any way.

The primary Brazilian law that applies to CSOs is the Civil Code,⁹ which outlines, among other things, the creation of legal entities. CSOs must a) register their social statute in the Registry of Legal Entities in their area b) register with the Federal Revenue Department for the National Register of Legal Entities (NRLE) c) have a permit to function issued by their municipality and d) register as a taxpayer at the local or state level, depending on what services or commercial activities they intend to undertake.

For CSOs, there are two possible categories: Foundation and Non-profit Association.

3.1.1 Foundation

A foundation is established to support religious, moral, cultural, or social assistance purposes, created by individuals who define how it will be run.¹⁰

The chief characteristic of this type of CSO is that it has an endowment linked to a cause. This endowment can be composed not only of money, but also of any other good, such as real estate, stocks, objects, pieces of art, or authorial or image rights, as long as they are not under contest or restrictions and may be legally transferred to their beneficiaries. Once willed to the foundation, they will never be returned to the donor (or institutor) because they

were destined for the chosen cause, which becomes their “owner”. This endowment can be dedicated to a foundation in a will or during the owner’s lifetime, by an individual or a business.

Another important characteristic is the absence of *members*, which, as it will be shown later in the guide, is another difference between foundations and associations. It is therefore incorrect to allow for members in foundation statutes.

As a general rule, foundations are administered by boards—commonly called “Boards of Curators”—chosen by the donor or, in the donor’s absence, by the members of the board, who appeal for their reinstatement. This board directs the foundation and supervises its financial and operational management, which is handled by a volunteer directing board elected by the curators or, directly, by a paid team led by a paid professional, commonly called “executive director” or “executive president.” These positions can change as the organization changes or becomes more complex.

A foundation is always created by an unequivocal manifestation of will on the part of the founder, which can be accomplished through a public declaration or a will. This document should indicate clearly and specifically the purpose of the entity. In the case of creation by public decree, the founder must present a social statute to the Ministry of Public Affairs, which will approve it, make suggestions, or reject it.¹¹ After approval of the statute, the definitive creation of the foundation takes place. Next, the document must be entered into the Registry of Legal Entities of the municipality, which represents the foundation having earned its status as a legal entity.

Once created, a foundation may regularly sell services or merchandise, so long as this commercial activity does not stray from the purpose of the foundation.

To ensure that foundations stay loyal to their purposes, they are supervised by the Ministry of Public Affairs,

8 Art. 12, § 3, Law 9.532, 12/10/1997

9 Law 10.406, 01/10/ 2002

10 Art. 62, Civil Code

11 Arts. 65 and 66, Civil code



which receives yearly accounting reports that follow a standardized model (Record- and Bookkeeping System, available at www.fundata.org.br) and should be consulted about any relevant endowment operations, such as the sale of real estate or taking out loans. Because of this stipulation, any alteration in the foundation's social statute must be authorized by the Ministry of Public Affairs after approval by a 2/3 majority of the foundation's Board of Directors.¹²

3.1.2 Association

An association is defined as the union of persons for a non-profit purpose with no rights or reciprocal obligations among them.¹³

It is, therefore, the union of individuals or legal entities joined by a common interest. These members can pool resources and participate in the administration of the association. It differs from a business association because of the absence of profit as a motive, or in other words, the ban on distributing profits to association members.

To form an association, all that is needed are two people over the age of 18 and/or two legal entities (for- or not-for-profit) who want to engage in legal and not-for-profit activity. The entity should have a social statute describing its purpose and characteristics, which will be registered in the Registry of Legal Entities in the district in which the association is headquartered.

An association is run as outlined in its social statute, which establishes leadership positions and their responsibilities. The statute also states the quorum necessary for decision-making by the Board of Directors. However, only the general assembly can depose board members or change their statutes. The quorum for these actions is also established in the social statute.¹⁴

The Brazilian system divides associations into two categories: social initiatives, which benefit people out-

side their membership, and interest groups, which are intended to aid their own members. The first are the type described by the terms "NGO," "philanthropic organization," and "institute," and in the second category fall, for example, recreational clubs and professional and hobby-related associations. This second type is not generally afforded fiscal incentives. This guide focuses on social initiatives.

3.1.3 Designations

At times fiscal benefits depend on the pre-existence of government recognition. As a result, it is important to make reference to the titles conceded by Brazilian government agencies for institutions that fulfill certain requirements. They are as follows:

- **Federal Public Utility:** title conceded by the Ministry of Justice to foundations or associations who disinterestedly serve the general public. Some benefits are guaranteed with this designation, such as tax-deductible donations.¹⁵
- **Registration in the CNAS—National Council of Social Assistance:** available for social assistance foundations or associations which fulfill certain requirements. Allows the institution to sign agreements with public agencies or receive government subsidies.¹⁶ After the implementation of Law 12.10, the registration is no longer required by the Beneficent Entity of Social Assistance Certificate. However, it continues to be required by some public agencies as a proof of the organization's existence in the social assistance field.
- **Certification as a Social Assistance Entity:** awarded to social assistance foundations or beneficent associations of social assistance that fulfill certain criteria¹⁷ required by Law 12.101. The application is reviewed by the Ministry of Social Development, of Health or of Education, according to the main activity of the organization. If approved, the organization receives a social contribution exemption.¹⁸

12 Art. 67, Civil code

13 Art. 53, Civil code

14 Art. 59, Civil code

15 Law 91, 08/28/1935

16 Resolution 31, 02/24/1999

17 The criteria to obtain CEBAS can be found at: http://www.planalto.gov.br/ccivil_03/_Ato2007-2010/2009/Lei/L12101.htm

18 Decree nº 2.536, 04/06/1998



- Qualification as an OSCIP—Civil Society Organization in the Public Interest: granted by the Ministry of Justice to foundations or associations dedicated to certain activities. It guarantees advantages such as the possibility to pay directors named in the statute (members of the Board) without losing the immunity to or exemption from the income tax and social contributions on profits (OSCIP is the only designation that allows paying directors while maintaining tax benefits).¹⁹

3.1.3.1 OSCIP—Civil Society Organization in the Public Interest

Created in 1999, this designation for non-profit entities has been adopted often in recent years. To obtain this qualification, an association or foundation must present a petition to the Ministry of Justice showing fulfillment of several criteria. Among these are: (i) carrying out one of a spectrum of activities which represent the work of most CSOs, in categories such as social assistance, education, cultural diffusion, health, environment, economic development, etc.;²⁰ (ii) certain statute provisions, such as an article stipulating that should the institution dissolve, its endowment will be granted to another OSCIP; (iii) election of at least two people to the executive panel of the entity (board or its equivalent), and another three people to the internal regulation panel (fiscal council).

After the request is approved, the institution must register in the NRE—National Register of Entities - qualified by the Ministry of Justice, and must present an annual report by February 28th of each year in order to maintain tax-deductibility for donations received.

Aside from the ability to pay the members of the Board without losing immunity or exemption, there are other considerable advantages to being an OSCIP.²¹ One of these is the privilege to receive direct donations with benefits from the donor. This incentive is valid for businesses, which can deduct the value of the donation as an operational expense, up to 2% of the gross profit.

Another advantage to being an OSCIP is the possibility to sign deals with the federal, state, or local government to use government resources to carry out programs in the public interest.²² Furthermore, they can sign up to receive donations of goods confiscated by the Federal Revenue Department. These goods may be utilized by the entity or resold to raise funds.²³

3.2 Taxation and Exemptions

Before examining the specific rules pertaining to commercial activity and taxation of CSOs, this guide provides an overview of taxation in the country and the types of tax exceptions that benefit the entities.

The Brazilian taxation system is laid out in the Federal Constitution, which establishes all the types of taxes as well as the institutions responsible for their collection. The vast complexity of taxation in Brazil is due to the fact that many different institutions are responsible for different types of levies, under different rules. These levies are divided into **taxes, excises, and contributions.**

¹⁹ Law n° 9.790, 03/23/1999

²⁰ Law n° 9.790/1999 Art. 3. "promotion of social assistance; promotion of culture and defense and conservation of historic and artistic heritage; free promotion of education, in the way described by this law; free promotion of health, in the way described by this law; promotion of food safety and nutrition; defense, preservation, and conservation of the environment and promotion of sustainable development; promotion of volunteerism; promotion of economic and social development and working against poverty; non-profit attempts at new socio-productive models and alternative systems of production, commerce, employment, and credit; promotion of current rights, creation of new rights, and free legal help; promotion of ethics, peace,

citizenship, human rights, democracy, and other universal values; studies and research, development of alternative technologies, production and diffusion of scientific and technical information and knowledge."

²¹ In Brazil, often the founders of a CSO are also members of the CSO's Board and simultaneously working for the CSO on a daily basis but cannot receive financial compensation. If the CSO is classified as an OSCIP, this person can remain a member of the Board and also be financially compensated as an employee ,

²² Art. 116, Law n° 8.666/1993

²³ Directive n° 256/2002



For **taxes**, the Federal Union collects the income tax, rural territory tax, industrial products tax, importation tax, and exportation tax. The states are responsible for the sales tax, the tax on transportation and communication services, the *causa mortis* and donations tax, and the car tax. Finally, local governments are designated to collect the service, urban property, and real estate transfer (between live people) taxes.

