



Non-residents' capital gains from sale or disposal of equity interest in Brazil

Brazilian legislation states that a non-resident's capital gains on the disposal of assets or rights located in Brazil are subject to definitive taxation under the rules applicable to persons resident in Brazil.

Thus the capital gain is determined at the rate of 15% (fifteen percent) of the positive difference between the disposal value and the acquisition cost of the asset or right.

The acquisition value of the good or right must be proven with appropriate documentation; if provision of such proof is not possible, acquisition cost must be selected on the basis of the capital registered with the Central Bank of Brazil and associated with the purchase of the asset or right, or equal to zero in other cases.

The acquisition cost as a rule coincides with the amount foreign currency of the registration of an investment with the Central Bank of Brazil. This is due to the fact that stock held in Brazil by non-residents may have two origins: (i) acquisition from residents in Brazil, in which case the amount of foreign exchange corresponding to the price enters the country; or (ii) subscription through initial investment in foreign currency or through capital increases involving absorption of profits or reserves registered with the Central Bank of Brazil as reinvestment.¹

However, the value of the investment registered with the Central Bank of Brazil may not in some cases correspond to the acquisition cost of the investment in question. This is the case when another person (or corporation) also domiciled in another country is successor to a Central Bank of Brazil registration due to their (or its) acquisition of equity from a non-resident.

In these cases, we believe that the acquisition cost of the stock may be proven through documentation showing acquisition of the stock in Brazil involving non-residents on both sides of the transaction.

In other words, proof of acquisition cost must be provided through a document reflecting the real price of acquisition and equating the latter with the amount of the investment registered with the Central Bank of Brazil would be legitimate only as an auxiliary resort in cases in which there is no direct documentary proof.

However, note that the Brazilian tax authorities have recently posed a different interpretation in which they argue that acquisition costs must be the one registered with the Central Bank of Brazil.

¹ XAVIER, Alberto. *Direito tributário internacional do Brasil*. 6th ed., revised. Rio de Janeiro: Forense, 2004. page 544.



The tax authorities base their interpretation on the idea that there are two different types of income-tax liability under Brazilian legislation: one levied on capital gains from *investments in foreign currency*, another on capital gains obtained through disposal of *assets or rights*.

In our view, however, an investment in foreign currency corresponding to the share capital registered in the Central Bank of Brazil, is specie of the "*assets or rights*" type, hence the two income tax liabilities referred to by the Tax Authorities.

Finally, it is noteworthy that since February 1st, 2004 Brazilian legislation determines that the purchaser, individual or corporate, resident or domiciled in Brazil, or a representative, if the purchaser is resident or domiciled in another country, is responsible for withholding and collecting income tax on capital gains obtained by persons or corporations resident or domiciled abroad and disposing of assets located in Brazil.

Prior to February 1st, 2004, persons or corporations resident or domiciled abroad were only subject to capital gains tax if they sold or disposed of assets located in Brazil to a resident in Brazil, in other words, when payment originated from a Brazilian source.

Under the legislation currently in force, the income-generating source acts as the element of connection sufficient to authorize taxation of a non-resident's capital gains from sale or disposal of shares in Brazil.

In this context, we believe that a series of practical problems arise from making a non-resident purchaser's representative abroad accountable for withholding and collecting income tax on capital gains obtained by a person or corporation resident or domiciled abroad selling or disposing of assets located in Brazil. One of these problems is the difficulty of knowing the cost of acquisition of an asset if not the amount registered with the Central Bank of Brazil.

Although there are arguments to question such a legal ruling, it is a fact that under Brazilian legislation as it stands, capital gains obtained by a non-resident from the sale or disposal of shares in Brazil to another non-resident are subject to income tax, therefore foreign investors should pay particular attention to liability for this tax when making transactions involving assets located in Brazil.



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