Changes in Brazilian CFC rules

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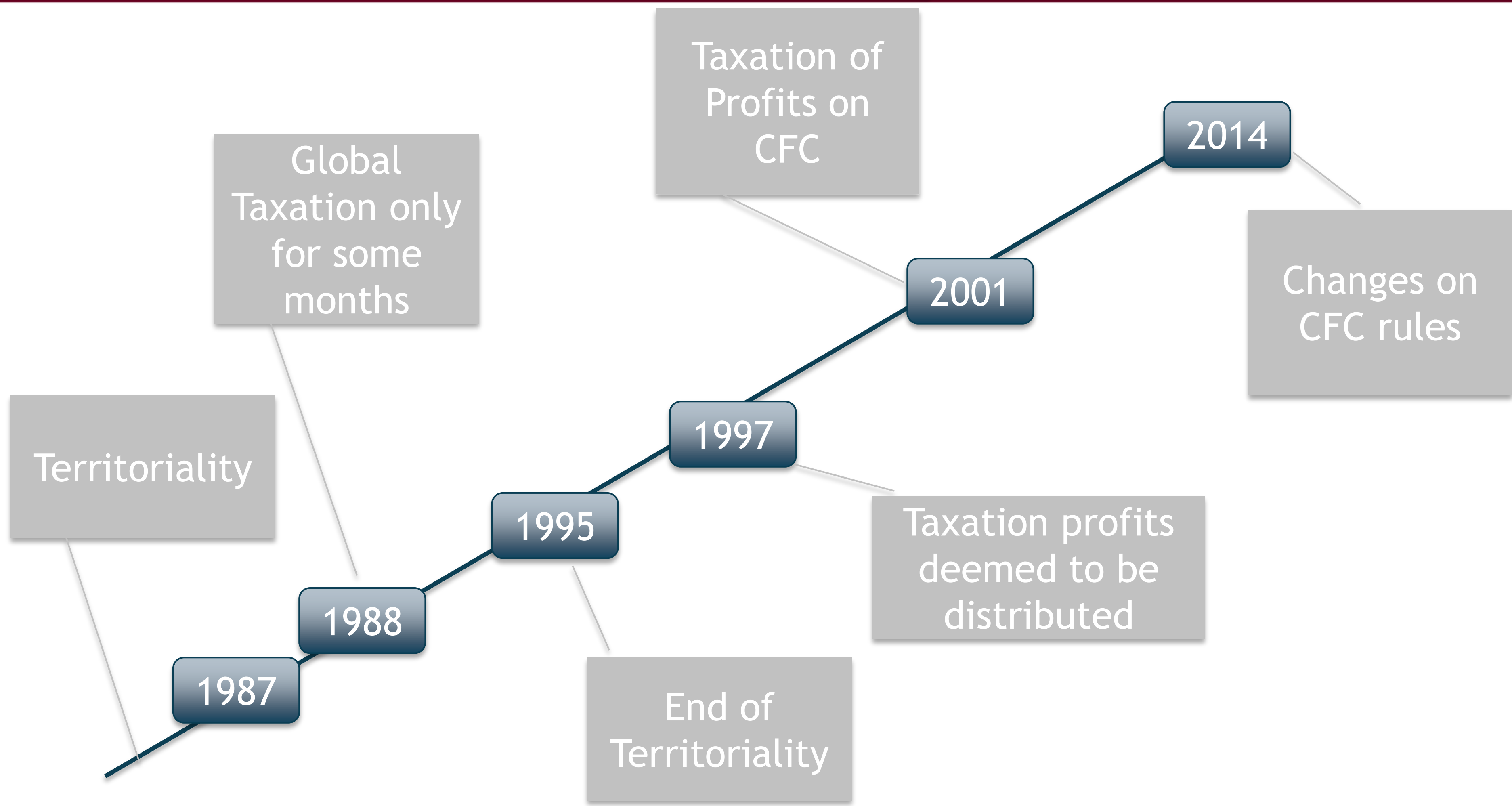
Main Topics

- CFC rules in Brazil: a recent history with many chapters.
- After ten years appreciating a single case, the decision of Brazilian Supreme Court is...?(ADI 2.588)
- Now that we have a precedent issued by Supreme Court about the constitutionality of CFC rules, let's change them! (Provisional Measure 627/13 – Law 12,973/14)
- Is it necessary to control a foreign company to apply CFC rules?
- Brazilian Innovation: Value of Investments adjusted by CFC profits is not equal to CFC income.
- And how Brazil punish CFC tax havens with passive income?
- Avoiding Litigation about new CFC rules.