The constitution allows some **immunity**, impeding the responsible tax collectors from exercising their right of collection in some cases. The “endowment, income, and services” of “not-for-profit education and social assistance institutions which operate legally” are protected by constitutional immunity.²⁴ Immunity is therefore a constitutional right.

There are also **exemptions** from taxes. These are granted by the institution responsible for collection, which may create or revoke them of its own free will. In this sense, the Federal Union can, for example, establish exemptions from income tax; the states control exemptions from the tax on circulation of merchandise and transport and communication services; and so on. Exemption is a legal favor.

The implication of this distinction is that a CSO can demand, in court, the defense of its *right*, but it must submit to the conditions imposed by the *favor*, which may be revoked. For example, the state of São Paulo exempted cultural associations from the *causa mortis* transmission and donations tax, but this benefit depends upon recognition by the Ministries of Culture and Finance that this is indeed a cultural association. If not recognized, the CSO must pay the tax.²⁵

Excise taxes are taxes which pay for public services that benefit citizens, such as the police service and street cleaning.²⁶ Although called excises in the law, they are also called by a variety of other names, such as “public administration costs”. CSOs are not

immune from paying excises, but they can receive exemptions. One example is the exemption from the public cleaning excise that the Federal District grants to non-profit social assistance organizations declared as public service providers.²⁷

There are four types of **social contributions**. They are all administered by the Federal Union: the precautionary contribution, also known as the “[protective] quota”; liquid profit social contribution (9% on liquid profit); social integration program (1.65% on earnings, but for non-profit organizations, 1% on salaries)²⁸; and social security (7.6% on earnings). The Constitution exempts social assistance organizations from these contributions if they comply with the rest of the requirements specified by law.

3.2.1 Conditions for Attaining Immunity

As already mentioned, immunity can only apply to institutions dedicated to education and/or social assistance.

Education refers to any activity related to “personal development,” “preparation for citizenship,” or “job training.”²⁹ It is a wide definition not applicable only to formal teaching. Education as a means to job qualification, environmental education, and physical education, among other things, is constitutionally exempt.

The concept of **social assistance** refers to services for “those in need, independent of social security.”³⁰ Its objectives are to: protect families, [maternity], children, adolescents, and the elderly; support needy children and adolescents; promote integration into the workplace; train and rehabilitate the handicapped and promote their integration into community life; and guarantee a minimum monthly pension for the handicapped and the elderly who demonstrate an inability to maintain themselves or their families.³¹

24 Art. 150, VI, “a”, Constitution

25 Law n° 10.705/2000, art. 6, § 2

26 Art. 77 National Tax Code

27 Law n° 2.627/2000, art. 1, III

28 Provision n° 1.858-6, 29/06/1999. Currently, this rule is included in Normative Instruction n° 247, 11/21/2002.

29 Art. 205 Constitution. Also interesting, art. 1 of the Education

Guidelines (Law n° 9.394/96): “Art. 1 – Education includes those processes carried out in family life, human interaction, at work, in research institutions, in social movements and civil society organizations, and in cultural manifestations.”

30 Art. 203, Federal Constitution

31 Supreme Court, ADIN 2036, Rel. Min. Moreira Alves, DJU 11.11.1999.



Along with these activities, the organization must follow certain guidelines to receive exemption for its endowment, income, and services. These are: (i) not distributing any part of its wealth; (ii) funneling all earnings back into its mission, and keeping the money inside the country; and (iii) using formal accounting practices (see section 3.7 of this guide for detailed information about formal accounting) of all their earnings and expenses. All organizations following these guidelines will be free from taxation on their endowment, income, and services.³²

However, there are other requirements found in other sections of legislative code. Of these, the following are especially important: (i) not paying directors (except if the organization is a OSCIP); (ii) presenting an annual declaration of income to the Federal Department of Revenue; and (iii) including a provision in the statute willing the endowment to another immune organization in case of incorporation, fusion, dissolution, or ceasing activities.³³

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Along with all of this, there are also the conditions placed by each level of government. For example, the state of São Paulo has a process for recognition of immunity to the *causa mortis* and donations tax, in which the organization must present a series of documents to guarantee that there will be no tax collected on the donations it receives.³⁴

3.3 Commercial Activities and Not-for-Profit Organizations

In accordance with the above definition, nonprofits apply all surplus wealth to the furtherance of their purpose. As aforementioned, CSOs are not prohibited from engaging in commercial activity, as long as this does not change their purpose. In other words, as long as the commercial activity does not become the purpose of the organization, overshadowing the

social goals for which the CSO was created. In two situations, the Federal Revenue Department believed that certain commercial activities were improper:

- Convenience store attending only to the CSO's members;³⁵
- A social assistance organization participating as a stakeholder in a commercial business, which meant applying resources to something not related to the social goals of the organization.³⁶

In situations where organizations deviate from their cause, the judge can decide, if asked by a concerned party or someone in the Ministry of Public Affairs, that certain obligations be extended to the private assets of the board of directors or members of the legal entity.³⁷ In this way, if a group of people attempt to earn a profit while evading taxes by creating a CSO, they have committed fraud and, from the start, abused the definition of a CSO. If this situation goes to court, the judge can declare the involved persons responsible for the tax debts of the CSO, because they were the ones guilty of abusing the purpose of the CSO.

The Constitution states that government entities cannot tax the *services* of non-profit institutions. In other words, the text of the document allows for the possibility of nonprofits providing services, without requiring that they be free, ensuring that the remunerations for these services are protected from taxes.

There is just one restriction to mention with respect to exemption from social contributions. Only nonprofits proving that at least 20% of their income goes toward providing services at no charge are exempt (this is one of the conditions to receive certification as a social assistance entity).³⁸ **To qualify for exemption, the entity must offer freely, at no charge, a part of its services, such that the**

32 Art. 14, National Tax Code

33 Law 9.532, 10/12/1997

34 State Decree nº 45.837, 06/04/2001

35 Solution of consultation 106, 04.30.2004; in the law: Law 9532/97, art 15; PN CST 162/1974, 9th fiscal region, DOU of 05.10.2004

36 Decision 171, 12.15.2000; in the law: art 32, §10, Law 9430/96, IN SRF 2/97, arts 12, 13, 14, 15 and 18, Law 9532/97; art 10,

Law 9718/98, 10th fiscal region. DOU 01.19.2001.

37 Art 50, Civil Code. Although this article states that the Ministry of Public Affairs may only act when it is appropriate for it to intervene in the process, we believe that it also has the right to act on non-profit entities, even when not designated a foundation, because these entities enjoy tax immunity or exemptions and take in resources on behalf of a public cause.

38 Decree 2.536, de 04/06/1998



amount spent on these free services is equal to at least 20% of its total income. In other words, for each R\$5.00 received, at least R\$1.00 must be spent on free services.

Examples of commercial activities commonly carried out by CSOs:

- **Licensing of a brand:** some entities of national prestige cede their brand name to private businesses, which pay royalties in return. For example, the S.O.S. Atlantic Forest Foundation (www.sosmatatlantica.org.br/english.html) allowed the use of its emblem by a line of oral hygiene products;
- **Educational services:** many CSOs are dedicated to education, both formal education, in schools, and more specific endeavors like job training, environmental education, or physical education. When courses are not free, they are considered a service;
- **Health services:** hospitals, clinics, etc. that charge for their services but do not redistribute their profits;
- **Events:** there are CSOs dedicated to holding events, such as cultural manifestations, artistic events, etc. The Sangari Institute (www.institutosangari.org.br/index2.htm--English), for example, has held cultural expos for several Brazilian capitals. The income earned from the tickets, or at times from a business that contracted the CSO to organize the event, is considered commercial earnings.
- **Sale of merchandise:** many organizations earn income from the sale of merchandise, in stores or online. Some organizations produce their own merchandise to sell, while others sell donated merchandise.

3.3.1 CSOs as Stakeholders in a Commercial Business

CSOs can participate or own shares in a for-profit entity and the revenues earned or gained by the organization are simply considered another stream of resources. A CSO's nonprofit nature will not be tainted so long as it distributes none of the surplus to members of its board of directors and the resources are used toward the organization's purpose.

However, there is no consensus on this practice. There are differing opinions, with some claiming that participation in a business is disloyal to the purpose of a CSO.

It is common for individuals or legal entities to donate assets, particularly stocks of publicly-traded companies. In this case, it is legal for a CSO to receive stocks, and it can receive the dividends or resell the stocks.

3.4 Taxation of commercial activities of CSOs

Some taxes apply directly to the *object* of commercial activity, like the sales tax, the services tax, the industrial products tax, and the importation and exportation taxes. Others apply to the *earnings* received through sale, like the contributions to the social integration program. Finally, some apply to the *profit* from commercial activity, like the income tax and social contributions.

