

Overview of the Legal Treatment of Licenses and Technology Agreements in Brazil

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In recent years, Brazil has experienced a series of changes and improvements in the laws and regulations concerning licensing and transfer of technology. Since the revocation of Normative Act 15 of 1975 by the Brazilian Patent and Trademark Office (BPTO) in the early '90s, there has been considerable relaxation of the rules and practices governing the examination and approval of licenses and know-how agreements.

However, Brazil continues to adopt the centralized exchange control regulation as far as the transfer of funds for trademark and patent licenses and transfer of technology agreements are concerned. Therefore, the recordation of the agreements with the BPTO and subsequent registration thereof with the Brazilian Central Bank continue to be required for remittance of payments abroad.

The new patent and trademark law that came into effect in Brazil as of May 15, 1997, eliminated all restriction on royalty-bearing trademark or patent licensing and has substantially reduced the discretionary powers of the BPTO to interfere with the conditions and terms of the transactions.

However, under the excuse of regulating the provision of the statute, the BPTO issued on May 15, 1997, Normative Ordinance 135 which, deviating substantially from the liberalization prescribed by the law, raised a number of questions as to whether the BPTO actually would follow more flexible rules for examination and approval of licenses and transfer of

technology agreements.

This Normative Act begins by establishing that the BPTO will approve the agreements taking into account the exchange control regulations, fiscal regulations, anti-trust and competition laws, the principles of defense of consumer, the franchise offering law and so forth.

The ordinance is rather laconic and simply states that the BPTO will record agreements concerning trademark or patent licenses, technical services, transfer of technology and franchises. The automatic approval if the BPTO fails to decide on the recordal within 30 days, which is in the new law, is not even mentioned in the ordinance.

The act expressly revokes the prior cost-sharing agreement and franchise acts that have proven to be very flexible and advantageous regulations.

From the requirements issued, one can easily perceive that license of unpatented know-how—as opposed to sale thereof—will not be admissible. Therefore, the actual implementation of the law seems to have deviated from the general principle set forth in the law. In fact, the BPTO continues to exercise a careful and detailed examination of the agreements applying rather restrictive interpretations of the laws.

TECHNOLOGY AGREEMENTS

Under the Normative Act 135, the BPTO has jurisdiction to review and approve the following agreements that are broadly defined as

technology agreements:

1. Acquisition of unpatented know-how
2. Patent or industrial design license
3. Trademark license
4. Franchise
5. Technical assistance services

RECORDAL OF CONTRACTS

The prior recordation of licenses and technology agreements with the BPTO is required for three specific purposes:

- to produce effect against third parties, thereby ensuring the licensee's exclusive rights in Brazil (if the agreement grants the exclusive license) and enabling the licensee to defend the involved marks and patents or to join the licensor in disputes involving the industrial property rights;
- to allow the payment and remittance of royalties overseas, relating to the licensing of industrial property rights and know-how; and
- to permit the local licensee to obtain the fiscal deduction of remitted values, as foreseen by Ministerial Ordinance No. 436/58.

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FISCAL DEDUCTION AND TAXATION

The payment of royalties by the local licensee or recipient of know-how is deductible provided that the agreement is recorded with the BPTO and that the ceiling for deductibility is observed. In fact, Law 4,131 of 1961 established that the payment for licenses and know-how are deductible by the local party to the extent that it does exceed altogether the limit of 5 percent of net sales of the licensed products.

Furthermore, the law sets forth that the fiscal authorities will set additional reduced ceilings based on the industrial segments involved. Ordinance 436 of 1958, still in force these days, lists the different segments and attributes a maximum ceiling for deduction for each industry, up to 5 percent.

For trademark licenses the limit is 1 percent of the net sales of the licensed product. For know-how and patent license the limit may vary from 1 percent up to 5 percent, depending on the area of activity.

No accumulation of ceilings for trademark with know-how or patent license is admissible.

As for taxation on the amounts to be paid, credited or remitted to a foreign entity, there is a 15 percent withholding tax levied upon the payments, which should in principle be paid by the foreign licensor or supplier. The fiscal burden may be contractually passed over to the local licensee.

In addition, a contribution on the economic domain of 10 percent of the amount to be paid, credited or remitted to a foreign entity has been introduced as of January 2001. Despite certain technical unconstitutionality, which may permit the judicial challenge of such tax, such taxation needs to be paid by the local entity before remittance. There is a credit of tax that may be applied to benefit the local party

and reduce the taxation in practice by 50 percent until 2003. The Financial Transaction Tax levied on remittance of royalties remains reduced to 0 percent.

