



International Tax

Brazil Tax Alert

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Repeal of RTT and changes to CFC/share premium allocation rules converted into law

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Provisional Measure No. 627/13 (PM 627) was converted into Law 12,973/14 and published in Brazil's official gazette on 14 May 2014, a full six months after its enactment in November 2013. PM 627 introduced measures to update the tax rules to account for differences with Brazilian GAAP and for the transition to IFRS, and made some other broad changes to the tax rules. For example, PM 627 repealed the transition tax regime (RTT) and introduced new controlled foreign company (CFC) rules and allocation of share premium recognition criteria. (A summary of the measures can be found in our tax alert dated 13 November 2013.)

Most of the changes in Law 12,973/14 are taxpayer favorable and provide more clarity, although additional guidance from the Brazilian tax authorities still will be needed in several areas.

This alert summarizes the most relevant aspects of Law 12,973/14 in relation to PM 627/13.

Transition tax regime

Law 12,973/14 repeals the RTT as from 1 January 2015, but also provides for an early adoption election, under which a taxpayer can adopt the changes made by Law 12,973/14 as from 1 January 2014. If a taxpayer makes such an election, the RTT regime automatically is repealed and the new provisions are effective on 1 January 2014. The tax authorities are expected to issue specific guidance on the procedure for making an election.

The following table compares the RTT measures in PM 627 with those in Law 12,973/14:

Topic	PM 627	Law 12,973/14
Early adoption election	RTT would be repealed as from 1 January 2015, unless a taxpayer elects early adoption, in which case the RTT would be repealed as from 1 January 2014.	No change
Dividend	If a taxpayer elects early	The early adoption requirement is

distributions*	adoption, it would be relieved from the taxation of dividends <i>effectively paid until the date of enactment of PM 627</i> and generated in the period 1 January 2008 through 31 December 2013, in excess of the balance sheet amount determined based on the accounting criteria in effect on 31 December 2007.	removed, as is the phrase, <i>“effectively paid until the date of the enactment of PM No. 627.”</i> In other words, a taxpayer may be able to obtain relief from the taxation of dividends generated during the relevant period, regardless of whether it elects early adoption.
Interest on net equity (INE)	If a taxpayer elects early adoption, the INE computation would be able to be made based on the accounting criteria in effect on 31 December 2007, for calendar years 2008-2013.	Regardless of whether a taxpayer elects early adoption, the computation of INE can be made based on the accounting criteria in effect on 31 December 2007, for calendar years 2008-2014
Net equity pick-up criteria	If a taxpayer elects early adoption, the net equity pick-up amount would be able to be calculated based on the accounting criteria in effect on 31 December 2007 for calendar years 2008-2013.	The early adoption requirement is eliminated, i.e. a taxpayer can calculate the net equity pick-up amount based on the accounting criteria in effect on 31 December 2007 for calendar years 2008-2014.

*The controversial Normative Instruction 1,397/13 issued on 17 September 2013 has not been revoked. See the alert on NI 1,397/13 dated 24 September 2013.

Share premium allocation and goodwill

Law 12,973/14 clarifies some critical issues relating to the recognition of premiums on acquisitions of shares, ending the debate that arose when IFRS was introduced as to whether the tax rules granting a deduction for goodwill would be grandfathered using the RTT regime (tax GAAP) or whether the purchase price criteria under IFRS (accounting GAAP) would prevail for the determination of tax goodwill.

The following table compares the provisions of PM 627 with those of Law 12,973/14 relating to premium allocation:

Topic	PM 627	Law 12,973/14
Recognition	The allocation of the premium in an acquisition of shares would be broken down into two categories, in the following order: (1) identifiable assets acquired and liabilities assumed at fair value; and (2) future profitability (goodwill) or negative goodwill. Both amounts would have to be recognized in separate accounts and be supported by an independent appraisal registered with the Federal Revenue Service or the registry of deeds and documents. A premium would not be recognized if the transaction is between dependent parties.	No change
Tax amortization	The deduction for the premium would be taken based on the depreciation and/or amortization of the assets acquired and liabilities assumed at fair value and/or	No change

	<p>amortized within a minimum five-year period (for the portion allocated to goodwill).</p> <p>The tax amortization triggered by a merger would be determined based on the existing accounting balance at the <i>merger event date</i>.</p>	<p>The term <i>merger event date</i> is replaced by “acquisition event date.”</p>
Appraisal report	<p>The appraisal report would be able to be disregarded by the tax authorities if it is not filed in a timely matter or if it contains inconsistencies or errors.</p>	<p>The appraisal report may be disregarded by the tax authorities only if there is evidence that the appraisal contains significant errors.</p>
Timing to complete merger	<p>The goodwill paid on acquisitions made through 31 December 2014 would be able to be amortized based on the pre-IFRS rules, provided the merger is completed by 31 December 2015.</p>	<p>The merger completion date is extended to 31 December 2017.</p> <p>Acquisitions that depend on regulatory approval can be completed up to 12 months from the date the merger is approved.</p>