In Brazil, local governments regulate and tax the sale of services, while the states regulate and tax the sale of merchandise.³⁹ Only the Federal District, because of its unique "city-state" form, has the right to regulate and tax both. To standardize the functioning of these taxes somewhat, the federal government imposes general norms for each tax, including fixing the minimum and maximum rates.⁴⁰

39 Information about tax rates and state exemptions can be found in the virtual pages of Finance Secretary of each State; Bahia (<http://www.sefaz.ba.gov.br/>), Rio de Janeiro (<http://www.fazenda.rj.gov.br/portal/index.portal>), São Paulo (<http://www.fazenda.sp.gov.br/>).

40 Arts. 146, III, 155 V and 156 I, Constitution



3.4.1 Income Tax

The income tax is collected by the Federal Union. It taxes the income or any other gains (increases in wealth not classified as “income”) by the taxpayer.⁴¹ This concept is used for the tax collected from individuals.

In terms of legal entities, legal code defines the income tax as a tax on **profit**. Therefore, a legal entity should collect the tax on profit, the definition of which includes gains from investment, capital gains, and gains from general commercial activity.

When discussing the income tax, one could say that the profit considered taxable is that which the business distributes to its stakeholders. In other words, the tax is on the results of the business which will benefit those involved. The profits of CSOs do not fit into this idea, since the surplus in their accounts can never be distributed to stakeholders. This is why the exemption rules are fairly extensive, as explained later in the guide.

The basic income tax level is 15%.⁴² Furthermore, if monthly income exceeds R\$20,000.00, (approximately US\$11,100) it is subjected to an additional 10% tax, totaling 25%.⁴³

In Brazil, there are two schedules for taxing profit: real and presumed. To find real profit, one subtracts all costs and expenses from income, and the result is the taxable profit. This is the schedule for large businesses, which earn over R\$48,000,000.00 (approximately US\$26,667,000) per year, and commercial banks, credit unions, etc. On the presumed profit schedule, the law⁴⁴ generally establishes a fixed percentage of earnings which will be considered profit, independent of expenses. In this system, the profit is calculated as 8% on earnings from the sale of goods and services or specifically from the sale of hospitality services and 32% on earnings from other types of services. This calculation gives the taxable profit, to which the income tax is applied (15%, with or without the additional 10%).

For non-profit entities, the conditions for constitutional immunity or exemption are broad, such that nonprofits are rarely taxed, even for commercial activity.

Immunity is only granted to CSOs dedicated to education or social assistance. Exemption can apply to the following: “philanthropic, recreational, cultural, scientific, and civic organizations that offer the services they were created to offer to the individuals for whom they are intended, without profit as a motive.”⁴⁵

Exemption is much more broadly applied than immunity, reaching entities dedicated to many activities, as long as they are nonprofits. The inclusion of the term “philanthropic” means that the majority of CSOs are exempt as long as they do not distribute their profits.

To earn immunity or exemption from income tax, an entity must fulfill the following requirements:

- a) Not pay board of directors in any way for their services;
- b) Apply resources to the furtherance of its purpose;
- c) Keep complete accounting records of receipts and expenses under formal bookkeeping standards which ensure exactness;
- d) Maintain in good order, for five years from the date of inception, documents that show the origin of receipts and amounts spent, as well as records of other acts that change its financial situation;
- e) Present an annual Declaration of Income following guidelines by the Federal Revenue Department;
- f) Collect taxes and social security properly, and comply with the related obligations;

41 Art. 43, National Tax Code

42 Law nº 9.249/1995, art. 3

43 Law nº 9.249/1995, art. 15

44 Law nº 9.249/1995, art. 15

45 Art. 15 da Law nº 9.532, 12/10/1997



- g) Ensure that its endowment will go to another immune institution or public agency should it incorporate, merge, dissolve, or end its activities.⁴⁶

Observe the restriction in “a” which prohibits paying directors for their services (except in the case of a OSCIP). Because of this, any CSO that wants tax immunity cannot pay or reward its Board of Directors in any way. This does not, however, prohibit the entity from having paid employees.

3.4.2 Sales Tax

The sales tax is the responsibility of the states and the Federal District. It taxes the circulation of merchandise (commerce) based on the value of the commercial act. **The rates vary in each state (although in most cases they are 17%) and, within each state, they vary depending on the product.**⁴⁷ The base rate in the states of São Paulo and Rio de Janeiro is 18%.

The sale of merchandise does not immediately make one a merchant, because a merchant is, in the law “any person or legal entity that **habitually or in large volume characteristic of commerce** carries out operations relating to circulation of merchandise or interstate and inter-municipal transportation or communication services, even if the operations or services begin in another area.”⁴⁸ Therefore, the sale of used goods by a CSO does not make it a merchant, unless it regularly has, for example, a store to sell goods received as donations. Once the status is defined, the institution may proceed with its application to the State Registry through the Finance Secretary of the State where the CSO is legally established.

3.4.2.1 CSOs as Final Consumers

Since the sales tax is indirect, it falls on the final consumer, because the tax (like the industrial products tax—see section 3.4.3) is non-cumulative, meaning the tax paid in an earlier step of the process is repaid

by that owed in the next transaction, so that the tax is “carried” from the first transaction to the last and is paid by the final consumer, whether that be a legal entity or an individual.

The complexity of the non-cumulative system of this tax is due to the fact that each state can lay out certain aspects of the tax, for example the rate and any exemptions or benefits. The commercialization of any product will have its taxation rate determined by the seller’s state of residence. In interstate operations (in which the seller is in one state and the buyer in another) the product will have its own tax rate, at times different from that specified in the legislation of either state. In this situation, the seller’s state is responsible for collecting the tax.

Still, the question remains: should a CSO pay the sales or industrial products taxes on goods it *buys*?

In most cases there is a legal provision to avoid taxation, although it may be necessary to turn to the courts. Recent verdicts from superior courts have sided with CSOs, seeming to imply that the prohibition of taxation should be interpreted broadly and that constitutional criteria for classifying such terms as “merchant,” “buyer,” and “seller” should be disregarded in the case of CSOs.⁴⁹ In other words, if the good bought becomes part of the entity’s wealth, it is safe under the immunity conceded from the sales tax.

A CSO’s purchase of goods should become part of the endowment recognized as immune from the sales and industrial products taxes. The next step is to formalize this recognition with state finance ministries, and if denied, seek recognition through judicial action.

The entities may also request restitution of these taxes paid in the past, as article 166 of the national tax code states that [“the restitution of **taxes which implies transfer of financial responsibility** will only be conceded to the individual or entity who

46 Law nº 9.532/97, Art. 12, § 2

47 Art. 155, § 2, III, Federal Constitution

48 Art. 4, Complementary Law 87, 12/13/1996

49 See 2. Supreme Federal Court in an extraordinary resource situation 203.755/ES, judged 09.17.1996, by Min. Carlos Velloso: “Constitutional. Tax. Sales tax. Tax immunity. Non-profit educational institution.



proves to have assumed responsibility, or in the case of its transfer to a third party, be expressly authorized by this third party to receive it.]⁵⁰

3.4.2.2 CSOs as Sellers

The same question persists, from a different angle: should a CSO pay the sales tax (and industrial products tax) on the goods it *sells*?

For the sale of merchandise, a non-profit entity does not enjoy immunity or exemption from this tax, where the cost is passed to the final consumer. The only valid way to obtain exemption from the sales tax in sales is one of the following: (i) sell products that are immune or exempt from the sales tax; (ii) sell products that are produced by the CSO; or (iii) obtain a special exemption through an agreement with the government.

According to the sales tax rules in São Paulo, the tax does not apply, for example, to: (i) operations involving books, newspapers, or periodicals (ii) regional handicrafts, sold directly by the artisan, in their residence, without salary and (iii) certain products for people with physical disabilities, such as wheelchairs and specialized vehicles.

The above-mentioned products are exempt from taxation no matter who is involved in the sales activity. So, if a CSO works—even in resale—with any of these types of products, it will be exempt from the sales tax.

As already mentioned, each state of the Federation has the liberty to institute exemptions as it sees fit. One relevant example is the **State of São Paulo, which exempts the commercialization of products produced by any nonprofit education or social assistance program from the sales tax.** In this case, the entity must observe the following requirements: (i) use all gains to further its

social objectives; (ii) the value of revenue from sale of the product must not surpass the micro-business exemption limit (gross income of R\$240,000.00 per year) (approximately US\$133,300);⁵¹ and (iii) present proof of the above to the Finance Ministry, which will decide whether or not to allow exemption.

The State of Paraná concedes a similar benefit.⁵² In both cases, the exemption applies only to education and social assistance organizations, leaving out, for example, cultural and recreational groups.