CFC rules in Brazil: a recent history with many chapters.

recent history



recent history

- The main difference of CFC rules adopted by Brazil tax law is the application to any type of investments:
  - with or without control of the company,
  - in tax haven or jurisdictions with high taxes,
  - passive income or business income.
- Brazilian multinationals with international subsidiaries to attend only their business purpose are included in CFC rules with the same provisions applicable to international structures settled only to reduce tax burden.

After ten years appreciating a single case, the decision of Brazilian Supreme Court is...?(ADI 2.588)

ADI 2.588

- The dispute:
  - Taxpayer arguments:
    - Non distributed profits of a subsidiary of a Brazilian company cannot be considered income in the definition of income tax basis provided by Brazilian Tax Code.
    - When the Brazilian company is not the controller shareholder (or quota holder), the payment of taxes occurs in cases in which the investor has no power to approve an effective distribution of profits.
  - Tax Authorities arguments:
    - Taxation of equity value of CFC is taxation of an increase of value of the Brazilian company caused by the results of its international subsidiaries.

ADI 2.588

- Case began to be discussed in 2003 and the final decision was enacted in 2013!
- Decision:
  – It is not possible to tax with CFC rules the profit of invested companies when the Brazilian entity has no control and effective power to vote for a distribution of dividends.
  – CFC rules applies when the subsidiary is in a tax haven jurisdiction.
  – It is not allowed the taxation of profits earned by the invested companies before the issuance of the CFC rules.

Now that we have a precedent issued by Supreme Court about the constitutionality of CFC rules, let's change them! (Provisional Measure 627/13 - Law 12,973/14)

Law 12,973/14

- The final decision was issued in April, 2013 and the Provisional Measure 627 was enacted in November, 2013.
- The Provisional Measure 627 was converted into the Law 12,973 in May, 2014 and it will be effective in January, 2015.
- Several changes were made in Provisional Measure 627 by the Congress – the most relevant was the exclusion of CFC rules to foreign investments held by individuals.

Law 12,973/14

- Tax Experts have different views about the new Law 12,973/14:
  - Some of them consider it is better than the precedent rules, because it has considered the interpretation of Supreme Court.
  - Others consider it worse than the previous law, because it was issued with the purpose of prevail on the dispute with taxpayers using the legislative power to overcome the limits imposed by the Supreme Court.
  - A few experts are considering it better than the former law in some aspects and worse in others.

Is it necessary to control a foreign company to apply CFC rules?

Control is necessary?

- Taxation of income earned by undirected controlled foreign company.
- Taxation of income of controlled foreign companies in any type of jurisdictions.
- Deemed control when the CFC is in a tax haven jurisdiction.
- Control is defined considering the business group to include common control by related parties.

Brazilian Innovation: Value of Investments adjusted by CFC profits is not equal to CFC income.

Adjusted Value of Investment

- The tax basis is the value of investments calculated as the result of the percentage of participation on capital multiplied by the equity value.
- Only profits are considered in tax basis, losses will not reduce the tax basis and they cannot be consolidated vertically or horizontally.
- The law try to impose that this value of investments adjusted by profits is not the income earned by a foreign company, but the increase of value that was generated to the Brazilian company in consideration of its investments abroad.

Adjusted Value of Investment

- In the view of tax authorities:
  - Treaties to avoid the double taxation of income cannot relieve the taxation of the increase of value of a Brazilian resident.
  - There is no double taxation in this case, because taxation in Brazil considers only the increase of value of a Brazilian company.
  - In corporate law increase of value of investments may derive profits to be distributed as minimal mandatory dividends for the shareholders of a Brazilian company.

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And how Brazil punish CFC tax havens with passive income?

tax havens

- There are some exceptions to the restriction of consolidation of profits and losses, that are not applicable to investments in a tax haven jurisdiction.
- Deemed control of companies in tax haven jurisdiction.
- Some international concepts related to CFC rules are used in the law only as limitation to some reliefs provided by the new law:
  - Passive income.
  - Jurisdictions that don’t exchange tax information.

Avoiding Litigation about new CFC rules.

Avoiding Litigation

- In order to reduce the litigation against the new law some benefits were granted to taxpayers that resign to the right of go to the discuss the application of the law 12,973/14 in Administrative and Judicial Courts.
- Specific sector receive reduction of tax rate.
- Oil and gas sector was excluded from the application of the new CFC rules.

Many Thanks!

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