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Global Tax Alert

News from Americas Tax Center

Brazil amends regulations related to taxation of capital gains earned by nonresidents and cross-border payments related to rental or lease of aircraft

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On 3 and 13 October, 2016, respectively, the Brazilian Revenue Service (RFB) published Normative Instructions 1,662 (NI 1662) and 1,664 (NI 1664), amending the current rules[1] related to withholding income tax on transactions between Brazilian residents and nonresidents. Specifically, the NIs discuss the general withholding income tax rate on capital gains, the adequate proof requirement for purposes of calculating capital gains realized by nonresidents and the rules for payments related to the rental or lease of aircraft to beneficiaries in low-tax jurisdictions. The NIs are effective 3 and 13 October 2016, respectively.

General withholding income tax rate

Article 1 of Normative Instruction 1,455/2014 (NI 1455) does not provide withholding income tax rates for capital gains paid abroad by a Brazilian company. NI 1662 amends Article 1 to establish a general 15% withholding income tax rate on income and capital gains paid, credited, delivered, used or remitted abroad by a Brazilian source, except if there is a specific rate applicable to the case.

Further, NI 1662 establishes a 25% withholding tax rate when the beneficiary of the income is resident in a low-tax jurisdiction, unless the remittance is for certain leasing and interest payments.

Upon a preliminary analysis, these changes appear to clarify the applicable rates, rather than introduce new taxation rules.

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Capital gains calculation

NI 1455 requires the acquisition cost value for capital gains purposes to be supported by reliable and adequate documents. If such proof is not possible, the cost should be based on the amount registered with the Brazilian Central Bank (BACEN), when the asset or right is subject to registration. If the asset or right is not subject to registration, the cost is deemed as equal to zero. The registration data with the BACEN has been frequently used when there are sales of shares and quotas of Brazilian companies held by foreign investors. The same provision also is in Normative Instruction 208/2002 (NI 208), which regulates taxation of capital gains earned by individuals that are not resident in Brazil and other matters.

NI 1662 eliminates, however, the use of BACEN statements as proof of the acquisition cost. As a result, for capital gains purposes, the acquisition cost value must be determined by the acquisition price stated in the relevant documents (reliable, adequate and legitimate documentation). In the absence of documentation, the tax cost basis will be deemed as equal to zero.

The exact scope of this amendment is unclear. Instead of disqualifying the BACEN's registration as reliable and adequate proof of the acquisition cost of foreign investments, it seems the RFB may be trying to prevent taxpayers from using the acquisition cost contained in the BACEN's statements to calculate the capital gain in foreign currency. This issue is controversial in Brazil because it is unclear whether capital gains upon the sale of shares and quotas held by foreign investors should be calculated in foreign or Brazilian currency, which tend to lead to different results due to the exchange variation.

Although the mentioned rule will possibly bring further concerns and discussions, which will require a case-by-case analysis, it is essential that taxpayers are prepared to present all the relevant documents of the transaction to the RFB.

Additionally, NI 1664 amends the capital gains provisions of NI 1455 with respect to the merger of shares and securities held by foreign investors to establish that the withholding and collection of the applicable income tax must be done by the company in Brazil into which the shares are merged. NI 1664 also establishes that capital gain is calculated as the difference between the value in Brazilian currency of the shares issued by the company in Brazil as a result of the merger of shares held by foreign investors and the acquisition cost in Brazilian currency of the shares transferred by such nonresident investors. The amended rule seems to reinforce the idea that the calculation of capital gains should be done in Brazilian currency when there is a merger of shares held by foreign investors.

Cross-border payments

NI 1662 updates the regulations on cross-border payments related to: (1) freight and rental of ships and foreign aircraft or aircraft motors; and (2) rental of containers and other payments related to the use of port installations, previously introduced by Law 13,043, of 2014. NI 1662 amends Article 2 of NI 1455 to establish such payments are generally subject to a 0% withholding income tax rate, provided certain conditions are met, unless the beneficiary is resident in a low-tax jurisdiction, in which case the 25% rate applies.

NI 1662 also incorporates into NI 1455 the provision of Law 13,043/2014 that extended until 31 December 2022, the 0% withholding income tax rate on payments for the lease of foreign aircraft or motors used in foreign aircraft. To benefit from the 0% rate, the companies must have entered into a lease agreement until 31 December 2019, and must be engaged in the business of regular public air transport. In addition, NI 1662 adds paragraph 4 to Article 6 of NI 1455 to state that payments for the mere rental of aircraft or its motors are subject to the tax treatment established in Article 2 of NI 1455.

In view of these rules, it is important to note the difference between a rental and a leasing. Under the rental of an aircraft or its motor, the Brazilian company may use the aircraft or motor for a certain period. Under the leasing of an aircraft or motor, the Brazilian company is entitled to use the aircraft or motor and either purchase it for a residual amount or renew the agreement, following certain provisions.

With Ireland included in the Brazilian list of low-tax jurisdictions by Normative Instruction 1,658/2016[2] last month, payments abroad for the rental or lease of aircraft have become a primary issue of concern for airline companies. Airline companies claim that the qualification of Ireland as a low-tax jurisdiction will significantly increase the costs associated with their operation, considering that several aircraft are rented from companies located in Ireland.

In fact, based on the applicable rules, rental payments to Ireland will not benefit from the 0% withholding income tax rate, and, therefore, will be subject to the 25% rate. Leasing payments to Ireland, however, could continue to benefit from the 0% rate if the agreement is entered by companies engaged in regular public air transport.

To address these concerns, NI 1664 amends NI 1455 to establish that the 0% rate may apply to payments made by companies that are engaged in regular public air transport, even if the beneficiary is located in a low-tax jurisdiction. Also, NI 1664 seems to allow the application of the 0% rate when the transaction is a rental, instead of limiting the application to a lease. The wording of NI 1664, however, is not entirely clear and may raise questions on the appropriate interpretation.

Endnotes

1. Note: Normative Instruction 1,662/2016 has amended (i) Normative Instruction 1,455/2014 and (ii) Normative Instruction 208/2002.
2. For further information, see EY Global Tax Alert, *Brazil updates lists of low-tax jurisdictions and privileged tax regimes*, dated 16 September 2016.

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