Also, due to specific sales tax agreements, many nonprofit institutions have obtained exemption from the sales tax, including: (i) the Tamar Project Foundation⁵³ (ii) the National Industrial Education Service (SENAI) and (iii) the Art Museum of São Paulo (MASP).

Generally, these exemptions are the subject of interstate agreements created in an attempt to establish common rules for the sales tax.⁵⁴ Each state may decide whether or not to participate.

3.4.3 Services Tax

The services tax is collected by local governments, and it taxes any activity defined as a service. The law lists taxable services.⁵⁵

If it is difficult to understand the sales tax because it is different in each of the 26 states and the Federal District, the services tax is much more complicated: there are 5,564 municipalities which can exercise their power to institute and collect the tax.

Generally, the services tax is owed in the area where the service provider is based, even when the action takes place in another municipality. This is one of the few general rules of the services tax, applicable in the whole country. These rules also state that it taxes the price of the service and that **the maxi-**

50 See Higher Court of Justice - REsp 276.469/SP, 1.

51 Currently, this limit is defined in art. 12, § 4, State Law n° 10.086/1998 (changed by State Law n° 12.186/2006).

52 Decree n° 1.980, 12/21/2007

53 RICMS/SP Annex 1 - Article 68 (PRÓ-TAMAR) – Promoted by the Pró-Tamar Foundation, which agreed to promote objectives linked

to the National Program for Sea Turtle Protection. This benefit will last until April 30, 2005.

54 For example, sales tax agreement n° 38/92, from which the São Paulo and Paraná exemptions listed above is taken.

55 Complimentary Law (Federal Constitution art 156) and Law n° 116, 07/31/2003.



mum rate is 5%.⁵⁶ The organization should verify the local procedures with the municipality where its services are offered.

The rule of constitutional immunity is the same,⁵⁷ which determines that the tax does not apply to earnings from services provided by non-profit entities dedicated to education and/or social assistance. Each municipality, meanwhile, establishes a procedure for this right to be recognized.

For example, in Goiânia, the endowment, income, and services of not-for-profit education and social assistance institutions are exempt. To earn this exemption, the entity must receive a Declaration of Recognition of Immunity from the Finance Ministry.⁵⁸

The City of São Paulo also established its own process for recognition of immunity: to solicit recognition of immunity from taxes, the entity must present a Solicitation of Recognition of Tax Immunity.⁵⁹

Therefore, there are prior processes which must be followed to earn the right to tax immunity.

For exemptions, rules vary greatly, because there are so many municipalities which collect the tax in different ways.

The case of the City of Rio de Janeiro is relevant. It exempts cultural, recreational, and sporting associations; concerts, recitals, shows, festivities, expositions, fêtes, and other such events with the earnings intended for furthering the entity's purpose; and the showing of films in theaters owned by Brazilian non-profit entities.⁶⁰

Immunity in Rio is very specific. While it covers social assistance and education entities, exemption specifically benefits those listed above. Along the same lines as other examples, exemption also depends on express recognition by the fiscal authority.⁶¹

3.4.3 Industrial Products Tax

The industrial products tax is collected by the Federal Union, and it taxes the fabrication of products for sale. The tax applies to industrial products, understood to mean the results of any operation defined as industrial, including incomplete, partial, or intermediary production. "Industrial" refers to any operation that modifies the nature, functioning, finishing, presentation, or intent of the product or that perfects it for consumption.⁶²

Although somewhat open for interpretation, the tax's application can better be comprehended when considering the meaning of "industrial establishment." This concept opposes the definition of "office," an establishment employing a maximum of five manual laborers, and if using mechanical force, does not use anything more powerful than five kilowatts.

In other words, an entity is only practicing activities in the domain of the industrial products tax if it modifies or transforms products in a well-equipped establishment with a large number of manual laborers using high-powered equipment. Therefore, it seems reasonable to conclude that a non-profit CSO linked to the promotion of social values will rarely engage in this type of activity.

In any case, when a CSO constitutes a large establishment and produces at elevated levels, it should verify whether its activity fits the definitions outlined in the industrial products tax table,⁶³ which also lists the tax rate, which varies depending on the activity.

3.4.4 Social Contribution on Liquid Profit

The social contribution on liquid profit is collected by the Federal Union, and it concerns profit, defined as an operating surplus or positive result from commercial activities.^{64,65}

56 Complimentary Law nº 116/2003

57 Art. 150, VI, "c"

58 Municipal Tax Code (Law nº 5040/1975, § 8, art. 7)

59 SUREM Normative Instructions nº 03/2008, art. 2, § 1

60 Decree nº 10.514, 10/08/1991

61 Decree nº 14.602, 02/29/96, which instructs the entity to present a request for consultation about its right to exemption

or immunity from the Tax Consultation department of the Tax Consultations and Studies Institute.

62 Decree nº 4.544, 12/26/2002

63 Approved by Decree nº 6.006/2006

64 Federal Constitution, art 195 I 'c'

65 Art. 3, Law nº 7.689/1988



Note that for this tax, the concept of “profit” is viewed as a final result, requiring merely a surplus to take effect.⁶⁶ Therefore, whether or not an entity works for profit does not imply that it is not taxed on liquid profit. With a positive final result, the tax applies.

Although this is technically considered a required social contribution and not a tax, there are cases of immunity. Social assistance entities are exempt from social security contributions.⁶⁷ The criteria for this benefit are that the entity (i) be recognized as publically beneficial both federally and by the state or Federal District or municipality (see section 3.1.3) (ii) be a holder of the Certification of Philanthropic Entities (see section 3.1.3) (iii) promote social assistance, including educational and health services, to minors, the elderly, the handicapped, or the needy (iv) not pay or afford benefits to directors, consultants, members, institutors, and benefactors (except for those entities qualified as OSCIPs) (v) use earnings to continue and develop its institutional objectives, presenting annual reports on their activities to the responsible National Social Security Institute agency.⁶⁸

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In summary, immunity from the social contribution on liquid profit is only granted to social assistance organizations that fit the requirements and their corollaries regarding obtaining and renewing certification, as well as presenting documentation and reports.

However, for this social contribution, the same rules for exemption apply as for the income tax.⁶⁹ To be exempt, an institution must be “philanthropic, recreational, cultural, scientific, or civic, and carry out the purpose for which it was created by providing services to the people for whom they are intended, without seeking profit.” Therefore, there are broad exemptions, which cover most nonprofit CSOs that practice philanthropic acts or any of the others listed above.

3.4.5 Social Integration Program and Social Security

Contributions to social integration and social security follow a framework similar to that on liquid profit, though they tax earnings, not profit.

However, with regard to the social integration program, for philanthropic, recreational, cultural, scientific, or civic institutions, the tax is not on earnings, but rather on salaries (at a rate of 1%).⁷⁰

For the vast majority of CSOs, the social integration contribution is therefore not a tax linked directly to earnings from commercial activity, but rather a tax on salaries paid out by the entity.

Social security taxes the “gross profit of the legal entity.”⁷¹

There are two different systems for social security collection: cumulative and non-cumulative. For cumulative collection, each part of the production chain collects a 3% tax, without rights to tax credits paid by producers. In the non-cumulative system, the rule is the same as for the sales tax: the cost is passed on to the final consumer. For the non-cumulative system, the social security rate is 7.6%. As described later in the guide, in the case of CSOs, there is much confusion over which system they should adopt.

Immunity from social security payments follows the same rule as that for the contribution on liquid profit, as seen above: it is valid for social assistance entities that fulfill certain requirements.⁷²

Education and/or social assistance entities are exempt from social security. This means that income from the sale of goods and/or services for which the institution was created, such as monthly tuition at non-profit schools, are exempt.⁷³

66 Art. 2, Law 7.689, 15/12/1988

67 Art. 195, § 7, Federal Constitution

68 Law n° 8.212, 07/24/2001

69 Art. 15, Law n° 9.532, 12/10/1997.

70 Provision n° 1.858-6, 06/29/1999. Currently, this rule is in Normative Instruction n° 247, 11/21/2002.

71 Law n° 9.718, 11/27/1998.h

72 Art. 55, Law n° 8.212/91.

73 Provision n° 1858-6/99 (currently 2158-35)



However, the Federal Revenue Department has been implying that only income in the form of donations/contributions qualify for the exemption, while income from the sale of goods/services should be considered subject to social security collection.

The question was recently discussed in the courts, which handed down some verdicts in favor of nonprofits, recognizing that the exemption from social security extends to revenue from the sale of goods and services, which is also part of the purpose of the entities. Nevertheless, there is still no clear answer. Currently, income from the sale of goods and services is taxed for social security, save a specific verdict against taxation.

3.4.5.1 Social Security Collection Schedule

In the social security collection schedule (cumulative or non-cumulative), which defines the rate and taxable earnings, there is extremely complicated, messy legislation with regard to the percentage owed and the application of new exemptions.

