

Brazil: Bill of Law No. 2,337/2021 – 2nd Phase of Executive Tax Reform Proposal

On June 25, 2021, the Ministry of Economy delivered to the National Congress the 2nd phase of the Executive Tax Reform, which proposes changes to the tax legislation related to the individual tax income ("IRPF"), corporate income tax ("IRPJ") and social contribution on profits ("CSLL").

Among the main changes proposed, we highlight the following:

i. Profits and Dividends

- As of January 1, 2022, profits and dividends paid or credited by Brazilian legal entities will be subject to the WHT, exclusively at source, at the rate of 20%.
- A legal entity domiciled in Brazil may offset the WHT withheld on the dividends received against the WHT levied on the distribution of its own profits and dividends.
- The rate of the WHT will be increased to 30% if the beneficiary is resident or domiciled at a tax haven jurisdiction or if the beneficiary benefits from a privileged tax regime.
- Profits and dividends paid or credited by micro or small business to individuals resident in Brazil are exempted from WHT up to the limit of BRL 20,000 per month.
- Capital increases carried out through the incorporation of profits and dividends will not be subject to the WHT, provided that no capital reductions to be returned to the shareholders/quotaholders occur in the 5 years prior or 5 years subsequent to the capitalization.
- Profits and dividends will not be deductible from the taxable income, even if classified as financial expenses in the accounting books.
- The payment of profits or dividends with assets or rights will be subject to the WHT at the effective rate of 25% (or 37.5%, depending on where the beneficiary is resident or domiciled).
- The goods and rights delivered as distribution of profits and dividends must be evaluated at market value, except if the market value is less than the accounting cost of the assets/rights.

ii. Interest on Net Equity ("JCP")

- As of January 1, 2022, expenses related to the payment or credit of JCP will no longer be deductible from the taxable income.
- However, the rate of the WHT levied on JCP distributions is not changed (15%, or 25% if the beneficiary is resident or domiciled in a tax haven jurisdiction).

iii. Calculation Basis and Rate of IRPJ and CSLL

- IRPJ will be levied at the rate of (i) 12.5%, from January 1 to December 31 of 2022 and (ii) 10%, as of January 1, 2023.
- The IRPJ surplus at the rate of 10%, levied on taxable income that exceeds BRL 60,000 in the quarter, and the rates of CSLL will remain the same.
- As of January 1, 2022, legal entities will no longer be able to opt for the Annual Taxable Income; it will be mandatory that all legal entities assess the IRPJ and CSLL on a quarterly basis.
- Tax losses and negative balance of CSLL accrued on a quarterly basis may be offset, without the 30% cap, with the taxable income earned in the three subsequent quarters.
- The calculation bases of IRPJ and CSLL were standardized, meaning that there will be no revenue taxed or no tax deductibility only for the purpose of calculating IRPJ or CSLL. It is worth noting that the changes related to the CSLL calculation basis will be subject to the 90-day holding period set forth by the Brazilian Constitution.
- Legal entities that calculate IRPJ and CSLL under the Presumed Profit Methodology ("Lucro Presumido") will be required to keep commercial bookkeeping as required by law.

iv. Disguised Distribution of Profits ("DDL")

- For the purpose of being considered as DDL, the asset or right object of transactions that benefit related parties must be evaluated at market value. It is no longer necessary for the value to be "notably" higher or lower than market value.
- The forgiveness of debts with related parties will be deemed as DDL.
- The market value may be determined based on an appraisal report prepared by an expert or specialized entity.
- The appraisal report must observe the requirements established by law, such as the detailed breakdown of the criteria and information used and the assumptions about the risks of the evaluation method.
- Besides the taxation of revenues or non-deduction of expenses, as the case may be, in the operation where DDL is characterized, the profit disguised distributed will be subject to WHT at an effective rate of 25% (or 37.5%, depending on the tax residency or domicile of the beneficiary).

