

NEW BRAZILIAN RULES ON TAXATION OF FOREIGN SUBSIDIARIES

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Brazilian Act n. 12.973/2014 recently introduced amendments to profit rules covering foreign controlled companies – rules that seem certain to discourage investors.

The new law establishes universal taxation for foreign companies controlled directly and indirectly by Brazilian entities, which means that every valuation of investments made by the Brazilian company must be registered in its accounting books annually and, therefore, taxed even though the associated profits are not available in Brazil yet. Appreciation in the investment's value will be the basis for the calculation of income tax and contribution on profits related to the Brazilian controlling company.

Moreover, the new rules significantly increase the complexity of profit control. Appreciation and depreciation on an investment must be registered individually in a subaccount of the investment account. This method will probably increase taxation, given that previously taxes were due only when the sum of profits and losses of a directly controlled company was positive. Now, if an indirectly controlled company profits, the gain must be taxed automatically.

Despite resulting from the conversion of Provisional Measure n. 627, Act n. 12.973 has some nuances that may go unnoticed by observers who analyzed the Provisional Measure previously. Not to sound an overly optimistic note, the Act is considerably softer when it comes to controlling individuals. Provisional Measure n. 627 originally instituted the same rules outlined above the Brazilian individuals who control or are owners of foreign companies. This caused a commotion among the investor community

Foreign associated companies may enjoy better treatment in this regard, as the new law requires that profits gained by associated companies will only be computed when available to the Brazilian company, and they will fall into the rules of controlled companies if they are located in tax havens or countries with favorable taxation.

It is important to highlight that this “new” set of rules is, in fact, a rewrite of art. 74 of Provisional Measure n. 2.158-35/2001, which was ruled unconstitutional by the Brazilian Supreme Court (Adin 2.588). The justification for maintaining this rule is justified by some significant lawsuits involving Brazilian companies that did not include in their calculation basis profits of foreign controlled companies, based on agreements for the avoidance of double taxation signed by the countries where those companies are located.

It seems that the government's motivation is purely to maximize tax collection, as we are unable to glean from the Act any consistency regarding the economic policy the federal government intends to adopt.

This measure will certainly be detrimental to the competitiveness of Brazilian companies abroad, as they will be subjected to more taxation than other companies located in the same places. However, there is hope for Brazilian investors, since it may still be possible to get around the rules with several

because it would impair many small business and investments, such as foreign retirement plans, foreign pensions or real estate management. layers of companies of foreign trusts – at least until the next set of rules are introduced.