The Federal Revenue Department is unclear about this. It is understood that **on the earnings from the sale of goods/services by nonprofit institutions, the non-cumulative social security applies.⁷⁴ In other words, the entities must pay 7.6%, with possibility for a discount for credits from earlier operations.**

On the other hand, the law⁷⁵ says that CSOs that enjoy immunity from taxes (education and social assistance institutions) should pay social security on the sale of goods/services at the rate of 3%, without a right to credit for taxes paid in acquisitions (in other words, they are subject to the cumulative system).

Furthermore, exempt entities and those not qualified as immune must pay by the non-cumulative system. This causes confusion because the concept of tax-immune entities, defined in article 150 of the Federal Constitution, is the same concept used in the exemption rule for social security (provision 2158-

35) which is: nonprofit education or social assistance entities.⁷⁶

So, which tax schedule should a CSO that fits this definition (educational or social assistance) adopt for social security? This is a question that current legislation cannot answer. It would seem that constitutional law should prevail over any lesser laws, meaning that **the valid system is the cumulative system**, despite the direct contradiction from the Federal Revenue Department. As the cumulative regimen, which has a lower rate, is more favorable, we have been recommending that entities seek recognition of this right, which can be done through the fiscal consultation process and, if necessary, in court.

3.4.6 Importation Tax

As the name suggests, the Importation Tax taxes the importation of foreign products. The tax is paid when the product is brought through customs, and the rate depends on the nature of the merchandise.

Non-profit entities are exempt from this tax if they are dedicated to education or social assistance.⁷⁷

3.4.7 Exportation Tax

Like importation, exportation is also subject to federal taxation. Rates also vary depending on the type of merchandise to be exported.⁷⁸

Legislation does not allow exemptions for non-profit entities, so any organization that exports merchandise must pay this tax.

3.4.8 General Overview

To give a general overview of taxation on the commercial activities of non-profit institutions, it is necessary to split them into two categories. In the first table are the entities dedicated to education and/or social assistance, which are entitled to constitutional tax immunity. All other non-profit entities fall into the second table.

74 Decree n° 5.164, 2004 and Decree n° 5.442, 2005" (Solution of Consultation n° 96/2006)

75 Law n° 10.833/2003

76 Defined in art. 150 of the Federal Constitution, same rule used in social security exemption (Provision n° 2158-35)

77 Law n° 8.032/1990 (art. 2, I, 'b')

78 Decree-law n° 1.578/1977



Education and Social Assistance							
Activity	Income tax for legal entity	Sales tax	Services tax	Industrial products tax	Importation and exportation taxes	Social contribution on liquid profit	Social security contribution
Royalties for brands and authorial rights	Immune	Not applicable	Immune	Not applicable	Immune	Exempt*	Exempt*
Paid educational services (including monthly tuition)⁷⁹	Immune	Not applicable	Immune	Not applicable	Not applicable	Exempt*	Exempt*
Health services	Immune	Not applicable	Immune	Not applicable	Not applicable	Exempt*	Exempt*
Events (ticket sales)	Immune	Not applicable	Immune	Not applicable	Not applicable	Exempt*	Exempt*
Sale of merchandise	Immune	May be exempt depending on rules in state where located	Not applicable	Rarely applicable	Immune	Exempt*	Exempt*

* With regard to social contributions (liquid profit and social security), exemption depends on obtaining certification as a social assistance entity, and the social integration program contribution is calculated based on the payroll, as explained in section 3.4.5 of this guide.

⁷⁹ We use health and education services as an example, because they are activities commonly practiced by education and social assistance entities.



All Other Social Objectives							
Activity	Income tax for legal entity	Sales tax	Services tax	Industrial products tax	Importation and exportation taxes	Social contribution on liquid profit	Social security contribution
Royalties for brands and authorial rights	Exempt	Not applicable	Applies	Not applicable	Immune	Exempt	Applies**
Paid services (including monthly tuition)	Exempt	Not applicable	Applies	Not applicable	Not applicable	Exempt	Applies**
Events (ticket sales)	Exempt	Not applicable	Applies	Not applicable	Not applicable	Exempt	Applies**
Sale of merchandise	Exempt	May be exempt depending on rules in state where located	Not applicable	Rarely applicable	Exempt	Exempt	Applies**

** With regard to social security, the law allows exemption only for income from “contributions, donations, or annual or monthly fees” (such as school tuition).⁸⁰ Earnings from commercial activities are subject to social security contributions according to regulation, although some entities are questioning this restriction judicially. Contribution to the social integration program is taken from payroll, as explained in section 3.4.5 of this guide.

3.5 Laws about non-commercial sources of resources

Other types of gains are recognized in the law. Of private origin, there are donations, defined as “the contract in which one person or legal entity freely transfers goods or assets from their wealth to that of another person or legal entity.”⁸¹ Donations are not taxed under the income tax, but may be taxed under the *causa mortis* and donations tax, depending on local legislation.

This tax applies to goods received as *causa mortis* (inheritances) or donations. The maximum rate is

4% on the value received, but each state has its own rules and peculiarities. Education and/or social assistance entities which fulfill the legal requisites are covered by constitutional immunity, and it is the institution’s responsibility to determine what administrative process it must follow to have this right recognized, which varies in each state.

To present financial incentives to donors, entities can develop projects promoted by specific laws like the Cultural Promotion Law or “Rouanet Law,” Audiovisual Law, Sports Promotion Law, and those linked to the Fund for Childhood and Adolescence.⁸²

80 Provision n° 1.858-6, 29/06/1999 and Normative Instruction n° 247, 11/21/2002

81 Art. 538, Civil Code

82 Law n° 8.313, 12/23/1991; Law n° 8.685, 07/20/1993; Law n° 11.438, 12/29/2006; and Law n° 8.069, 07/13/1990, respectively.



The Rouanet Law allows non-profit entities involved in cultural activities to develop projects with public or private resources, under the designation of donation (support without any repayment) or sponsorship (transfer of resources as an endorsement tool, to promote the investor or its brand). As an incentive to private investors (individuals or legal entities, as long as these are for-profit), federal legislation allows these contributions to be deducted from the owed income tax (except the additional 10%).

It is important to note that the Rouanet Law describes two different types of benefits. The first is in article 18, which supports projects in specific areas.⁸³ Private investors can make donations or sponsor the entity, and deduct this support from the income tax owed, up to 6% (individuals) or 4% (legal entities). The second type of benefit is expressed in article 26, which is for cultural projects in less specific pre-defined fields.⁸⁴ In this case, the tax deduction is only partial. For donations, the deduction can be up to 80% (individuals) or 40% (legal entities) of the value invested, to the limit of 6% (individuals) or 4% (legal entities) of the amount owed. For this benefit, a legal entity can also claim the value donated as an operational expense to reduce the real profit for tax purposes. More information about the Rouanet Law can be found at:

<http://www.cultura.gov.br/site/categoria/apoio-a-projetos/mecanismos-de-apoio-do-minic/lei-rouanet-mecanismos-de-apoio-do-minic-apoio-a-projetos/> (Portuguese only).

The Audiovisual Law provides for incentives to those who invest in the exhibition, description, and technical infrastructure or coproduction of audiovisual works. Entities may present projects to the Securities Commission, requesting authorization to sell “commercialization quotas” to private investors, which can deduct the value of their investments from their income tax. These projects can also receive spon-

sorships, which also allow deduction from income tax on the part of the sponsor, though in different percentages. The purchase of commercialization quotas allows a deduction up to 3% (individuals) and 1% (legal entities), and sponsors can deduct up to 6% of the amount owed if they are an individual and 4% if they are a legal entity.

Further information: <http://www.cultura.gov.br/site/categoria/apoio-a-projetos/mecanismos-de-apoio-do-minic/lei-do-audiovisual/> (Portuguese).

The Sports Promotion Law works much like the Rouanet Law. There must be a sports project developed by a non-profit entity whose social objective is related to sports. This entity can receive contributions as donation or sponsorship, and the investor can reduce his amount of income tax due by up to 6% for individuals, or 1% for legal entities.

Further information: <http://portal.esporte.gov.br/leiIncentivoEsporte/> (Portuguese).

Furthermore, entities that develop assistance projects with the support of the Children’s and Adolescents’ Rights Funds⁸⁵ can receive donations through the municipal children’s and adolescents’ councils. Donors can deduct these amounts from their income tax, with limits of 10% of gross income for individuals and 5% of gross income for legal entities.

There are also benefits under state laws and, more commonly, under municipal laws. For example, the City of São Paulo allows deductions from the services tax and the building and urban territory tax for gifts to cultural entities (music, dance, theater, circus, cinema, photography, video, literature, art, stamp collecting, folklore, artisan handcrafts, historical and cultural heritage, museums, and cultural centers). Legal entities investing in the projects of cultural CSOs can deduct up to 70% of the value donated, up to the limit of 20% of the total tax due.⁸⁶ Further information:

83 “in theater; literary or humanistic art books; sophisticated or instrumental music; art expositions; donations to the collections of public libraries, museums, public archives, and film archives, as well as training of personnel and acquisition of equipment for these archives; production of short and medium-length films and preservation and diffusion of audiovisual heritage; preservation of material and immaterial cultural heritage; and construction and maintenance of theaters and movie theaters in municipalities with less than 100,000 inhabitants.”