v. Fringe Benefits

- As of January 1, 2022, the following will be deemed as DLL: The expenditures not necessary to the activity of the legal entity and to the maintenance of the producing source, incurred for the benefit of the related party, such as expenses with transportation used and real estate made available to the related party, as well as expenses with food, education, health plans, clubs, etc.
- The expenditures mentioned above will not be deductible from the taxable income and will be subject to the WHT at an effective rate of 25% (or 37.5%, depending on the tax residency or domicile of the beneficiary).
- The expenditures incurred on behalf of the legal entity's officer, even when the officer is a quotaholder/shareholder of the legal entity, must be considered as part of their remuneration, with the DDL rules not applying.

vi. Fringe Benefits

- As of January 1, 2022, the Actual Income Methodology ("Lucro Real") will be mandatory for the following legal entities:
 - ✓ those engaged in the security of credits of any nature, not only those credits related to real estate, finance and agribusiness;
 - ✓ whose gross revenue earned in the previous calendar year from royalties or management, rental or purchase and sale of real estate owned by the legal entity accounts for more than 50% of the total gross revenue of the same year;
 - ✓ those whose main activity or corporate purpose is earning revenue from the property rights of an author or image, name, brand or voice.

vii. Market Value

- For the purpose of calculating IRPJ and CSLL, the assets and rights delivered to the shareholders/quotaholders as returns from participating in the corporate capital must be evaluated at market or book value, whichever is greater.
- Similarly, the assets and rights used for the purpose of capitalization of companies and other entities domiciled overseas, including the transfer of ownership or management of assets to trusts of any kind, shall be valued at market value.
- The capital gain earned by legal entities for paying capital of legal entities held overseas at market value must be computed in the IRPJ and CSLL calculation basis at a fixed rate of at least 1/60 per month.
- The negative difference between market value and book value will not be deductible for tax purposes.

viii. Capital Gain on Indirect Disposal of Brazilian Assets

- Legal entities or individuals resident or domiciled overseas that indirectly dispose of assets located in Brazil will be subject to the Brazilian income tax levied on

capital gains in accordance with the rules applicable to individuals tax resident in Brazil.

- For the purpose of calculating the income tax, indirect disposal of assets is considered the transfer, in one or more operations within a 12-month period, of the property or economic benefits of shares held overseas, when:

(i) at any time during the 12-month period preceding the transfer, the market value of the assets located in Brazil corresponds to 50% or more of the market value of the legal entity or entity located abroad, and 10% or more of the ownership or economic benefits of these interests are transferred; or

(ii) if the market value of the participation in the assets located in the country exceeds USD 100,000,000 and 10% or more of the property or economic benefits are transferred.

- The acquirer, or their lawyer, when the acquirer is resident or domiciled overseas, will be responsible for withholding and paying the income tax calculated on the capital gain.
- The legal entity domiciled in Brazil whose shares or quotas are subject to the indirect sale will be jointly and severally liable for the tax due in the transaction.

ix. Goodwill

- The goodwill recorded in the accounting books as a result of the acquisition of shares in subsidiaries or affiliates will only be deductible in cases of mergers and spin-offs that occurred up through December 31, 2022, whose shares were acquired up through December 31, 2021.
- In cases where the acquisition depends on approval by regulatory and other authorities, the deadline for the merger will be up to 12 months from the date in which the transaction was approved.
- In addition, for the purpose of calculating the capital gain levied on the sale of equity of subsidiaries and affiliates, it may be considered, as acquisition cost, the balance of the goodwill recorded in commercial bookkeeping not yet realized, while a minimum realization of 1/60 for each month subsequent to the acquisition of the investment will be required.

x. Appreciation or Depreciation ("Mais-Valia" and "Menos-Valia") of Assets and Liabilities

- The balance of the appreciation ("mais-valia") of assets and liabilities existing in the accounting books on the date of merger or spin-off (and no longer on the date of the acquisition of shares in the legal entity) may be considered, for the purpose of calculating capital gains or losses, depreciation, amortization or depletion, as part of the cost of the asset or right that gave rise to it.
- Likewise, the balance of the depreciation ("menos-valia") existing in the accounting books on the date of merger or spin-off (and no longer on the date of the acquisition of the shares in the legal entity) should be considered, for the

purpose of calculating capital gains or losses, depreciation, amortization or depletion, as part of the cost of the asset or right that gave rise to it.

