




# TAX ALERT

## New Tax Rules for Individuals with Foreign Income

The Provisional Measure (MP) No. 1,171, published on April 30, 2023, brought new tax rules for individuals who are tax residents in Brazil earning foreign income, among other provisions.

 <b>To whom it applies</b>	Individuals who are tax residents in Brazil
 <b>Effective as of</b>	January 1st, 2024
 <b>What types of foreign income</b>	<p>Income from capital invested abroad in the following categories:</p> <ul style="list-style-type: none"><li>i. Financial investments</li><li>ii. Profits and dividends from controlled foreign entities</li><li>iii. Assets and rights held in Trust</li></ul>

## General Rule

These foreign incomes will be subject to taxation under the Individual Income Tax (IRPF) and must be reported in the Annual Adjustment Return (DAA). Such incomes are subject to the progressive rates below, without any deductions:

Rate	Annual Income Amount
0%	Up to BRL 6,000.00
15%	Between BRL 6,000.00 and BRL 50,000.00
22,5%	Over BRL 50,000.00

Note: this form of taxation does not apply to operations subject to capital gain on the sale, discharge, or settlement of assets and rights located abroad that do not constitute financial investments under the MP.

## Specific Rules

Type of Investment	Taxable Event	Comments
<b>Financial investments</b>	Income received by the individual upon redemption, amortization, sale, maturity, or settlement of financial investments.	<ul style="list-style-type: none"> <li>Broad definition of financial instruments and income, including the foreign currency exchange variation against the Brazilian currency.</li> <li>Such income will be computed in the DAA and subject to IRPF in the period in which the event occurs.</li> </ul>

Type of Investment	Taxable Event	Comments
<p><b>Controlled Foreign Entities</b></p>	<ul style="list-style-type: none"> <li>Profits earned as of December 31 of each year, from 01/01/2024 onwards (profits earned until 12/31/2023 will be taxed upon availability).</li> <li>Individualized calculation, but with the possibility of offsetting losses incurred by the controlled entity from years prior to 01/01/2024.</li> </ul>	<ul style="list-style-type: none"> <li>The concept of controlled entity includes legal entities and unincorporated entities, such as investment funds and foundations.</li> <li>This new rule provides specific criteria for defining control.</li> <li>This regime applies only to controlled foreign entities that:                             <ul style="list-style-type: none"> <li>i - are in countries with favorable taxation or are not beneficiaries of a privileged tax regime, or</li> <li>ii - generate active income lower than 80%.</li> </ul> </li> <li>Profits earned until 12/31/2023, as well as the profits earned as of 01/01/2024 by controlled foreign entities that do not fit the MP rule, will be taxed upon availability, which will occur at:                             <ul style="list-style-type: none"> <li>i - payment, credit, delivery, use, or remittance (whichever comes first); or</li> <li>ii - granting of credit (loan) if the creditor-controlled entity has profits or profit reserves.</li> </ul> </li> </ul>

<b>Type of Investment</b>	<b>Taxable Event</b>	<b>Comments</b>
<b>Trusts</b>	<ul style="list-style-type: none"><li>Income and capital gains related to trust assets and rights when earned as of 01/01/2024.</li><li>Taxed according to their nature (financial investment, controlled foreign entity, or capital gain).</li></ul>	<ul style="list-style-type: none"><li>Assets and rights held in a trust abroad will be considered as:<ul style="list-style-type: none"><li>I - remaining under the ownership of the settlor after the trust's establishment; and</li><li>II - passing to the beneficiary at the time of distribution by the trust to the beneficiary (lifetime donation) or the settlor's death (testamentary disposition), whichever comes first.</li></ul></li><li>If the trust has a controlled foreign entity, it will be treated as belonging to the settlor and subject to the specific rules for controlled foreign entities (see above item).</li><li>The settlor must declare the assets and rights of the trust in the DAA by the acquisition value as of 01/01/2024, regardless of the date of acquisition.</li></ul>

## Updating the Value of Assets and Rights Abroad

The Provisional Measure also allows individuals with assets and rights abroad to voluntarily update the value of their investments on 12/31/2022, with a more favorable taxation:

- Gain subject to a flat rate of 10%
- Tax must be paid by 11/30/2023
- The taxpayer may choose among the assets and rights that meet the requirements
- Gain will increase the acquisition cost, which may reduce future taxation when the asset or right is realized (as opposed to the progressive capital gain rates, ranging from 15% to 22.5%)
- It applies only to the following assets and rights, provided they are declared in the DAA for the 2022 fiscal year (filed by 05/31/2023):
  - financial investments;
  - real estate properties or assets that represent rights over real estate;
  - vehicles, aircraft, vessels, and other movable assets subject to registration in general, even in fiduciary alienation, and
  - stock participation in controlled entities.
- The following are excluded from the update: assets or rights that have not been declared in the DAA for the 2022 calendar year, filed by 05/31/2023; assets or rights that have been sold, discharged or liquidated prior to the option's formalization date; jewelry, precious stones and metals, works of art, historical or archaeological antiquities, pets or sports animals, and animal reproduction genetic material, subject to registration in general, even in fiduciary alienation
- Assets and rights subject to trusts also qualify.
- The individual who has opted for the reassessment of foreign controlled entities may carry out a new reassessment for the period up to 12/31/2023, with the gain also taxed at a rate of 10%, and the tax must be paid by 05/31/2024.

## Conversion of Foreign Currency

The Provisional Measure determines that the exchange rate to be used to convert foreign currency values to Brazilian currency is the closing rate of the foreign currency disclosed for sale by the Central Bank of Brazil, for the occurrence date, thus allowing other currencies, besides the US Dollar (USD), to be used.

## Repeals

The Provisional Measure repeals the following provisions of Section 24 of Provisional Measure No. 2,158-35/2001, which regulates the capital gain resulting from the sale of assets or rights and the liquidation or redemption of financial investments, owned by individuals, acquired in any currency other than the Brazilian Real:

- **Paragraph 5** - which did not tax the capital gain resulting from the exchange rate variation due to the sale of assets or rights and the liquidation or redemption of financial investments made with income originally earned in foreign currency; and,
- **Item I of paragraph 6** - which exempted from taxation of capital gain the disposition of assets abroad, including financial investments, when acquired as non-tax resident in Brazil.

## Key Take Aways

- Taxation of gains at 10% may be worthwhile, especially if the difference between the acquisition cost and the market value is significant and there is a possibility of realizing it in a short period of time.
- Holders of trusts without the purpose of estate succession (i.e., revocable trusts) should evaluate their usefulness considering the new rules.
- The new rules make it difficult to defer taxation on foreign income, but it is worth considering certain types of financial investments abroad that can achieve this objective (deferral), since the legislation defines the moment of taxation as being the actual perception by the individual.
- Congress must convert the MP into law within the Constitutional deadline, and in this process, new changes may arise.

**In case of any doubts about this subject, please contact our partners**

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