84 “theater, dance, circus, opera, mime, and related arts; film, photographic, musical, and related productions; literature, including reference books; music; sculpture, drawing and painting, engraving, stamp collecting, and related arts; folklore and artisanry; cultural heritage, including historic, architectural, archaeological, libraries, museums, archives, etc.; humanities; and non-commercial educational and cultural tv and radio.”

85 As established in art. 260, Law nº 8.069/90

86 Municipal Law nº 10.923/1990



http://www.prefeitura.sp.gov.br/cidade/secretarias/cultura/lei_de_incentivo/index.php?p=7 (Portuguese). There are also several possible ways to obtain public resources:

- Aid and contributions:⁸⁷ support from the Federal Union as authorized in the annual Law of Budget Guidelines;⁸⁸
- Economic and social subsidies: economic subsidies depend on availability under the Law of Budget Guidelines. Social and economic subsidies are specifically linked to a certain use, unlike aid and contributions.⁸⁹
- Pacts, agreements, or covenants: cooperation instruments signed between non-profit entities and public administration agencies or private organizations to promote common interests;⁹⁰
- Partnerships: available for organizations qualified as in the public interest (OSCIPs) with the goal of more objective action alongside public administration.⁹¹

3.6 Fiscal Declarations

At the federal level:

For the Federal Revenue Department of Brazil:

- (i) DIPJ—Declaration of Physical Economic Information of a Legal Entity (annual, due June 30th), with information about earnings, expenses, and changes in wealth over the calendar year;
- (ii) DIRF—Declaration of Withheld Income Tax: (annual, due February 15th), with information about tax withheld from employees and others, as required by specific legislation;
- (iii) DCTF—Declaration of Federal Debits and Credits (monthly, due the 15th business day of the

following month, or by semester, due the 5th business day of April and October), with information about the amounts of all taxes and federal contributions collected in the period;⁹² and

- (iv) DACON—Declaration of Collection of Social Contributions, with the base amounts on which the social integration and social security contributions will be collected (monthly, due the 5th business day of the following month).

These declarations must be presented even for non-profit organizations, except the DACON, which need not be submitted by entities that are immune or exempt to the income tax and will contribute less than R\$10,000.00 a month to these programs.⁹³

For the Ministry of Justice, OSCIPs or other CSOs declared to be working in the public interest must present an annual report, by April 30th, detailing their activities and related expenses and earnings, among other information, following the model of the NRE—National Register of Entities, which is available on the ministry's website (www.mj.gov.br/cnes; Portuguese only).

At the state level:

Foundations must present:

- To the Ministry of Public Affairs: annually, by April 30th, a report describing activities and related expenses and earnings, among other information, following the SRB—System of Registration and Bookkeeping, the specific rules of which are available at the regulatory agencies for foundations.
- To the Finance Ministry: monthly declarations about collection of the sales tax, following the model defined by the state, except for those that do not sell merchandise and are therefore are not listed in the state registry of contributors.

87 Law n° 4.320, 03/17/1964 and Decree n° 93.872, 12/23/86

88 Currently Law n° 11.514, 08/13/2007, art. 37

89 Law n° 4.320, 03/17/1964 and Decree n° 93.872, 12/23/86

90 Decree n° 6.170, 07/25/2007 and Normative Instruction n° 01/1997, from the National Treasury

91 Law n° 9.790, 03/23/1999 and Decree n° 3.100, 12/30/1999

92 Changes are result of new Normative Instruction, published December 30.

93 Art. 5°, II, Normative Instruction n° 590/2005



These state declarations are only required of foundations. Associations do not need to present them.

At the local level:

To the Finance Ministry: Monthly declarations about collection of sales tax, following the municipality's procedure, except for entities that do not provide services and are therefore not listed in the municipal registry of contributors.

3.7 Necessary Expertise to Carry Out Commercial Activity

Bookkeeping is extremely important and, as seen above, is necessary to enjoy tax immunity. For non-profit entities, accounting follows the same general rules as those applying to businesses. Acts involving earnings, expenses, and changes in wealth must be registered in individual books.

Things to be shown are the same as those of for-profit businesses:⁹⁴

Balance: variations for the period;

- Results: final result based on earnings and expenses for the period;
- Accumulated gains or losses; tracking the entity's surplus;
- Changes in the endowment: tracking endowment funds;
- Origins and applications of resources: information of a financial nature.

There are some peculiarities to be observed, established by the Brazilian Accounting Standards.⁹⁵ These peculiarities apply specifically to nonprofit organizations, and state that, for example, notations in the books must be accompanied by "explicatory

notes" stating certain information. Furthermore, there are elements that apply only to foundations and lay out "specific procedural criteria for evaluation of accounting registers and structuring of financial documents" for this class of entities.

For foundations, earnings must be registered in different columns, obeying two criteria:

- Donations, subsidies and contributions to be *spent* are noted as receipts. Donations, subsidies, and contributions to the *endowment*, including those brought in the creation of the entity, are registered in the endowment column.⁹⁶
- Accounting registers must show earnings and expenses separately when identifiable by *type of activity*, such as education, health, social assistance, technical-scientific, etc., as well as commercial, industrial, or services.⁹⁷

Therefore, there is a bookkeeping distinction depending upon whether the resource is destined to the endowment or to expenses. Furthermore, **earnings from any activities undertaken to self-finance (commercial⁹⁸, industrial, or services) must be registered separately from all other income.**

The standards are relatively complex and not widely known. Generally, entities must contract a person with accounting knowledge to keep their books.

Some observations are available on the Social Development Ministry's website:
<http://www.mds.gov.br/institucional/secretarias/secretaria-nacional-de-assistencia-social-snas-1>

There are also organizations dedicated to helping entities, particularly the GIFE

94 Brazilian Accounting Standard n° 3.

95 N° 10, items 10.4 and 10.19

96 Brazilian Accounting Standard N° 10.19.2.3

97 Brazilian Accounting Standard N° 10.19.3.5

98 Commercial in this instance refers to the sale of goods.



GIFE—Group of Institutes, Foundations, and Businesses

www.gife.org.br

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ABONG—Brazilian Association of Non-Governmental Organizations

www.abong.org.br

Rua General Jardim, 660 - 7º andar

Vila Buarque, São Paulo SP, CEP 01223-010

Telephone/Fax: (55 11) 3237-2122

E-mail: abong@uol.com.br

NESsT – Non-profit Enterprise Self-sustainability Team

www.nesst.org

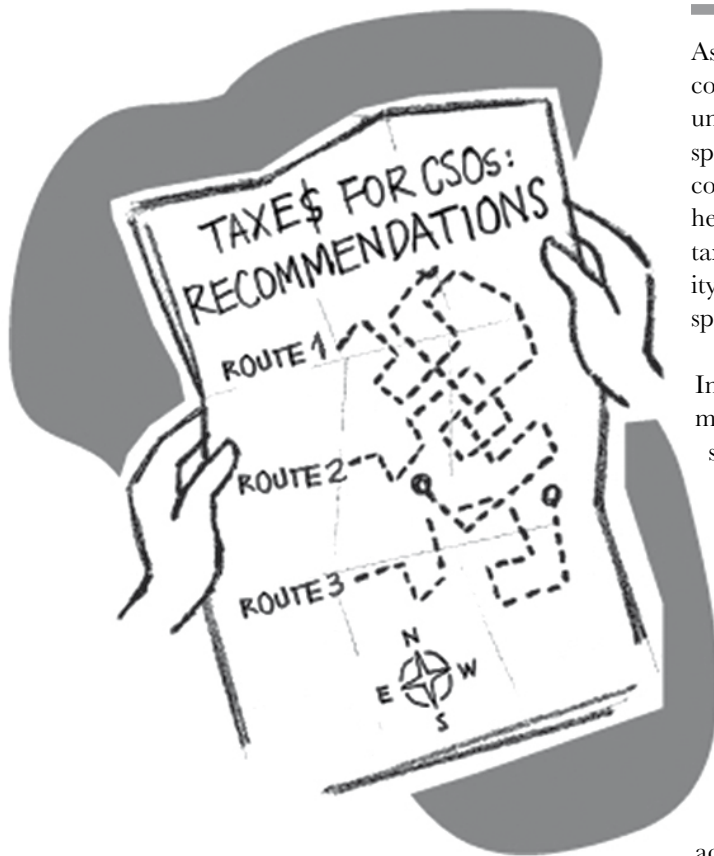
Telephone: (55 11) 8116-5138

São Paulo, SP





Interpretation and Critique of Brazilian Legal Framework



As it has been shown, Brazil's legislation is quite complex, constantly being modified, and difficult to understand. One problem is the lack of legislation specific to commercial activities of CSOs. The tax code, in particular, is even more difficult to comprehend because of the division of responsibility for taxation, meaning that each state and municipality has its own rules and regulations with their own specificities.

