

Brazil

Moving with the times: major changes to the IP framework

In 2007 the Office of the US Trade Representative moved Brazil from the Priority Watch List to the Watch List in its Special 301 Report, an annual review of the global state of IP rights protection and enforcement. This ranking was maintained in the 2008 Special 301 Report, further recognising the escalating momentum in Brazilian IP rights enforcement.

One such positive development is the recent reduction of the patent and trademark application backlog due to improvements in the capacity of the Brazilian Industrial Property Institute (INPI). In addition, at the end of 2007 the INPI was appointed an international search authority for the Patent Cooperation Treaty, which is administered by the World Intellectual Property Organisation (WIPO). This appointment recognised the INPI's recent modernisation.

As the Brazilian economy continues to move towards liberalisation and further exposure to other markets, new issues have come to light in the IP field, including:

- the harmonisation of Brazilian accounting principles with international standards;
- the upcoming adoption of the Madrid System for the International Registration of Trademarks; and
- a new framework of tax incentives for innovation activities.

This chapter looks at how these issues may affect the protection and exploitation of IP rights, as well as their implications for business opportunities in Brazil.

Impact of new accounting principles on IP owners

Since IP rights are the most important assets in a knowledge-based economy, they have become crucial for companies wishing to compete in the global market. IP managers are increasingly required to deal not only with the protection of such rights, but also with their valuation as intangible assets.

As defined by accounting theory, 'intangibles' are assets that:

- have no physical substance;
- grant rights and privileges to a business owner; and
- are inseparable from the enterprise.

Most importantly, international accounting standards set out detailed rules for the inclusion of IP assets in financial reports in light of the need for greater transparency and better information for shareholders.

Brazil has now adopted this trend in certain limited cases; however, the intention of the Brazilian accounting authorities is to extend the new rules to all companies that own IP assets.

Harmonisation of national accounting practices with international standards

Following the evolution of global accounting standards in recent years, as developed by the International Accounting Standards Board, the Brazilian accounting community has been deeply concerned with the harmonisation of Brazilian accounting practices with international standards.

The international convergence of accounting standards, which is effected by International Financial Reporting Standards (IFRS), implies the reduction of:

- costs for the preparation of financial reports;
- risks and cost in the analysis and decision-making process; and
- capital costs.

Discussions on the convergence of accounting standards have led to the enactment of two controversial new pieces of legislation: an instruction issued by the Brazilian Securities Commission (CVM) and a federal law modifying the Corporations Law.

CVM Instruction 457/2007

On July 13 2007 the CVM issued Instruction 457, according to which all publicly held companies must, from fiscal year 2010, report their financial statements in accordance with IFRS.

As a result, from 2010 Brazilian publicly held companies will no longer report their financial statements under Brazilian generally accepted accounting principles as conversion to IFRS will be mandatory.

Publicly held companies will then be required to report their intangible assets in accordance with IFRS. For example, under the new rules intangible assets shall be subject to a periodic measurement process carried out using one of the valuation methodologies established by IFRS (ie, cost or revaluation).

Law 11,638/2007

Five months after CVM Instruction 457/2007 was issued, Congress approved a new law that modified several provisions of the Corporations Law.

The modifications made by Law 11,638/2007, which came into effect at the beginning of the 2008 fiscal year, are also intended to establish new standards for the preparation and reporting of financial statements in light of IFRS.

With some exceptions, the new rules apply to all Brazilian corporations, as well as to other companies which qualify as 'large companies' based on certain thresholds.

Law 11,638/2007 also contains specific rules regarding the treatment of intangible assets in financial statements.

Although the previous legal framework established that IP rights should be reported, few rights were included in company balance sheets due to a lack of clear rules and criteria. However, under the new system balance sheets must contain a specific category for intangible assets.

The new law also establishes that rights classified as intangible assets will be valued according to their acquisition cost, less the balance of the respective amortisation account. In Brazil, the amortisation of an IP right can occur only if it is demonstrated that the IP right is limited in time.

This rule implies that Brazilian law now provides that intangible assets shall be valued on a cost basis. However, the law does not make it clear whether internally generated intangible assets (eg, in-house trademarks) must be reported as an asset.

Although specialists have argued that internally generated assets should not be included in companies' intangible accounts, the rules to implement the new requirements imposed by Law 11,638/2007 are still being

formulated by the Brazilian authorities. Thus, no specific position has yet been set down.

Finally, the new system establishes that companies shall periodically revisit the original value attributed to the intangible assets so that any related capital losses may be duly registered in the financial statements. Experts have said that increases in the market value of IP assets should not be included on the balance sheet. However, again the rules are not yet clear.

Consequences for IP owners

A major consequence of the new rules is that intangible assets will have to be finally valued, particularly when acquired through mergers and acquisitions. In practical terms, this means that intangibles will need to be dissociated from the price of other assets in the purchase or transaction price.

In addition, once such assets are acquired they will have to be reported in the purchaser's balance sheets in a specific account, as required by Law 11,638/2007. A periodic measurement of the acquired intangibles (notably the amortisation of their value) will also need to be reported.

Getting ready to adopt the Madrid Protocol

In recent years there has been much discussion regarding Brazil's adoption of the Madrid Protocol Concerning the International Registration of Trademarks. The Madrid Protocol establishes an international, centralised system for the registration of trademarks, resulting in lower trademark registration costs, a simpler system and shorter terms for trademark registration in several countries.

