Changes in investment funds taxation in Brazil

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Law 14.754 was enacted in December 2023, establishing a new legal framework for the taxation of investment funds in Brazil, with impacts on domestic and foreign investors and other market participants.

Main Changes

Asserting that its intention is to make the tax system more equitable and transparent, Brazil's federal government has instituted "come-cotas" taxation for exclusive funds.

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Funds excluded from come-cotas

Earnings from Private equity funds – FIPs, Receivables Investment Funds – FIDCs, Exchange-traded funds - ETFs (provided they are classified as investment entities), Stock Funds – FIAs, Real Estate Funds – FIIs, and Agrobusiness Funds – Fiagros will still be taxed only on redemption or amortization of units.

FIPs that are not investment entities

Private equity funds – FIPs that do not fall within the regulatory definition of "investment entity" will now be subject to "come-cotas" on their total earnings, although the new rules allow taxpayers to exclude increases or decreases in the value of investments in Brazilian controlled companies due to their valuation at fair value or by the equity method when calculating the fund's earnings.

FIIs and Fiagros

Real estate funds and agribusiness funds remain subject to the previous rules, although the minimum number of investors required for exemption has increased from 50 to 100.

Offshore Funds

Earnings from offshore funds controlled by individuals residing in Brazil, located in tax havens, or subject to a privileged tax regime, will be deemed to have been distributed to the fund unitholders annually, and taxed at a rate of 15%.

Reorganizations

Spin-offs, mergers, and transformations of investment funds will now be subject to withholding income tax (IRRF – Imposto de Renda Retida na Fonte). The only exceptions are transactions involving funds subject to the same tax regime, as long as there is no change in unit ownership and fund assets are not made available to unitholders.

Usufruct

Where fund units are subject to usufruct, the beneficiary of fund earnings will be taxed, even if the beneficiary is not the legal owner of the units.

Another change to the taxation of funds was made by Law 14.711, also enacted in 2023, which repealed restrictions on application of the zero-rate withholding tax on earnings from units in FIPs, FIC-FIPs, and FIEEs held by non-resident investors. For example, the zero-rate withholding tax now extends to investors that hold more than 40% of the fund, and to sovereign funds (even when such funds are located in tax havens).

In January 2024, two more pieces of legislation with significant tax impacts on the financial market were enacted: Law 14.801 and Law 14.803.

Infrastructure Debentures and Exempt Funds

Law 14.801 grants tax benefits to infrastructure debentures. Issuers of infrastructure debentures benefit from an additional deduction of 30% of the interest paid. Earnings paid on the debentures to investors in Brazil will be subject to withholding tax at rates from 22.5% to 15%, which decline the longer the investor holds the investment, while earnings paid to non-resident investors will be subject to withholding tax of 15% (or 25%, if they are located in a tax haven or enjoy a privileged tax regime). The withholding tax on earnings paid to exempt funds, such as funds directed to infrastructure and R&D (FIP-IE, FIP-PD&I, and FI-Infra), will be of 10%.

Pension Funds

Law 14.803 allows participants investing in private pension funds to opt for levy of withholding tax at rates declining from 35% to 10% the longer the investment is held at any time before the benefit is paid or the first redemption is made.

With so many significant changes, we recommend that investors reassess how their investments are organized, and consider whether other types of investment funds or structures might be better suited to their needs.

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