LICENSE OF PATENTS AND INDUSTRIAL DESIGNS

Despite the flexibility foreseen in the 1996 legislation, certain conditions for the patents to generate remissible royalties stay in force. The most critical limitation in this connection requires that the titles have been regularly granted in Brazil for payments to be made overseas. In case of licenses during the pendency of the patent application, the payments may not be remitted abroad, but the licensor may be entitled to a credit for payments if the patent issues in the future.

The licensee may be invested by the patentee with all powers to act in defense of the patent. A license contract must be recorded at the BPTO to produce effect with regard to third parties. The recordal will produce effect with regard to third parties from the date of its publication. A license contract need not be recorded at the BPTO for it to have effect for validating proof of use, so that use by the licensee may inure to the patentee's benefit, regardless of recordal.

Any improvement to a licensed patent belongs to the person who made it, the other contracting party being guaranteed the right of preference with respect to a license.

LICENSE OF TRADEMARKS

The proprietor of a registration or the entity that has applied for a registration may enter into a license contract for use of the mark, without prejudice to his right to exercise effective control over the specifications, nature and quality of the respective products or services. Quality control is no longer an obli-

gation of the licensor but a contractual option.

The licensee may be invested by the registrant with full powers to act in defense of the mark, without prejudice to his own rights.

License contracts must be recorded at the BPTO in order to produce effect with respect to third parties. Recordals will produce effect with respect to third parties from the date of their publication. In order to validate proof of use, license contracts need not be recorded at the BPTO.

Royalties can only accrue as of the issuance of the registration of the marks and no payment will be credited or remitted for licensing in the pendency of the application.

TRANSFER OF KNOW-HOW

The policy of the BPTO is that unpatented technology (trade secrets and know-how) is not viewed as a proprietary right and, as a result, cannot truly be licensed to a Brazilian party. The agreement may be entitled a license agreement, but the BPTO makes sure to impose restrictions to characterize the agreements as sale or acquisition of technology. Thus, once transferred and duly paid, the technology shall be free for use by the recipient henceforth.

Therefore, transfer of unpatented technologies is viewed as outright acquisition of know-how and the periodic royalties, fees or other considerations receivable by the foreign supplier are, in essence, the purchase price. Based on this principle, the BPTO does not accept in the agreements covenants for return of know-how after expiration, perpetual confidentiality or discontinuance of use of know-how.

Thus, while it is generally possible to impose secrecy and restricted use of technology obligations on the Brazilian party applicable while the agreement is in force and up to

five years after expiration or termination, once the agreement expires or is terminated, the local party will be entitled to continue using the unpatented technology.

As a matter of policy, the BPTO does not approve contracts containing clauses prohibiting or restricting the Brazilian party's right to use or to disclose such technology after the contract comes to an end, nor does it approve clauses requiring the Brazilian recipient to return all documents and other physical property embodying such unpatented technology.

Based on a misinterpretation of the fiscal laws, the BPTO has taken the position that the recordal of the contracts may not exceed five years, so that even when the term of the contract exceeds the five years, the recordal will be limited to five years and renewals may be applied for to the extent that it is demonstrated to the examiner's satisfaction that there is justification for such extension of the recordal.

The BPTO considers that payments can only occur after the agreements have been filed for recordal, so that generally no retroactive payment will be admitted.

Exceptions to these policies are rarely made by the BPTO, although the agreements are presently dealt with on a case-by-case basis so that there are exemptions that may be exceptionally obtained depending on the details of the case and the benefits of the transaction to the Brazilian party.

PAYMENTS BETWEEN PARENT COMPANY AND SUBSIDIARY

In the case of agreements between independent companies without direct or indirect control, the examination by the BPTO, during the recordal proceedings, is based upon the assessment of the validity of the involved industrial property rights in Brazil as speci-

fied by Law No. 9279/96. There should be no limit as to the maximum royalty or payment acceptable. In this case, the BPTO should not question the price and the payment conditions under the agreement.

However, when the parties are parent and subsidiary or controlling and controlled companies, certain limitation as to the maximum royalty admissible apply.

Article 50 of Law 8,383 of 1991 sets forth that payments resulting from trademark or patent licensing or transfer of technology between the subsidiary and the parent company have become fiscally deductible and remissible in respect to agreements executed and recorded with BPTO from December 31, 1991, onwards.

Although the language in the law is not straightforward, the official interpretation has been that payment and remittance of royalties between subsidiaries or controlled companies and the parent company (not branches) should be admitted, as long as the technology has been introduced in Brazil after December 31, 1991, and the payments do not exceed the ceilings of fiscal deduction under Ordinance 436. Therefore, for a trademark license, the royalties cannot surpass 1 percent of the net sales price of the licensed products. For patents and know-how, the percentage allowed is based on the industrial segment involved but cannot overrun 5 percent of the net sale price or revenue of the products.

