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PRESS

IMPORTATION OF LNG INTO BRAZIL: KEY ISSUES INVOLVING THE DELIVERY OF CARGO AT THE DESTINATION PORT

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Liquefied natural gas (LNG) has become an increasingly important backup source of natural gas worldwide. New liquefaction facilities projects are expected to increase up to 60 million tonnes per annum (mmtpa) of capacity in the international market, leading many to say that 2019 could be the year of LNG oversupply.[1]

In Brazil, the natural gas market faces many challenges, among which a monopoly structure and regulatory constraints are particularly important. Some ongoing debates towards greater competition and initiatives such as the *Gás para Crescer* ('Gas to Grow' programme) launched by the Ministry of Mines and Energy, were specially conceived to promote discussions with industry players in order to open the market.

In such a scenario, new LNG projects involving the chartering of Floating Storage and Regasification Units (FSRUs) are gaining space, especially when connected with gas-fired power plants, which are projected to drive investment and create demand for such infrastructures. Because of this, importation of LNG is being carried out and discussed by important market players and becoming increasingly significant. Future stages of such projects will likely involve the commercialisation of regasified natural gas in the Brazilian market and its injection into the transportation and distribution systems.

The importation of LNG has some particularities in Brazil, from the moment prior to the arrival of the LNG vessel at the delivery port until the moment the natural gas is finally considered transferred to the buyer. In general, the LNG importation is ruled, between buyer and seller, by a Gas Sale Agreement (GSA), which provides for the procedures for placing cargo orders and delivery of cargo.

From an operational point of view, after the LNG vessel carrying the LNG cargo ordered in accordance with the GSA arrives at the destination port, it will be moored alongside the FSRU, and flanges and hoses will be connected to the FSRU for the transshipment operation to begin. After completion of transfer of cargo, the LNG vessel will disconnect the hoses and flanges, be unmoored and finally sail to the next destination port.

The importation of LNG is subject to special procedures by the customs authorities, due to the peculiarities of the product and its discharging and handling operation.

In contrast to the regular import procedure applicable to general products (in which the Import Declaration is filed after the arrival of the goods in Brazil within a bonded area), the customs procedure of LNG starts before the discharge of the product from the LNG vessel, which may deliver the product either in bonded areas or not.

If LNG is discharged from the LNG vessel to a non-bonded area (such as to a FSRU facility), the importer must inform customs authorities of the transaction up to two business days before the actual discharge, filing a predefined form with some documents provided in the customs legislation which include, among the relevant information, the quantity of cargo to be unloaded. The actual discharge of LNG is automatically allowed by legislation as long as the importer presents such documents.

The actual quantity of LNG discharged to the FSRU will be measured by a draft survey and a variation in relation to the declared quantity is expected due to elements such as heel on board and boil off.[2] From a customs standpoint, the legislation sets forth that the difference of quantities between those: (1) declared by the importer; (2) actually discharged; and (3) remaining on board is deemed as consumed in the international transport and in the cryogenic maintenance of the LNG vessel.

Delivery and use of LNG by the importer is authorised upon presentation of the main documents provided in the legislation, which includes the quantification appraisal.[3] Formal customs clearance of the product shall be completed up to 50 days from the discharge of LNG.

The quantification of LNG is a relevant issue in the customs procedure and release of cargo, and a certified expert will perform such activity following procedures provided in specific Brazilian regulations. Among other aspects, the legislation sets forth that water and sediments shall not be considered in the quantification of the product.

After the issuance of the quantification appraisal and the presentation of the documents provided in the legislation, the importer will rectify the customs documents (especially the Import Declaration) in order to reflect the actual information of the transaction. Some specific waivers in relation to variation of quantity of cargo due to losses are provided in the legislation.

The LNG will then be regasified in the FSRU and injected into a pipeline to be delivered at the final destination.

To the extent that this may affect final delivery of cargo, it is also important to highlight that no federal customs taxes[4] are imposed on the import of LNG. However, a State tax (a type of State VAT called ICMS)[5] may

apply.[6] Such tax must be paid based on the quantities of cargo declared in the Import Declaration, which does not necessarily correspond to the final quantity discharged. Because of that, depending on the actual quantification of LNG, the importer will collect additional ICMS on the transaction or request the reimbursement of overpaid taxes at the moment of the discharge of the product from the LNG vessel.

Based on the above, it is clear that, for this procedure to be followed in full, the involved parties must fulfil a number of requirements before the public authorities, which ultimately has an impact on the final delivery of the cargo.

As previously stated, the procedure relating to the measurement of cargo for purposes of quantification of delivered quantities, losses and collection of taxes is a key point of the import and delivery of LNG, since the importer may only take possession and make use of or commercialise the product after this activity is completed, unless it is dismissed by authorities in the specific transaction.

One of the bottlenecks related to the measurement activity is the obligation for it to be performed by certified experts by customs authorities, and the current lack of legal provision which allows for the importer to use exclusively its own automatic measurement equipment (in existence previously until December 2018 and then revoked).

The release of LNG cargo may also be complex in a situation where the LNG to be unloaded in the same regasification facility is acquired by more than one importer and at the moment of discharge or filing of customs documents the quantities to be taken by each party are not defined. As a rule, this occurs on the import of LNG by gas-fired power plants, since in some situations it is not possible to foresee the dispatch demand.

Considering that the customs documents must be filed by each importer before the discharge of LNG, and the quantity of the cargo must be set out in such documents, importers must frequently try to find alternative legal solutions or commercial structures to overcome this difficulty.

In addition to those facets described above, there are other complex aspects that may be present in the import structures of LNG, including the sharing of facilities between several agents; the loan of the product to third parties; the legal nature (and taxation imposed) on the regasification activity; the ancillary obligations applicable on the symbolic remittance and return of LNG/regasified natural gas; the conflict between the legal and physical flows of LNG/regasified natural gas; the possibility of FSRUs being treated as customs areas; and the granting of different tax benefits depending on the case, among others.

Despite all of these challenges, and considering the relevance that such types of projects are gaining in Brazil, there is great effort both from public authorities and market players to improve regulations, simplify current procedures and address these challenges in order to bring incentives to the market and increase the import of LNG into the country.

Notes

[1] See Wood Mackenzie, 'Is 2019 the year of the much-talked-about LNG oversupply'? (*Wood Mackenzie*, 7 January 2019) www.woodmac.com/news/editorial/is-2019-the-year-of-the-much-talked-about-lng-oversupply accessed 15 March 2019.

[2] In some cases, Brazilian authorities may dismiss the formal quantification of LNG discharged for customs clearance purposes.

[3] Customs authorities may dismiss such quantification.

[4] Even though the tax burden imposed on import depends on the product, as a rule the federal customs taxes are the following: Import Duty (14 per cent); Excise Tax (ten per cent); PIS (2.1 per cent); COFINS (9.65 per cent).

[5] ICMS tax burden may vary depending on several different aspects, such as the State in which the importer is located, the activity performed by such entity (ie, if the importer is a Power Plant, industry, refinery, etc), among others.

[6] In order to attract import transactions or projects involving LNG, some States grant tax benefits to reduce or even exempt the ICMS on the import of LNG.

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