

Amnesty, Transparency and Opportunity for Brazilian Tax Payers

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"A fine is a tax for doing something wrong. A tax is a fine for doing something right." (Anonymous).

Whatever one's views on tax it is usually a hard sell to convince people that the payment of tax is an opportunity for the payer. Tax is an emotive and political subject, but it is fundamentally a fiscal issue and in the current difficult economic conditions affecting Brazil it is entirely understandable that the government is seeking to increase its tax receipts.

The Brazilian government has instituted two key tax initiatives in 2016, which should increase the federal tax receipts, but which also present opportunities for those Brazilian tax payers with international assets who will be directly impacted by the legislation.

Tax Amnesty

Law no. 13254/2016, Implementation of Special Regime for Monetary and Tax Regulation (the "Repatriation Law") establishes a mechanism for Brazilian tax residents to voluntarily disclose and regularize previously undeclared assets held overseas. In essence, the Repatriation Law requires participants to file a special tax return between 4 April and 31 October 2016 together with full payment of income tax at 15% owed on the unreported assets plus a penalty of an additional 15%, resulting in a total tax payment of 30%. The tax and penalty is payable on assets in possession before 31 December 2014 on the basis of their value at that date. The amount of tax and the penalty must be calculated using the Brazil/U.S. exchange rate as at 31 December 2014 of R\$2.6562:US\$1.00. In addition, participating tax payers must file amended tax returns for 2014 and 2015.

Currently there are many lawyers, financial advisors and financial institutions working long hours on behalf of their clients in order that they can benefit from the amnesty offered by the Repatriation Law. However, despite being commonly referred to as the Repatriation Law, the legislation does not require that the assets be transferred into Brazil, they can remain overseas, as long as the taxes and penalties are paid in Brazil in local currency and the affected tax returns are rectified to include the assets in the taxpayer's declaration.

Amnesties are quite common in other areas of the complex Brazilian tax system. For instance, it has long been a practice amongst some real estate owners who would repeatedly become delinquent on their property taxes and wait for amnesties offered by municipalities every few years in order to clear their affairs and in this way to defer, and often considerably reduce, the amount of tax paid. However, this is the first time that the Brazilian government has offered an amnesty to Brazilian residents to regularize undeclared overseas assets. Political opposition to such a measure, that is seen as favouring an elite section of society who have deprived the country of resources by stashing their wealth abroad, has succumbed to the fiscal reality that an amnesty will raise significant revenue. Furthermore, there appears to be a recognition that there are multiple justifiable economic and personal reasons why assets were kept or transferred overseas. Many of those participating in the amnesty are successors of family members who acquired real estate or other assets several generations ago. The provisions of Law 13,254/2016 and its regulations seem to have struck the right

balance between the interests of the tax payers and the government by creating a process and an effective rate of tax that makes it feasible and attractive to participate.

Tax Transparency

It is perhaps no coincidence that the Repatriation Law has been enacted at a time of unprecedented global tax cooperation. The second key Brazilian tax initiative of 2016 has been the ratification in June of the OECD's Amended Multilateral Convention on Mutual Administrative Assistance in Tax Matters (the "Convention"). As a result of the ratification, the Brazilian IRS will be able to receive tax information relating to Brazilian taxpayers under the OECD's Common Reporting Standard ("CRS") which will come into force in Brazil on 1 October 2016. So, from October onwards the Brazilian IRS will be able request information about Brazilian taxpayers from the other countries participating in the CRS (currently more than 90 worldwide) if there are appropriate grounds for doing so. The purpose of the CRS is to enable automatic exchange of information between participating countries and Brazil will participate in this automatic exchange in 2018 using the data collected in the 2017 tax year. The current era of international cooperation on tax reporting began with the US government implementing its FATCA initiative (by which banks all over the world are forced to provide information about US taxpayers to the US tax authorities) and it has now been widened and strengthened by CRS. Although there is an irony in the US not participating in the CRS, there is already a Tax Information Exchange Agreement in place between Brazil and the US through which the Brazilian IRS can access tax information relating to its taxpayers from its US equivalent. The end game for this global initiative in tax cooperation is that undeclared assets held in financial institutions anywhere will be reported to the tax authorities of the country of residence of their ultimate beneficial owner.

Opportunity

Brazilian taxpayers in the fortunate position of having international assets, who participate in the amnesty, will now be free to maximize those assets, whether they repatriate them to Brazil or not.

Previously, when a taxpayer held undeclared assets, usually the main concern was to avoid attracting attention and, therefore, secrecy was paramount: bank accounts were set with "hold mail" and "don't contact" features; communication regarding the assets only happened in person when the client and the account manager could meet in a "safe place". Matters like allocation, risk/return, timing of returns were of much less importance. Well, the days of secret undeclared international assets are over both for Brazilians and the residents of the US and the 90+ countries participating in the CRS.