In this context, CSOs find themselves working with more and more rigorous legislation for the non-profit sector, trying to overcome the many barriers imposed by the state.

The ICNL typology introduced in Chapter Two of this guide is a helpful way to understand the current legal and fiscal regulations that apply to Brazilian CSOs engaging in self-financing activities.

Firstly, it should be noted that according to the Brazilian Civil Code, CSOs are permitted to engage in self-financing activities so long as the activity does not deviate the CSO from its main social purpose and does not become the principal activity of the organization. This interpretation applied in Brazil would be in line with the ICNL principal-purpose test criteria.

The ICNL destination of income test also applies to



Brazil. For example, as highlighted in the previous chapter, the participation of a CSO in the ownership of a for-profit is allowed if none of the income from this investment is distributed to the CSO's personnel or board and all of the income from this participation is invested directly back into the CSO's mission-related programs. Although these cases are judged on an individual bases, generally speaking this practice is allowed.

Interestingly, if one assesses this case according to the ICNL principal-purpose test, the CSO could be considered as deviating from its social purpose, particularly if the for-profit activity has no association with the CSO's mission. However, if one regards the ICNL destination-of-income test, the activity would be considered permissible, as long as all income is re-invested into the CSO's social programs, and, the CSO would therefore maintain its non-profit classification. In other words, when considering the ICNL typology in the case of Brazil, one of the two tests must be satisfied by the CSO in order for its non-profit status to remain intact.

With regards to the taxation of a CSO's self-financing activities, the Brazilian tax code is not only quite complex, but also lacks legislation that applies specifically to self-financing activities performed by CSOs. However, generally a "destination-of-income tax" is applied, which exempts all profits from economic activities that are for public-benefit purposes from taxation. The Income Tax Law does not make a distinction among origins or sources of income (for income from commercial activities), but instead generally establishes tax exemption for associations and foundations whose self-financing income is used for specific and exclusive social purposes carried out in the country.

Brazilian legislation was not based upon ICNL criteria, yet many similarities exist, particularly when one looks at the application of the law and certain court judgments. In sum, Brazil applies both the destination-of-income test and the principal-purpose test in order to analyze an organization's non-profit status

when it engages in self-financing activities, and the destination-of-income-tax to the taxation of income generated from these activities.

Where the Brazilian legislation differs from the ICNL typology is in its complexity and susceptibility to interpretation by authorities and professionals in the legal and tax sectors. This could cause Brazilian CSO managers to feel unsure regarding their legal and fiscal rights and responsibilities, and potentially de-incentivize them from engaging in self-financing activities.

4.1 Perception of CSOs

Legal regulation encourages CSOs to seek ways to generate their own revenues through self-financing or commercial activities and to decrease their reliance on public funding through contracts or subsidies. There is a series of fiscal incentives that exempt taxes on income earned from these activities. In 1995, a study⁹⁹ revealed that 61.1% of the income of non-profit sector entities was generated by the entities themselves and that the overall public perception of these organizations and their self-financing efforts was positive.

Entities that use State financing have been somewhat rejected by civil society in the face of growing criticism on the misuse of public resources. One prominent case was the LBA—Brazilian Assistance Legion in the early '90s. Rosane Collor de Melo, the wife of the president, Fernando Collor de Melo, presided over the organization, and she was investigated for irregularities in several public contracts. Her actions, along with those of her husband who was impeached for corruption related actions while in power, resulted in a growing mistrust of philanthropic and non-profit entities overall.

There has also been corruption and abuse of the law among entities that conduct commercial activities. Some have used tax immunity to benefit third parties, and appointed friends or family to positions within the institution to take advantage of financial incenti-

99 Cf. Lawlah Landin and Neide Beres. Occupations, expenses, and resources: Non-profit organizations in Brazil. 1^a Ed, Rio de Janeiro, Nau, 1999, p. 47.



ves. Although these are isolated cases, they received significant attention from the public and contributed to promoting a negative public image of CSOs.

In view of increasing inappropriate conduct on the part of CSOs, the legislation was overhauled and made stricter. The rules for obtaining public resources or accessing the right to tax immunity have become more stringent, and the concession of benefits more restricted. The result has hurt all CSOs despite the fact that the majority abide by the law. Rather than making legislation more rigid and less permissive, which only creates a larger, less efficient and more harmful bureaucracy, the State should focus on monitoring the activities of CSOs, punishing only those that don't comply with the laws and regulations.

4.2 Implications of Regulatory Framework for Public Policy

This section applies the evaluation criteria from Chapter 2 of the Legal Guide to the Brazilian regulatory framework. Based on the parameters in that chapter, NESST assesses the Brazilian legal framework, pointing out the most important positive and negative points, and giving its recommendations on how best to develop the legal and regulatory system for the use of self-financing among Brazilian CSOs.

4.2.1 Simplicity or Complexity of Administration

Poor

Brazilian tax law, in general, is quite complex and tedious, which is also reflected in accounting standards. There are dozens of different taxes, subject to three different levels of legislation: federal, state, and municipal, and the last two present marked differences depending on the location of the organization. For-profit businesses spend large amounts of money to contract professional accountants and consultants in an attempt to fulfill all legal obligations. Since CSOs do not have specific legislation regarding their economic activities and are also subject to this complex system, they are often also required to make this type of investment in professional services. When they do

not have the resources to do so, they often unknowingly act illegally, putting themselves at risk for heavy fines with high interest rates.

4.2.2 Effects on Revenue Collection

Moderate

Although the legislation is stringent and the tax burden is heavy, Brazil is known for the inefficiency of its regulatory agencies. Because of this, tax evasion occurs in large volume. The chief form of inspection is visits to business headquarters, but this is a questionable means of inspection, subject to frequent corruption. Since evasion impacts the amount collected, the authorities, instead of improving the regulatory process, increase tax rates and create new taxes, further damaging the situation of those who comply with the law.

Also, the Brazilian legal framework depends more and more on tax substitution by withholding. In these cases, the recipient of a service or buyer of a product must withhold and collect tax owed by the CSO in question. This mechanism has increased revenue by making recipients themselves responsible for controlling tax evasion. However, its use has led to injustice, because a business receiving a service or buying a product may not know about the possible tax benefits (immunity or exemption) that the entity in question receives, and often withholds taxes that are not owed.

The tax withholding process is in itself bureaucratic, and also costly to the taxpayer in terms of time and money, given the three levels of taxation (municipal, state and federal), the quantity of different taxes and the sheer number of declaration forms and complex procedures that differ according to the type of tax being declared, the tax-collecting entity to which the taxpayer is reporting and the differing due dates stipulated by these different entities.

The State should invest more in the quality of its inspections to combat tax evasion and increase tax revenue, which would then permit a reduction of taxes and elimination of bureaucratic mechanisms like tax withholding.



4.2.3 Effects on the Commercial Sector

Moderate

The activities of non-profit entities do not have a great impact on the commercial sector. This is because these organizations are working in areas that are primarily focused on social objectives and are for the most part different from the areas where for profit businesses operate. For example, an entity that organizes sales of donated products, whose profit will be applied to social assistance, or an institution that organizes cultural expositions to bring in resources for the education of needy children. As a result, there is not a significant amount of competition between non-profits and businesses.

There are, however, some concerns over unfair competition. A good example is that of technology businesses in Brazil. For a long time, they complained of competition from non-profit entities in contract bidding for the development of technology, in which educational CSOs participate. Because they enjoy tax immunity, CSOs can sometimes present more competitive prices for contracts. This practice is criticized by the commercial sector.

Recently, a decision in a case brought before the Federal Department of Revenue showed it agreed with the commercial sector by stripping certain entities of their tax immunity when they participated in these competitive processes. The decision does not have practical implications for now, but it is expected that a long discussion in the courts will be started. In many respects, the court's ruling is disturbing, since it could start a precedent and there is really no substantial proof that CSOs have benefitted from tax immunity in competitive processes in Brazil.

4.2.4 Effects on the Development of the Non-Profit Sector

Fair

Although the possibility of self-financing exists for CSOs, as do tax benefits, the complex and bureaucratic legislation impedes greater growth in the Brazilian nonprofit sector. For the vast majority of CSOs, it is very difficult to know exactly what they are allowed

to do. There is also a lack of information about the required conditions and procedures to take advantage of tax immunity or exemption.

The country needs a more uniform, modern, and systematic regulatory framework that reduces inefficient bureaucracy and permits the growth and action of non-profits.

4.3 Limitations of the Legal Framework and Recommendations for Legal Reform

4.3.1 Legal and Regulatory Framework for CSOs

The complex and heterogeneous regulations for the activity of CSOs is, without a doubt, one aspect that impedes the growth and functioning of the sector. It would be helpful, for example, for the Federal Union to create a legal document compiling all legislation pertaining to nonprofits; a "Non-profit Sector Legal Code" of sorts. Current regulations could be systemized and improved and government regulations standardized, especially the procedures for recognition of tax immunity.

