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**TAX INCENTIVES IN THE MANAUS FREE ZONE****Regional raw material for production of “concentrates”**

The Manaus Free Zone (ZFM) was created in 1967 for the purpose of promoting the socio-economic development of the Amazon Region, which embraces the States of Amazonas, Roraima, Rondônia and Acre, an area equivalent to 25% of the national territory.

The model of development is based on tax incentives that benefit industrial and agricultural and livestock activities with the objective of compensating for or reducing the locational disadvantages of the region and in this way promote its socio-economic integration with the other regions of the country.

The goods industrialized in the ZFM may be finished products ready for sale to the final consumer, or intermediate products still to undergo a new industrial process. The federal government granted equal incentives to two categories of products.

The chart below presents the chief industrial sectors installed in the ZFM in 2013, with the respective billings (in R\$ millions) and the labor-related figures:

Industrial sector	Billing	Labor force
Electro-electronic	41,400.0	49,240
Two wheel	13,434.8	18,249
Concentrates	8,339.0	14,250
Thermoplastics	4,008.7	9,904
Mechanical	3,901.0	8,302
Metallurgical	3,450.4	7,814
Watches	1,262.1	2,338
Químico	1,134.7	1,439
T o t a l	76,930.7	111,536

These sectors account for 88.5% of the total billing (R\$ 86.9 billion) of the ZFM in 2013. We can see that the electro-electronic sector, which includes the production of televisions, notebooks, cellular telephones and tablets, represented close to 50% of the total billing.

The distribution of the labor force accompanies the sectorial volume of billing. Labor includes the employees allocated in the respective industries and regional suppliers of raw material, intermediary products and packaging material.

In the particular case of “concentrates” (composed preparations meant to produce non-alcoholic beverages, such as soft drinks), the employees allocated in the following activities are included:

a) the sugar mill in the municipality of Presidente Figueiredo, in the interior of the Amazon Region: planting and harvesting *guaraná* cane and seed, and producing castor sugar, neutral alcohol for industrial use, and *guaraná* extract;

b) in various municipalities in the interior of the state: producing brown sugar, planting and harvesting *guaraná* seeds and seeds of local fruit crops, such as *açaí* and pineapple.

The chart below presents the labor force allocated according to the principal products used directly or indirectly as raw material in the industrialization of “concentrates”:

### Concentrates – Allocated labor force

Location	Products	Labor force
Interior of the State	<i>Guaraná</i> (1)	8,000
	Brown sugar	400
	<i>Açaí</i>	2,000
	Pineapple	400
Jayoro Mill	Sugarcane	1,200
	Sugar and others	300
	Local services (2)	200
	Concentrates (3)	1,750
Total labor force		14,250

## Notes

(1) Includes Coca Cola (3,000) and Ambev (5,000)

(2) Administrative activities, hotels, restaurants, etc.

(3) Includes industries (900) and their local suppliers (850)

The following figures represent fiscal exemption as a result of federal tax incentives, covering the Import Tax, the Excise Tax (IPI), the Employees' Profit Participation Program (PIS) and the Tax for Social Security Financing (Cofins).

The fiscal benefit of the Import Tax occurs in two stages: it begins with suspension of the customs clearance charge, and ends with an 88% reduction in the value owed when the product is sent to any part of the country.

The calculation of tax exemptions related to the Import Tax considered the average rate of 10% for importing industrial input-materials from the ZFM; it was supposed that all the industries used the reduction coefficient of 88%. In this case the tax exemption was equal to 0.88 of 10%, or 8.8% of the value of imports (the supposition was therefore that the amount imported each year was equivalent to the total used in industrialization the same year).

The tax benefit of the IPI includes suspension of the tax due in importing industrial input-materials and the exemption granted in the outflow of the product from the factory door in the ZFM to any point in the country.

Exemption of the IPI is in each case granted by means of the resolution passed by the Administration Council of the Superintendence of the Manaus Free Zone (**Suframa**), approving the company's industrial project, which should comply with the basic productive process (PPB) established by the Executive Power (Law 10.176 of 11 January 2001, article 4).

In the case of a product for use or final consumption (televisions, cellular phones, motorbikes, etc.), it suffices to attend to two requirements – at installation, to have the industrial project approved; and at operation, to comply with the PPB – in order to have the right to exemption from the IPI as provided in Decree-Law 288 of 1967).

In the case of intermediate products (such as the above-mentioned “concentrates”), it is also necessary for products industrialized in the ZFM to be made with agricultural and vegetable extractive raw materials from the region (Decree-Law 1.435, article 6).