As regards payments, lump sums are, in principle, not permitted in agreements between a parent company and a local subsidiary. In fact, when the parties involved are controlling and controlled companies, the BPTO applies an extremely restrictive approach.

Nevertheless, when the technology is state-of-the-art, sophisticated and/or quite important for

the Brazilian economy, exceptions have been made. In any event, however, the BPTO will always insist that the lump-sum payments be treated as anticipation of royalties, so they must be deducted from the initial running royalties of the agreement. Also, the lump sum and the royalties together cannot exceed the maximum percentage fiscal deduction.

Furthermore, the BPTO views that, when the remuneration is already charged for patented or unpatented technology, the trademark license in relation to the same products has to be royalty-free, as the combination of the limits for know-how with trademark license cannot be accepted. In this sense, if the local party is already paying for the know-how, it is not permissible to add the fee for trademark license.

TERM AND RENEWAL

As far as know-how contracts are concerned, the BPTO limits the approval to a five-year period, regardless of the terms set by the parties in the contract, since Fiscal Law 4,131 only allows the deduction for five years.

At the end of this term, the parties need to apply for renewal and the BPTO reexamines whether to approve it for an additional five-year period.

However, the BPTO will not renew the agreement more than once, so that the maximum possible term of such agreements is 10 years for purposes of royalty payments to be made abroad in foreign currency.

In addition, it will not necessarily be easy to obtain approval by the BPTO of a five-year extension of an approved agreement. On the contrary, experience has shown that extension approval has been granted where the BPTO was convinced that the bulk of the technology or additional technology to be

transferred to the Brazilian party was yet to be accomplished, or that its application and implementation by the Brazilian party required continued assistance, know-how, etc. of the foreign party, or that completely new technology was to be supplied.

The parties seeking an extension should be sure to prepare and submit to the BPTO a detailed report setting forth the reasons why an extension should be granted. It should also be emphasized that a five-year extension is the maximum that the BPTO can grant.

BUNDLED AGREEMENT

The BPTO currently accepts bundled agreements combining patents, unpatented know-how, trade secrets and services, to the extent that the subject matters are clearly and separately defined and dealt with. Such exemption is narrowly applied and the likelihood of obtaining the recordal for bundled agreements will need to be addressed on a case-by-case basis.

COST SHARING AGREEMENT FOR RESEARCH AND DEVELOPMENT

The BPTO has revoked Normative Act No. 116/93 for the recordal of cost-sharing agreements.

Cost sharing was considered the co-financing of the cost for research and development (R & D) of new technologies. The BPTO will no longer record those agreements whereby the local party (recipient) will co-finance the costs of R & D by technology centers or companies (supplier) within the country or outside.

However, in special circumstances, the BPTO has been admitting similar contracts provided that they are presented as know-how agreements and relevant reasons for such format are consistently presented to the examiner's satisfaction.

FRANCHISE

Franchising is currently governed by two regulations in Brazil.

The first one is the Normative Act 135, which was designed to permit direct remittance of royalties from local franchisees to the foreign franchisors without need of other local subsidiaries or separate agreements.

Thus, international master or unit franchise agreements need to be recorded with the BPTO so that the franchisee may be able to pay the remuneration and royalties to the franchisor abroad. Indeed, in order to be officially recognized in Brazil, franchise agreements where one of the parties is a non-resident of Brazil shall only be enforceable after recordal.

In the past, due to the restrictive exchange control regulations, franchisors had to split the franchise agreement into several individual agreements (royalty-trademark license, service agreement, know-how agreement and so forth) and also set up local companies so as to be able to structure the business.

Currently, the legislation concerning the remittance of fees and royalties stemming out of master franchises is quite flexible.

According to this recordal practice, the agreement is admissible as long as the marks are filed in Brazil. There is no longer any requirement that the mark must be registered in Brazil under priority claim and during the first 10-year term. As long as the marks are already on file in Brazil, the parties are entitled to enter into the franchise agreement and record it with the proper Brazilian authorities.

Another requirement that franchisors must meet is that they must show evidence that they are franchisors in other jurisdictions. In the event Brazil is the first country where the franchise system is adopted, the BPTO will require evidence of a business format fran-

chise to allow recordation.

The second legislation is Law No. 8,955 of December 16, 1994, requiring that as of February 14, 1995, any prospective franchisees be presented a Franchise Offering Circular (FOC) 10 days before any agreement or payment.

Under the law, franchising is defined as the system by which a franchisor grants to a franchisee the right of trademark or patent use, associated with the right to exclusive or semi-exclusive distribution of products or services and, eventually, also the right of use of technology of implantation and administration of a business or operational system developed or retained by the franchisor against direct or indirect remuneration, however, without characterizing an employment relationship.