This guide consolidates the most important rules and regulations affecting the non-profit sector, but it does not have the scope to compile all the relevant laws.

4.3.2 Commercial Activities and Non-Profits

Today, Brazilian legislation is very clear in not linking commercial activity to working for profit. It is perfectly possible for a nonprofit to carry out commercial activities, as long as it follows a list of legal requirements that attempt to guarantee that the resources will be used to further its cause and will not be misused in any way.

NESST considers the legislation satisfactory in this aspect. The law is clear with respect to commercial activities undertaken by nonprofit entities. Nevertheless, its content is not widely known to authorities and is often subject to random and often conflicting interpretations, contributing to confusion on the part of CSOs.



4.3.3 Taxation of Commercial Activities

Legal regulation clearly states that generic immunity from taxes only applies to social assistance and/or education institutions. For the rest, regulation is heterogeneous because each state and municipality has its own rules for exemptions, which, without a doubt, makes tax law more difficult for CSOs to understand. The administrative process for recognition of immunity seems unjustified given that the Federal Constitution does not mention any such process. The Federal Law should clarify that these processes are not necessary and prohibit government agencies from demanding them as a step to immunity while upholding their role to verify that organizations that have been given immunity are complying with all legal requirements.

Finally, a timely critique to the tax system with regard to the non-profit sector is that it privileges only those entities involved in education and social assistance. Constitutional immunity only applies to these institutions and to local exemptions (sales and services taxes). In this way, entities dedicated to other important activities, like the promotion of human rights, culture, the environment, community development, and others, do not receive fiscal benefits. Given the importance of the non-profit sector in responding to important social problems, limiting these benefits to only education and social assistance organizations is no longer justified.

4.3.4 Relevant Laws about Non-Commercial Sources of Resources

Legislation related to the use of state resources is constantly changing, generally towards greater stringency and regulation by public agencies. Currently, a key problem is the lack of clarity about procedural standards (rules for bookkeeping) that the entity must follow. This sometimes leads to lawsuits and fines, which may even be taken on personally by the representatives of the entity.

Regulation of donations and sponsorships is also unclear about benefits for donors. The rules are complex and constantly changing, confusing potential donors and negatively affecting CSOs who depend on these sources of income.

With more homogenous and flexible laws and stronger regulations, the country could certainly create a more favorable enabling environment for serious and transparent CSOs while still fighting the misuse of resources by a few inept institutions

4.3.5 Related Obligations

Like the tax code, compliance regulations are also complex and difficult to understand. There are a large number of forms and declarations, and each document has its own rules and due dates, making it cumbersome for CSOs to manage.

The requirements for recognition of immunity are also unsatisfactory. In addition to the heterogeneity that results from each state and municipality creating its own rules, procedures are long and bureaucratic. There is, for example, a lack of maximum time limits for agencies to hand down decisions. In the City of São Paulo, organizations have had to wait one to two years to have their immunity from the services tax approved.

Presenting so many forms and declarations, on different dates, impedes the activities of the non-profit sector. By systemizing legal regulation, this information could be gathered with a smaller number of documents, facilitating the administration of these entities and mitigating the necessity of expensive hiring of specialized personnel.

4.3.6 Necessary Expertise to Carry Out Commercial Activity

Entities that plan to engage in commercial activity should consult professionals who understand the legislation and its specificities related to the nonprofit sector, avoiding irregularities that could bring administrative and fiscal complications.



4.4 Case Studies that Demonstrate the Application of the Legal and Regulatory System

S.O.S. Mata Atlântica

The S.O.S. Mata Atlântica (Atlantic Forest Foundation) is a civil society organization whose mission is the promotion and conservation of biological and cultural diversity in the Atlantic forest biome and other ecosystems under its influence. It accomplishes this by encouraging sustainable development and education and teaching about the Atlantic forest through mobilization, training, and promoting socio-environmental citizenship. The organization was created in 1986 by a group of scientists, entrepreneurs, journalists, and environmental activists already working in other organizations. It began by doing studies that showed the level of damage done to the environment from the beginning of civilization up until the present day. One study revealed that only 8.8% of the original Atlantic forest is still preserved, leading society to reflect on the possibility of losing this valuable natural legacy.

In partnership with other CSOs, and always seeking to inform the public, the Foundation works fiercely to ensure that government agencies act to combat deforestation. The great victory of this struggle was Federal Law no. 11.428, of 12/22/2006, which regulates the use and protection of the native vegetation of the Atlantic forest biome.

The Foundation, from the start, understood that a memorable name and logo would be fundamental in educating the public. It named itself “SOS Atlantic Forest,” a clear message of danger and need for help, and also created its logo, a Brazilian flag, where the green rectangle, which represents Brazil’s forests, is disappearing (to represent deforestation). A strong, clear message helped build the reputation of the organization and the brand, which from the start was widely promoted on stickers, buttons, mugs, t-shirts, hats, etc.

The brand, with time, became popular, and became a marketing tool for businesses. Partnerships were established, and today the brand sells, for example, toothpaste and financial products (credit cards and leveraged bonds), generating millions of reais in royalties.

Because it is a OSCIP—Civil Society Organization in the Public Interest (see section 3.2.1 of this guide), the Foundation submits its books and a report of its activities annually.¹⁰⁰ Furthermore, to stay exempt from the income tax and the social contribution on liquid profit, it obeys the complete rules for recording earnings and expenses and uses all of its received resources to further its purposes.¹⁰¹ The Foundation also has a clause in its statute ensuring that, in case of dissolution, all of its wealth will be given to another OSCIP.¹⁰²

Instituto Ayrton Senna

The Instituto Ayrton Senna (Ayrton Senna Institute) is a CSO with the mission of improving the quality of education. It was created in 1994 by the family of racecar driver Ayrton Senna, who died tragically that year. Since its creation, it has changed the lives of 7,896,146 children and adolescents. In 13 years, R\$161.7 million were invested in social programs. In 2007 alone, 1,350,532 children and adolescents were benefited, 67,350 educators graduated from college with the institution’s help, 10,670 schools, NGOs, and partner universities affected, and 1,360 municipalities benefited, across 25 states.

To fulfill its mission, the Institute receives 100% of the royalties from the licensing of the brands Senna, Senninha, and Senninha Baby, and from Senna’s image, donated by the family, and investment from social responsible allies who want to help change Brazilian education. Many Brazilian and international businesses license the Senna brand, the characters Senninha and Senninha Baby and Senna’s image because they share the same principles that orient the Institute: they are businesses conscious of their social responsibility and the quality that they want in what

100 Law n° 9.790/1999 and Decree n° 3.100/1999

101 Art. 14, National Tax Code, and art. 12, § 2, Law n° 9.532/1997

102 As stated in art. 4°, IV, Law n° 9.790/1990.



they produce. The brand is stamped on a diverse range of products, including clothing, shoes, stationary, food, toys, and credit cards.

The entity was created as a Civil Association, under the stipulations of article 53 of the Civil Code. Because it is an education and social assistance entity, it is immune to taxes, as determined by the article 150, VI, 'c,' of the Federal Constitution. It is therefore free from the income and service taxes, as well as the *causa mortis* and donations tax on its donations. It also holds the Social Assistance Entity Certificate, which frees it from all social contributions. Every three years, it requests renewal of this certificate.

Furthermore, the Institute complies with all requirements to enjoy tax immunity, like those stated in article 14 of the National Tax Code (do not distribute profits, apply all earnings to activities within Brazil, and follow formal accounting standards) and in Law no. 9.532/1997, such as not paying directors and presenting an annual declaration of income to the Federal Revenue Department.

CONCLUSION

Although there are many factors that lead a CSO to start self-financing activities, the primary one is the necessity to generate unrestricted income to contribute to the daily administration of the organization and to ensure the continued delivery of its programs. Income resulting from self-financing complements income from other sources such as donations and partnerships, which, together, contribute to the CSO's overall financial sustainability.

An additional benefit of self-financing activities is that they allow the organization to reach out to a larger audience beyond its beneficiaries, donors and partners. Engaging in the sale of products and services, often to new sectors, leads to a greater awareness on the part of society at large of the issues the organization is trying to resolve through its social and/or environmental programs. Therefore by promoting awareness of issues that affect society, self-financing has the potential to significantly strengthen the organization's overall social impact and contribute to systemic social change over the long term.

For these reasons, legislation and tax codes should facilitate and foster the use of self-financing activities among CSOs that are honestly engaged in these activities, ensuring that they will contribute to their overall organizational and financial sustainability and allow them to increase their social results.

Although legislation and tax codes in Brazil permit self-financing on the part of CSOs, they remain either unclear or unknown to third sector practitioners, tax and legal professionals, and the authorities which control and monitor CSO activities in the country. By simplifying the procedures, and making them known to a wider public, the enormous potential for self-financing to strengthen civil society in Brazil, and therefore, society at large, will be unleashed.