If the product industrialized in the ZFM is for use or final consumption, the benefit of exemption is transferred throughout the marketing chain without the price of the product being affected by the IPI.

If it is an intermediary product, there will be a second industrial stage, when two situations occur:

a) the product exempt in the ZFM is used to make final products that are not subject to the IPI, in which hypothesis neither the intermediary (exempt) product nor the final product will have been charged the IPI, and for this reason the law (DL 1.435, article 6) does not authorize the industrialist in the second stage to benefit from the tax;

b) the product exempt in the ZFM is used to make final products subject to the IPI; in this hypothesis the final product is therefore charged the IPI. So, the price of an intermediate product, whether exempt or not, will always be one of the portions that make up the price of the final product.

On this question there can be no doubt, nor as regards the fact that if this portion is taxed by the IPI, the corresponding exemption will have been annulled. This would be as if the exemption had become a deferment: the tax that was not paid in the ZFM would be charged at the second phase of industrialization.

In principle, two alternatives exist to maintain exemption:

1) exclude from the price of the final product (the basis for calculating the IPI) the portion corresponding to the exempt intermediary product;

2) authorize, on purchase of the exempt product, the credit of the IPI, calculated as if it were owed.

Since the IPI is a non-accumulative tax assessed in the “tax against tax” regime as provided by the Federal Constitution, the above-mentioned DL 1.435, article 6, § 2, as was inevitable, adopted the second alternative and in so doing preserved the economic effect of the exemption.

Calculating the tax exemption of the IPI took into account the average TIPI rates of the principal products in each selected industrial sector. The benefits of the PIS and Cofins taxes are expressed by differentials of tax rates (Law 10.996 of 15 December 2004, articles 3 and 4).

When the product leaves the ZFM and is sent to any part of the country, tax rates of 0.65% and 3%, are charged respectively. In turn, the buyer of the product, in any part of the country, may be credited 1% of the PIS and 4.6% of the Cofins. In this way, there is a presumed credit of 0.35% (PIS) and 1.6% (Cofins). These benefits affect both final and intermediary products made in the ZFM, except for the preparations to produce soft drinks, which have a tax rate of zero and so do not generate the presumed credit granted to other products. The preparations meant for production of some other non-alcoholic beverages (nectars, chocolate drinks, etc.) are liable to the general tax rate, so they enjoy the benefit of presumed credit.

The total figures of tax exemption in accordance with the incentivized taxes and calculated according to the premises and legal provisions described above, were as follows:

### Tax exemption – 2013

Taxes	Values
<b>IPI</b>	12,082,756,638
<b>Import tax</b>	2,287,190,532
<b>PIS + Confins</b>	1,346,229,665
<b>T o t a l</b>	14,369,947,170

Particularly notable is the relative importance of the IPI, which accounted for 84% of the amount of incentives in 2013. The chart below also refers to tax exemption in the ZFM in 2013, now detailed according to the benefitted economic sectors:

### Tax exemption – 2013

Industrial sector	Value – R\$	%	Exemption per worker	Exemption/Billing
<b>Electro-electronic</b>	8,580,415,649	60%	174,257	21%
<b>Two wheel</b>	2,527,050,114	18%	138,476	19%
<b>Concentrates</b>	1,681,925,232	12%	118,030	20%
<b>Thermoplastics</b>	718,680,510	5%	72,565	18%
<b>Mechanical</b>	749,934,826	5%	90,332	19%
<b>Metallurgy</b>	627,143,392	4%	80,259	18%
<b>Watches</b>	353,572,425	2%	151,229	28%
<b>Químico</b>	200,503,086	1%	139,335	18%
<b>T o t a l</b>	14,369,947,170	100%	130,256	19%

Notable in this chart is the impressive share (60%) of the electro-electronic sector in the total figure for tax exemption. The share of the biggest productive sector of intermediary goods (concentrates) was 12% of the total. Bearing in mind that the use of the labor force is one of the main indicators to measure the efficacy of tax incentives, especially regional exemptions, as in the case of the ZFM, the value of the tax exemption was calculated per worker allocated in each sector. It is also important to note that the sector of concentrates, in addition to the jobs created in the ZFM, is the only one to generate wealth to the interior of the State of Amazonas, through agribusiness and family farming, activities that are responsible for supplying regional agricultural raw materials.



This indicator shows that the tax exemption per worker was of the order of R\$ 174,000 in the electro-electronic sector and R\$ 138,000 in the two-wheel sector, the two leading sectors in the ZFM. In the sector of concentrates for beverages, the exemption per worker amounted to R\$ 118,000. The following indicator is the percentage that the tax exemption represented in each sector's billing. This indicator reflects the "margin of preference" that the companies installed in the ZFM have at their disposal to cover the additional costs of producing in the Amazon Region, whether because of the distance to the consumer centers or because of the difficulties inherent to developing industrial production at satisfactory levels of productivity and environmental sustainability in that region.