Although discussions about the compatibility of the Madrid Protocol with Brazilian constitutional provisions have delayed the process, the debate appears to have come to an end and the Brazilian government has demonstrated clear signs of its intention to adopt the protocol. Media reports indicate that the INPI is already preparing its staff for the adoption of the international system.

Process

The Madrid Protocol sets out a system for the international registration of trademarks – it is not a substitute for national trademark systems. The idea of the protocol is to concentrate trademark registration in a single body – WIPO.

Under this system, trademark owners can extend their national trademark applications or registrations to any of the 66 countries that are parties to the protocol. For such purpose, an application must be presented to the applicant's local trademark office indicating the countries in which protection is sought.

The local trademark office then transmits the application to the WIPO International Bureau, which automatically grants the international registration. After registration is granted, WIPO notifies all countries indicated by the applicant. At this stage, the application enters its national phase and is analysed by each country as if it had been filed internally. If the trademark cannot be registered in a given country, WIPO shall be notified of the refusal.

Consequences for trademark owners

If Brazil adopts the Madrid Protocol, foreign trademark owners will be free to continue filing national applications with the INPI, but will also have the option to extend their registration to Brazil using the Madrid system. Under this second option, applicants will be free to elect the countries in which they wish to seek protection.

Opting for the Madrid system in lieu of the traditional national system will be preferable in most cases due to the lower registration costs and simplicity of the work required. In any case, since the national phase of the process follows the same path as ordinary local proceedings, it is likely that applicants will have to hire trademark attorneys to:

- respond to office actions;
- reply to oppositions;
- file appeals; or
- conduct any other required action before the INPI.

At the same time, Brazilian entities will be able to extend their local trademark applications and registrations to other countries through the Madrid system. This will allow more Brazilian companies to protect trademarks abroad, as costs will decrease.

Another peculiarity of the Madrid system is that international registrations are dependent on the original national application for a period of five years. Similarly, if the original application is cancelled within this period, the protection granted by the international registration in other countries is also cancelled. However, after the initial five-year period the international registration becomes independent of the basic application.

The different status of international registrations (ie, dependent or independent of the original application) may have important implications for transactions involving the transfer of trademarks registered under the international system. In any case, a careful review of the status of the international registrations as well as their counterparts before each jurisdiction will always be required.

Fostering innovation through investment and tax incentives

Since the end of 2004 the government has put forward several measures to foster innovation and research and development (R&D) activities in Brazil. The aim is to provide a wide range of tax incentives for companies that invest in the creation of domestic technology and engage in partnerships with universities and other R&D institutes.

Although this legislation is not new, this framework of incentives has become a hot topic among IP specialists. Discussions are now focused on the implications of the Innovation Law, the Law of Good and a more recent tax incentive for companies that invest in R&D and innovation activities.

Innovation Law

One of the government's key actions to foster innovation in Brazil was the passing of the Innovation Law (10,973/2004) on December 2 2004.

This legislation promotes partnerships between universities, technology institutes and companies by granting financial resources and economic subsidies to entities involved in joint innovation activities.

One of the advantages of the Innovation Law is that it stimulates R&D activities in a flexible manner as incentives are granted for different legal structures, including the creation of special purpose companies and the execution of different types of partnership agreement.

Some of the major public universities have already set up special innovation agencies to deal with the partnerships regulated by the Innovation Law. The new regulation facilitates most of the practical work related to those partnerships, especially when the public status of certain universities, including the special legal regime attached to their operations, must be taken into consideration.

Law of Good

The Law of Good (11,196/2005, November 21 2005) is an extensive piece of legislation establishing several tax incentives for certain companies, such as those engaged in export sales and small and medium-sized enterprises. It also provides more generally for incentives with respect to activities perceived as innovation or R&D. Even payments remitted abroad related to industrial property royalties qualify as 'innovation costs' and are therefore eligible for tax credits under the Law of Good.

Another incentive granted by this law is a 50 per cent reduction in the federal excise tax due on equipment, machinery, apparatus and instruments required for the performance of R&D activities. In addition, the withholding income tax rate for the remittance of

payments abroad has been reduced to zero when such payments are related to the registration and maintenance of trademarks and patents abroad.

Law 11,487/2007

This new law establishes certain tax incentives for projects carried out in accordance with the Innovation Law, particularly in respect to the payment of Social Security on net profits.

Discussion about this legislation is still ongoing, notably because it makes the ownership of IP rights developed by projects carried out under the Innovation Law conditional on the actual tax benefit that companies wish to have.

Opportunities for IP owners

As Brazil has fostered innovation through both direct investment and tax incentives, IP owners and R&D companies may benefit from this favourable environment by investing in the country.

As legislation in this area is complex, both tax and IP planning are crucial in order for companies to obtain all the incentives available and to guarantee protection for the IP rights that may be created through such incentive-based projects.

Conclusion

The latest amendments to the Brazilian IP framework demonstrate that the country is committed to updating and modernising its legislation and business practices. The recent steps towards the harmonisation of Brazilian practice with international standards also show that the government is keen to encourage and maintain further foreign investment in its economy.

Given the ever-changing landscape, IP owners are increasingly required to understand not only the rules related to the protection and enforcement of IP rights developments, but also the business implications attached to these changes. Successful companies carrying on business in Brazil should keep these developments in mind in order to maintain their positions in the Brazilian market. In particular, companies will have to pay attention to the adoption of international accounting standards, as well as the development of new strategies for working under the Madrid system for the registration of international trademarks. For those willing to invest in R&D in the Brazilian market, a careful review of the new legal framework intended to foster innovation and R&D is also advisable.

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