- For purposes of calculating the capital gain on the sale of investments in subsidiaries or affiliates, the balance of mais-valia and menos-valia not realized in the taxpayer's commercial bookkeeping will be considered a cost of the investment.

xi. Amortization of Intangible Assets

- The expenses related to the amortization of intangible assets may be deducted from the taxable income on a straight-line and uninterrupted basis at a maximum rate of 1/240 per month or for the period legally or contractually defined.
- This new rule applies only to intangibles whose amortization starts on January 1, 2022.

xii. Stock Options

- The expenses incurred with Stock Options will only be deductible from the IRPJ and CSLL calculation basis when related to employees' compensation. The expenses may only be excluded from the calculation in the period in which the legal entity makes its settlement in cash or other assets or when the shares or options are effectively transferred to the beneficiary.

xiii. Controlled Foreign Corporation Rules – Individuals Income Tax

- The profits accrued by controlled subsidiaries overseas will be deemed distributed to the controlling individual, resident in Brazil, on the date of the balance in which they were calculated, being subject to IRPF whenever the subsidiary is located in a tax haven jurisdiction or if it benefits from a tax privileged regime.
- This rule applies even in cases where the individual resident in Brazil, together with other related individuals or legal entities residing in Brazil or abroad, holds a participation greater than 50% of the subsidiary's voting capital.

xiv. Transactions Carried Out in the Financial Capital Markets

- In relation to investments in bonds and securities, it is proposed to apply a single rate of 15% for all types of assets.
- Exemptions related to investments in individual savings accounts and those specifically granted to income earned by foreign individuals and legal entities will be maintained.
- Open-ended funds will be subject to a single rate of 15%.
- Close-ended funds will be subject to the periodic taxation rule ("come-cotas"), including the income accumulated by the portfolios up to January 1, 2022, at the rate of 15%. The WHT due on the income accrued until January 1, 2022, must be paid, in a single installment, until May 31, 2022. If the taxpayer makes the

payment in advance until the third business day following the 10-day period following the occurrence of the taxable event, the WHT rate will be reduced to 10%.

- Closed-end equity investment funds and equity investment funds qualified as investment entities, constituted in accordance with the rules established by the Brazilian Securities Commission, are subject to specific taxation rules.
- Investment funds in quotas that are not qualified as investment entities will be deemed as legal entities for tax purposes. The institution managing these funds should comply with funds' main and ancillary tax obligation.
- Income distributed by real estate investment funds ("FII") to any beneficiary, including exempted legal entities, will be subject to the WHT at the rate of 15%.
- The FII must distribute at least 95% of the profits earned to their shareholders, calculated on a cash basis, based on the balance sheet ended in December 31 of each calendar year.
- Income or capital gains earned by the FII's portfolios will be exempted from WHT.
- Net gains earned on transactions carried out on the commodities and futures exchanges markets, and on organized over-the-counter markets, settled each quarter, will be subject to WHT exclusively at source, at the rate of 15%, if the beneficiary is an individual or an exempted legal entity or a legal entity under the Simples Nacional methodology. If the beneficiary is legal entity, net gains should be part of the taxable income calculated under the Actual, Presumed or Arbitrated Profit.
- In addition, it is proposed that the levy of the WHT at rates of 0.005% and 1% be eliminated, a levy that was created with the purpose of informing the Federal Revenue Service of Brazil of the occurrence of the tax triggering event.