Taxation of funds and offshore investments

31.08.2023 3 min read

Authors

Hermano A. C. Notaroberto Barbosa

Related areas

Tax

The changes were originally introduced by Provisional Measure 1171 (PM), which also proposed to increase the standard deduction for individuals. PM 1171's provisions were later transferred to the bill to convert PM 1172, which proposed an increase in the mini-mum monthly salary. Brazil's National Congress tacitly rejected the changes proposed by the federal government by failing to confirm the PMs. The federal government has now announced that it will again propose the measures, this time by means of a "presidential bill" which, according to the Constitution, must be considered by Congress on an urgent basis.

The main changes proposed to date, according to the most recent versions available, are:

Financial investments outside Brazil. Currently, income from financial investments is taxed as capital gain, at 15% (gains of up to BRL 5 million) and 22.5% (gains greater than BRL 30 million), calculated and payable monthly. Under the now-expired PMs, the top rate of 22.5% was to apply to annual income from financial investments greater than BRL 50,000.00, calculated and payable annually. All transactions were to be taxed separately, and offset of gains and losses was not allowed.

Controlled foreign entities. At present, profit earned by foreign entities is taxed only when it is distributed to the entity's shareholder(s) in Brazil, at rates of up to 27.5%. Un-der the expired PMs, the annual profit earned by foreign entities, including investment funds, controlled by individuals resident in Brazil was to be taxed automatically, in pro-portion to the shareholders' interest in the entity, regardless of whether the profit is dis-tributed. Other countries have similar rules. In Brazil, rules along these lines were pro-posed in both 2013 and 2021, but rejected. Under the PMs, the top tax rate of 22.5% was to apply to deemed distributions of more than BRL 50,000.00 per year, and the deemed distribution rules were to apply to entities that are located in "favorable taxation" countries, benefit from a "privileged tax regime", or have active income of less than 80%. The PMs would have allowed offshore entities to set off losses and taxes paid abroad against in-come, with some limitations. Many questions still need to be answered, however: what would happen, for example, when a profit exists on the books even when an entity does not have liquidity, so there are no funds available for distribution?

Trusts. The PMs also provided for taxation of trusts in Brazil. Trusts were to be treated as transparent for tax purposes, and income and capital gains from the trust's assets was to be taxed in the hands of their beneficial owner, in line with common practice in the market. In most cases, therefore, taxation was to occur in the hands of the settlor until distribution of the trust's assets to the beneficiaries. The lack of legislation and regulations governing trusts created uncertainty and the courts' treatment of trusts was unpredictable, so trusts should be re-examined to consider the impact of the new rules.

Updating the reported value of foreign assets. Exceptionally, the PMs gave individu-als the option to update the value of offshore assets reported on their income tax return for the 2022 tax year, and pay tax on the difference between the acquisition cost and the up-dated value, at a special reduced rate of 10%.

Capital gains. The expired PMs would also have revoked two rules dealing with the calculation of capital gains. The first allows capital gains to be calculated in a foreign cur-rency if the asset was acquired with income originally earned in a foreign currency. The second exempts from taxation in Brazil gains realized on the sale, settlement or redemp-tion of offshore assets acquired while the taxpayer was a non-resident. Legislation is required to introduce most of the new rules on taxation of investments pro-posed by the federal government, and any legislation that results in an increase in taxes will have effect only in the year following the year. According to public statements made by the federal governmnt, a new bill to deal with these rules and other sensitive tax issues, such as the taxation of closed-end funds, profits, and dividends, may be forthcoming.

>>>This article belongs to BMA Review 80. Click here to read more articles.

› PROFESSIONALS

Professionals who combine legal insight and market perspective

Hermano A. C. Notaroberto Barbosa