Note that the average indicator is 19% and that all sectors (save for watches) are very close to this average, which points to a relatively uniform treatment to the economic sectors detailed in the table presented above. On the other hand, also deserving of note is the fact that this uniformity represents a disfavoring of "concentrates", since this sector has a considerable additional cost due to the legal requirement to use regional agricultural raw materials in their industrial process. This condition means that in order to ensure effective balance in textured treatment, the "protection" given to concentrates must be greater than what the other sectors receive.

Just for example, it is worth observing the additional cost of sugar production, the most relevant raw material in producing concentrates, shown in the table below. The basic data were gathered from the site of the Ministry of Agriculture and the accounting records of the **Jayoro Mill**:

### Sugar – Productivity and costs of production - harvest of 2013/2014

Items	Unit	Center-South	Northeast	North	Notes
Productivity: the soil	ton/hectare	70.3	62.3	70.8	1
Productivity: cane	Kg/ton	136.1	131.5	69.9	2
Productivity: sugar	Ton/hectare	9.2	7.6	3.9	3
Cost of productivity: sugar	R\$/ton	910	886	2.943	4

#### Notes

- 1 – Tons of sugarcane harvested per hectare
- 2 – Kilos of sugar obtained from 1 ton of sugarcane
- 3 – Tons of sugar obtained per hectare of sugarcane planted
- 4 – Includes agricultural, industrial and administrative costs

The table above shows three indicators of productivity and the cost of producing sugar in the Center-South (principally the States of São Paulo and Paraná), Northeast and North regions (States of the Amazon, where the **Jayoro Mill** concentrates 95% of the production, directly entirely to the **Recofarma** company).

The harvest of 2013 at **Jayoro Mill**, located in the interior of the Amazon Region, rendered a total of 269,000 tons of sugarcane planted over 3,800 hectares. The productivity of the soil was 70.8 tons per hectare, above that obtained in the Northeast and also a little above that of the Center-South.

The production of sugar that year used 201,000 tons of cane, which rendered 14,680 tons of sugar. This level of productivity resulted in 69.9 kilos of sugarcane for each ton of cane.

Comparing this figure with that of the Center-South, one notes that the productivity of the cane planted in the Amazon, as expressed in terms of sugar production, is 51% of that planted in the Center-South Region.

The third indicator derives from the previous ones. Considering that 14,680 tons of sugar were obtained in an area of 3,800 hectares, an average is reached of 3.9 tons of sugar per hectare of cane planted.

Comparing this figure with that of the Center-South Region, we see that the hectare planted in the North produces only 42% of the volume of sugar obtained per hectare in the Center-South.

This lower productivity, together with other factors of geographic disfavoring, greatly increase overpricing the operation in the North Region. Taking into account the agricultural, industrial and administrative costs, the final cost of production of 1 kilo of sugar in the North Region is R\$ 2.94, whereas in the Center-South Region the cost is R\$ 0.91. In other words, producing sugar in the North is 223% more expensive.

It is interesting to see the relative importance of sugar in the production of concentrates in the ZFM. As seen earlier, in the harvest of 2013/14, the **Jayoro Mill** used 201,000 tons of cane to produce 14,680 tons of sugar. This volume of sugar helped to make 30,000 tons of caramel coloring, industrialized in the Industrial Pole of Manaus by **D. D. Williamson do Brasil Ltda**. Caramel coloring is the main raw material of the concentrate.

Like sugar, *guaraná* is another important component that burdens the production of concentrates, a consequence of the obligatory use of raw materials from the Amazon Region. Brazil's total production of *guaraná* was 2,550 tons in 2013. The State of Bahia accounted for 60% (1,520), for an average productivity of 410 kg/hectare. As for the State of Amazonas, it produced 610 tons, just under a quarter of the total, but its productivity scored far lower: 205 kg/hectare.

The municipality of Maués is the biggest producer in the Amazon Region. In a planted area of 4,700 hectares, 2,700 of which with fruit-bearing *guaranazeiro* trees, 300 tons were harvested in 2013, for a productivity figure of only 110 kg/hectare. Ambev, the leading buyer of the product, has a permanent program to orient and promote productivity of the *guaraná* crop in Maués. It is worth noting that almost 90% of the production of *guaraná* in Maués, which employs 5,000 local workers, is meant for the production of concentrates in the Industrial Polo of Manaus.