CFC rules

The following table compares the main aspects of the CFC rules in PM 627 with those in Law 12,973/14:

Topic	PM 627	Law 12,973/14
Taxation of profits of controlled companies	<p>Pretax profits of a CFC would be included in the taxable income of the Brazilian controlling entity on 31 December of each calendar year.</p>	<p>Pretax profits (excluding foreign exchange results) of a CFC must be included in the taxable income of the Brazilian controlling entity on 31 December of each calendar year.</p>
Consolidation of CFC profits	<p>Taxpayers would be able to opt to make an irrevocable election (on a calendar-year basis) to consolidate the profits and losses arising from active income of CFCs until 2017.</p>	<p>The consolidation election can be made up to 2022, and profits and losses derived from both active and passive income will be subject to consolidation.</p>
Consolidation requirement	<p>Tax consolidation would not be allowed if at least one of the following conditions is satisfied at the level of the CFC: (i) is located in a jurisdiction that has not concluded an exchange of information agreement with Brazil; (ii) is resident in a tax haven jurisdiction (a jurisdiction on Brazil's black list) or in a privileged tax regime jurisdiction (a jurisdiction on the grey list); (iii) is controlled, directly or indirectly, by a black or grey-listed entity; or (iv) has income that is subject to a nominal income tax rate lower than 20%.</p>	<p>An additional criterion is added to disallow tax consolidation if the CFC's active income is lower than 80% of its total income.</p>
Transfer pricing and thin capitalization adjustments	<p>Profits of a CFC that already have been included in the taxable base of the Brazilian parent company as a result of transfer pricing and thin capitalization adjustments made in relation to transactions between</p>	<p>No change.</p>

	the CFC and the Brazilian parent may be excluded from further inclusion in the corporate income tax base of the Brazilian taxpayer under the CFC rules.	
Loss carryforward	Losses incurred by CFCs (on an individual or consolidated basis) would be able to be carried forward for five years.	Losses incurred by CFCs (on an individual or consolidated basis) may be carried forward indefinitely, provided the losses are disclosed to Brazil's tax authorities by following requirements to be established by the authorities.
Payment deferral	The payment of corporate income tax related to the profits of a CFC would be able to be deferred for up to five years, with a minimum of 25% paid in the first year and the balance subject to exchange variation based on US dollar currency and the 12-month US LIBOR interest rate.	The payment deferral period is extended to eight years (with a minimum of 12.5% paid in the first year).
Payment deferral requirements	<p>Payment would be able to be deferred if the CFC (on a cumulative basis): (i) is not subject to a nominal income tax rate lower than 20%; (ii) is not resident in a tax haven jurisdiction (i.e. a jurisdiction on Brazil's black list) or in a privileged tax regime jurisdiction (i.e. a jurisdiction on the grey list); (iii) is not directly or indirectly controlled by a black or grey-list entity; and (iv) has active income exceeding 80% of its total income.</p> <p>Deferral would not be available to taxpayers that currently are litigating the application of the CFC rules and that may qualify for the recent tax amnesty program.</p>	<p>No change</p> <p>The denial of deferral to taxpayers litigating the CFC rules is abolished.</p>
Taxation of noncontrolled CFCs	<p>The taxation of the profits of noncontrolled entities generally would take place at the time the profits are distributed to the Brazilian entity if the CFC satisfies (on a cumulative basis) the following requirements: (i) it is not subject to a nominal income tax rate lower than 20%; (ii) it is not resident in a tax haven jurisdiction (a jurisdiction on Brazil's black list) or in a privileged tax regime jurisdiction (a jurisdiction on the grey list); (iii) it is not directly or indirectly controlled by a black or grey-list entity; and (iv) it has active income exceeding 80% of its total income.</p> <p>Otherwise, the profits of such entities would be taxed on 31 December of each year.</p>	Item (iv) is removed.
Presumed	No provision	Until calendar year 2022, the

credit		controlling entity may utilize a 9% presumed credit to offset the income tax related to CFC profits included in its taxable income. However, this benefit is available only to taxpayers in the beverage, food and construction sectors.
Individuals	Similar CFC rules would apply to Brazilian resident individuals.	Abolished

Comments

Law 12,973/14 provides more clarity and certainty to taxpayers with respect to the rules governing the end of RTT. Although some further improvements are made to the CFC rules, the new legislation does not address critical issues, such as a tax treaty override and the immediate taxation of CFC profits. Considering the long-standing litigation in the Brazilian courts on these issues, more developments are likely.

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