The FOC needs to be in clear and accessible terms and should contain the following information:

1. Background information on the franchisor and all companies directly linked to it;
2. Balance sheets and financial statements of the franchising enterprise relative to the last two fiscal years;
3. Precise indication of all litigation involving the franchisor, the controlling companies and trademarks, patents and copy rights owners relative to the operation and their subfranchisors challenging specifically the franchising system or those which may directly become a reason for the impossibility of functioning or franchising;
4. A detailed franchising description;
5. A profile of the "ideal franchisee;"
6. Requirements concerning the direct involvement of the franchisee in the operation and administration of the business;
7. The estimated total investment necessary, the initial fee royalties, publicity fees, insurance

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- and other payments due to franchisor or to third parties linked to it;
8. A complete list of all franchisees, as well as of those who were terminated during the last twelve months;
 9. Territoriality considerations;
 10. Clear and detailed information on designated suppliers;
 11. An indication of what is effectively offered to the franchisee by the franchisor;
 12. Situation of the trademarks or patents, the use of which is being authorized by the franchisor;
 13. Situation of the franchisee after expiry of the franchising agreement regarding trade secrets and non-competition; and
 14. A copy of the agreement.

The Franchise Offering will be updated annually and should be delivered to the applicant at least 10 days before the signature of the franchise agreement or the payment of any kind of fees by the franchisee to the franchisor.

In the event of non-compliance with the provisions, the franchisee may argue the nullity of the agreement and require return of all amounts already paid to the franchisor or to third parties indicated by same, as initial fee and royalties, plus damages.

The franchise agreement must always be signed in the presence of two witnesses and shall be valid independently of being registered before a notary's office or a public agency.

For the purpose of recordation of the franchise agreement, the BPTO requires copies of the FOC or the acknowledgment of its receipt by the franchisee.

Technical assistance agreements are considered to be the rendering of specific engineering or technical services by technicians of a foreign company to a local one, be it locally or abroad. Remittances deriving therefrom may be effected on the basis of an umbrella agreement or specific invoices issued by the supplier. In cases where there will be a wide range of services, an umbrella agreement shall be required by the BPTO. The charges for the performance of the services must be a fixed amount based on the time spent for the service and the man-hour fee, to be detailed on a schedule or invoice based on a "time-sheet."

As presently defined by regulations, there are two sets of technical services that are treated substantially differently.

There are technical services with transfer of technology and technical services without transfer of technology. Those *with* transfer of technology are technical services directly related to the industrial or production area or where the local party is trained to render the services directly.

Those *without* transfer of technology are services relative to other areas not directly connected to industrialization or production, such as marketing, finance, distribution or commercialization, or when no training of a local technician takes place.

Prior recordal at the BPTO under Normative Act 135/97 and subsequent registration of the recordal certificate at the Central Bank are required for payments deriving from technical services involving technology transfer.

When this is the case, once the recordal and registration certificates are issued by the BPTO and the Central Bank (within 30 and 20 days, respectively) the local company will be allowed to start the remittances through a commercial bank using

the commercial exchange rate.

For technical services that do not imply know-how transfer, the transfer of funds to the parent company could be effected by directly presenting the agreement to the commercial bank without prior submission to the BPTO, and the remittance will occur under the provisions of Central Bank Ordinance 2.685/96 using the informal exchange rate.

In this instance, where the agreement is not recorded at the BPTO, Brazilian fiscal authorities may apply more stringent rules for fiscal deduction, such as proofs of the execution, demonstration of the necessity of the services, and assessment of fair market price of the service to allow fiscal deduction of the payments. This is, however, the most speedy manner in which to process remittances overseas.

In fact, the advantage of the recordal and registration at the BPTO is that such recordal and registration work as a guarantee as to the execution, necessity and fair market price of the agreement, ensuring the fiscal deduction of the amounts.

In case of doubt whether the services involve transfer of technology, the commercial bank will require submission of the agreement to the BPTO, which may issue a letter of exemption.

Recordation Formalities

Recordal with the BPTO must be decided within 30 days from filing of the contract. Before this time limit expires, the BPTO may issue office actions, which may defer any decision.

For filing, the agreement must bear signature by both sides along with two witnesses. The signatures collected abroad must be notarized and legalized by the Brazilian consulate. The local signature will need to be certified by a local notary. The agreement shall then

have to be translated into Portuguese. Furthermore, there are some forms and documents that will need to be completed by the local franchisee, licensee or purchaser for filing purposes.

The agreement can be entered into in the English language. In the case of bilingual agreements, one of the languages should be elected as the governing tongue.

An appeal may be filed against a decision rejecting the recordal of a license agreement.

There are some forms and documents that will need to be completed by the local franchisee for filing purposes.

The Central Bank usually registers the agreements electronically within approximately 10 days.