The municipality of Presidente Figueiredo is the second largest producer and the first in productivity, due to a partnership between the **Jayoro Mill** and **Embrapa** to improve the *guaraná* clones with new technologies and seedling nurseries for replanting. Soon the **Jayoro Mill** will have the biggest *guaraná* crop in the world: 350,000 plants. In an area of 420 hectares, the production of the *guaranazeiros* reached 832 tons of fruits picked in the field, which rendered 104 tons of dry seeds in 2013, for a productivity figure of 250 kg/hectare. The **Jayoro Mill** is an agribusiness that produces the extract of *guaraná* in liquid and powder form. The Recofarma industry installed in the ZFM buys 100% of the municipality's production through the **Jayoro Mill**.

As in the production of sugar production do sugar, *guaraná* has an additional cost to be produced in the Amazon Region, as shown by the significantly lower regional productivity when compared with the State of Bahia, despite the fact that *guaraná* is a regional endemic crop.

Aside from using regional agricultural raw material, the industrial concentrates companies buy intermediary products from companies based in the Industrial Polo of Manaus, which constitutes yet another factor that generates employment for the Region and Brazil.

In 2014, according to data on the purchase, by the sectors listed here, of regional (the State of Amazonas), national and imported input-products, one sees again that the chemicals sector, which includes principally the concentrates sector, scores highest in regional and national purchases: 66%.

In this regard, a comment must be made on the recent concern on the part of the Government of the State of Amazonas in respect to the high level of input-materials and components being imported by the industrial companies in the ZFM. The Government plans to extend to other industrial segments the requirement of a minimum level of purchases of such materials in the ZFM, to be regulated by means of the Minimum Productive Process (PPM).

Presented below are the values of sectorial imports and exports, as well as the figures of the trade balance:

INDUSTRIAL SECTOR	Imports		Exports	Trade balance (R\$)
	R\$	% Billing		
Electro-electronics	17,762,695,222	43%	302,002,411	-17,460,692,811
Two wheel	2,839,257,253	21%	475,025,174	-2,364,232,079
Concentrates	160,471,957	2%	737,431,491	576,959,534
Thermoplastics	1,333,765,877	33%	19,968,689	-1,313,797,188
Mechanical	1.872.551.864	48%	5,381,920	-1,867,169,944
Metallurgy	1,245,320,079	36%	27,881,374	-1,217,438,705
Watches	432,486,104	34%	364,349	-432.121.755
Chemicals	344,253,146	30%	90,547,477	-253.705.669
T o t a l	25,990,801,502	34%	1,658,602,885	-24.332.198.617

Unlike the “margin of preference”, the relation between importing and billing showed relevant variations of the average of 34%, with special mention of the mechanical sector (5<sup>th</sup> largest in billing), with 48%; the electro-electronic sector (the largest), with 43%; and the concentrates sector, with 2%.

It is also shown that concentrates is the only sector among the eight largest to have a positive trade balance, besides being the sector with the highest financial volume in exports in 2013 among industrial companies in the ZFM.

It also deserves noting that the largest export company in the region, **Recofarma Indústria do Amazonas**, which belongs to the concentrates sector, ranks 124<sup>th</sup> in Brazilian companies that export over US\$ 100 million a year. In 2013 this ranking involved only 271 companies. According to data of the Ministry of Development, Industry and Commerce (MDIC), the product most exported by the State of Amazonas in 2014 was concentrate to produce soft drinks: a total of US\$ 253.4 million. The **Recofarma Indústria do Amazonas** company exported US\$ 246.1 million of this total and accounted for more than 26% of all the exports of the State. The total production of concentrates in the ZFM posted 70,250 tons in 2013 and 72,100 tons in 2014.

## Final Comments

Based on the data presented above, gleaned mostly from the Suframa site, the conclusion can be drawn that the concentrates sector is the one that aggregates most socio-economic value for the region and the country<sup>1</sup>.

Company data include, among others, the number of the direct labor force, built area, total investment, description of products and their NCM code numbers.

What has been demonstrated above is that none of the industrial sectors present in the ZFM enjoys special favoring vis-à-vis the others. The highlight given to concentrates can be explained by the peculiar features of this segment, which, in comparison with the other sectors, was by law granted additional conditions for the right to exemption of the IPI, such as the use of regional agricultural raw materials.

<sup>1</sup>The data of the concentrates industry are available in the sub-sector of non-alcoholic beverages and their concentrates, in the Indicators page of the Industrial Polo of Manaus, Profile of the Companies with Projects Approved by Suframa.