Now that the assets will be declared and identified, they can be totally integrated in the taxpayers' long term financial plans, both in Brazil and internationally and owners and their advisors can take full advantage of the many structural and operational innovations over recent years that have improved the effectiveness and reduced the costs of owning international private capital.

At JP Integra we have been working with Brazilian law firms, private bankers, accountants and tax advisers, family offices and asset managers to assist them in structuring their clients' assets to enable them to meet their personal and financial objectives. Now is the time for those taxpayers who will be participating in the amnesty to consider consolidating, rationalizing and future-proofing their international assets. Some matters

that we are currently working on should give an idea of the type of issues that Brazilian HNWs and their advisors might wish to consider.

- Re-domiciling entities – for clients who have asset holding and personal investment companies in an offshore jurisdiction that is not recognized as being an international financial centre (“IFC”) with a long record of compliance with the international initiatives led by the IMF, OECD and FATF. A transfer by way of continuation is a relatively simple and cost efficient procedure which allows companies that are incorporated in for example Panama or the Bahamas to be re-domiciled in Cayman or another leading IFC. The effect of a transfer is that the company continues in existence, but has changed domicile and so is now a Cayman company. It is a very useful option to take where the company operates a business or owns assets and transferring the business or assets to a new company would be costly, impractical or would constitute a disposal for tax purposes. A transfer by way of continuation avoids such issues.
- Transform a personal investment company (“PIC”) into a private fund – many HNW clients hold their offshore investments through a PIC, but it is much more tax efficient to hold such investments through a fund where income is taxable at 15% rather than 27.5%. Establishing an offshore private fund that meets the substance tests for Brazilian law can be achieved directly or indirectly. The direct approach involves creating a standalone fund for a particular client or client family, the fund is registered with the Cayman Islands Monetary Authority and appoints an administrator and an auditor. The standalone fund could be controlled directly by the family or via a trustee or professional directors. The indirect approach is for the HNW client’s advisors (such as a private bank or wealth advisor) to create a segregated multi-fund platform which provides each HNW client or family with a separate sub-fund. The sub-fund approach is typically cheaper for the HNW client as the establishment, registration and administration costs of the multi-fund platform are shared by each of the sub-funds. In either the standalone or the sub-fund model the owner of the fund can determine whether it wishes to self-manage its assets or to appoint a professional manager.
- Simplify the management and administration of a private fund – professional service provider administration charges are often structurally higher than they need to be due to the constitutional nature of the fund. Where a fund issues shares the administrator will calculate the net asset value of an owner’s holding and this can be a relatively expensive process. It is now possible to create a fund using a limited liability company (“LLC”) which is a corporate entity with many of the characteristics of a partnership. Instead of issuing shares the LLC maintains capital accounts for its owners which can reduce administrative and operating costs as it avoids the need for calculations of net asset value and for processing subscriptions and redemptions of shares.
- Reduce brokerage and foreign exchange costs – establishing brokerage accounts, managing international currency needs and hedging exposures can be a difficult and expensive process as there is an enormous gulf between the access given to institutional billion dollar portfolios and the more modest sized private funds. However, it is worth engaging with a consultant on a no cost basis to evaluate and renegotiate the arrangements for private funds as in some cases obtaining ongoing cost savings that exceed the cost of the annual administration of the fund is achievable, so that what was previously a tax inefficient PIC could be a tax efficient private fund thereby saving 12.5% annual

income tax with little or no net operational cost (as it has been more than offset by trading cost savings).

- Estate Planning – many HNW families in Brazil lead international lives with older and younger generations spending time studying or working in another country as part of their professional careers and lifestyle choices. Maintaining assets in other countries and other currencies via an offshore IFC facilitates such movements, but care should be taken to ensure that the overall structure is a simple and tax efficient as possible. A family might require a planning solution that involves a Cayman or New Zealand domiciled trust for international holdings other than those in the US and a separate US trust for the benefit of those family members with a close US connection (by residence or otherwise) so as to avoid the non US family members being drawn into the US tax net.

What's next on the tax agenda for Brazil?

President Michel Temer and his government has set itself the task of recovering the economy and establishing a stable political environment for the next election cycle in 2018. Repatriated money and new inward investment deals to fund infrastructure projects will help, but balancing the books by taming the government's financial deficit will require additional tax receipts which is likely to require new measures and stricter enforcement. Proposals have been made public for a revamped estate tax and enforcement regime increasing the present maximum 8% rate up to 25%. This reinforces the need for proper planning and thorough consideration of the competing forces shaping the decisions of Brazilian investors when it comes to their international assets.

The tax amnesty provides an opportunity for Brazilian HNW clients to regularize their tax position. The international tax transparency initiatives simplify the decision making process in deciding which financial centres to use.

A tax “may be a fine for doing something right”, but in the case of Brazil's 2016 tax initiatives, they are also an opportunity for clients to organize and use their international assets more productively.

Further Information

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