MEMORANDUM TO CLIENTS

TAX

February 26, 2016

PLC No. 27/15
New Rules for Determining Capital Gains

As expected, the Brazilian Federal Senate approved Bill of Law No. 27/2015 ("PLC"), which originated from Provisional Measure No. 692 ("MP"), published on September 22, 2015.

The PLC now awaits presidential approval, which is the last stage before its conversion into law, significantly changing the original version of the MP. A portion of the approved version of the PLC violates the Constitution, and therefore may result in a presidential veto.

What are the rules approved by Congress?

As addressed in our Memorandum to clients regarding the MP (click here for the full version of our Memorandum to clients on the MP), the MP introduced new rules with respect to Income Tax ("IT"), which is levied on: (i) capital gains earned by individuals upon the disposal of assets and rights; and (ii) entities not subject to the actual, presumed or "arbitrated" profit tax regimes upon disposal of assets and rights registered as non-current assets.

Although the PLC has maintained the guidelines of the MP originally published, with respect to progressive taxation on the capital gains mentioned above, the approved text presents progressive rates and bases that are different to those in the MP, as follows:

i) 15% (fifteen per cent.) on any capital gain that does not exceed R$ 5 million;

ii) 17.5% (seventeen point five per cent.) on the portion of any capital gain which exceeds R$ 5 million, but is less than R$ 10 million;

iii) 20% (twenty per cent.) on the portion of any capital gain which exceeds R$ 10 million, but is less than R$ 30 million;

iv) 22.5% (twenty two point five per cent.) on the portion of any capital gain which exceeds R$ 30 million.

An important innovation introduced by the PLC relates to the fact that the amounts used as a reference for the progressive rates must be adjusted for inflation. The rate of adjustment will follow the adjustment for the lowest IT band for individuals, as per new legislation to be enacted from time to time by the government.

Pursuant to the new wording of the MP, if the same asset or right is disposed of in more than one stage, the capital gain earned in the second stage and each subsequent stage must be added to the capital gain earned in the original stage in order to determine the applicable tax rate. This provision seeks to avoid the disposal of assets in stages, with a view to avoiding higher tax rates. The text, however, establishes that this rule includes transactions carried out up to the last day of the year subsequent to that of the first transaction.

The approved text maintains the application of the new rules to certain transactions carried out by non-residents, as stated in our Memorandum to clients regarding the original MP. The exceptions listed in that document remain in force.

Were the questions regarding the scope and application of the new rules clarified?

The PLC also clarifies that the new rules will apply to all disposals of assets and rights as from January 1, 2016. All transactions carried out before this date, even if payment is partially or entirely received after December 31, 2015, fall outside the scope of the PLC. The taxpayer, nonetheless, must demonstrate that the transaction was finalized on or before December 31, 2015.

Even if well intentioned, the wording of the PLC presents blatant violations of the Constitution. The Constitution expressly requires that an increase in the IT rate is only enforceable in the year subsequent to the year it was converted into law. Considering that the MP was converted into law in 2016, its applicability before January 1, 2017 would be in violation of the Constitution. Therefore, in our view, this portion of the PLC, if approved as is, may be challenged in court by taxpayers.

Additional Issues

In addition to the new rules concerning taxation of capital gains, the PLC approved by Congress introduces changes relating to the rules on: (i) the Brazilian Controlled Foreign Corporation rules in connection with the definition of related entities; and (ii) the extinction of fiscal debts through transfer of real estate.

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