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Legal update

Brazil amnesty program (RERCT) and trusts

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Tax

Since its inception, Law no. 13.254/2016,[1] which establishes the legal provisions of the so-called Brazilian amnesty program (*Regime Especial de Regularização Cambial e Tributária* [RERCT]) for undeclared foreign assets, has generated many questions and some controversy. One of the main issues still not clearly addressed by the regulators is the treatment of trusts.

The law establishes the legal provisions for the voluntary declaration and regularization of unreported assets of lawful origin held abroad on or before December 31, 2014, by Brazilian residents or persons domiciled in Brazil.

Taxpayers who wish to participate in the program need to file a regularization declaration (*Declaração de Regularização Cambial e Tributária* [DERCAT]) with the Brazilian IRS (*Receita Federal Brasileira*) and pay (i) income tax at a rate of 15% and (ii) a fine in an amount equal to 100% of the income tax due. An additional requirement is the amendment of the taxpayer's annual tax return for the 2014 calendar year.[2]

The 210-day period for filing the DERCAT was triggered by the publication of IN RFB No. 1627, issued by the Brazilian IRS on March 11, 2016 (Regulation 1627). In accordance with Regulation 1627, compliance with the program can be effected between April 4 and October 31, 2016.

Trusts

Regulation 1627 also provides some clarification on disclosing assets held in a trust. First, it clarifies that the description of the assets on the DERCAT must include assets that have been transferred, directly or indirectly, to any type of trust, foundation or pass-through entity.

As set forth in Regulation 1627, the value of the declared assets corresponds to (i) the amount of such assets on December 31, 2014, if the declaring taxpayer or his or her representatives are the effective beneficiaries; or (ii) the value of the transferred assets, if the beneficiary is a third party.

The obligation to file the DERCAT and rectify the tax return falls upon the beneficiary of the trust or foundation. However, the settlor also has the option to file a DERCAT on the beneficiary's behalf.

Any person or entity participating in the RERCT must retain in its possession for a period of five years from the delivery of the DERCAT all documents supporting such filing, including, specifically for trusts: (i) identification of the settlor, the trustee and, if applicable, the protector; (ii) the trust documents (e.g., trust agreement, letter of wishes, and equivalent documents); (iii) a list of assets under the trust; and (iv) the accounting information prepared by the trustee or an accountant and approved by the protector, if applicable.

Issues

The treatment given by the Brazilian IRS to the disclosure and regularization of assets held in trusts is incompatible with the very nature of such instruments.

A trust can be either revocable or irrevocable. When a trust is revocable, i.e., when its provisions can be altered and/or the trust can be revoked by the settlor at any time during his or her lifetime, the trust assets are still considered part of the settlor's property for tax purposes. The settlor must include such assets in his or her annual tax return and pay taxes on any income earned by the trust during the relevant calendar year.

Therefore, it should be the settlor, rather than the beneficiaries, who is the party responsible for filing the DERCAT and paying the related taxes and fees. Regulation 1627 does allow the settlor to file the DERCAT, but adhering to the RERCT is only deemed completed when the taxes and fines are paid. Considering that the beneficiaries still must file and pay the relevant amounts themselves, regardless of whether the settlor joins the program, this alternative would result in double taxation.

Even when a trust is irrevocable (i.e., when the settlor transfers the property definitively to the trust and cannot alter its terms), the property should not be deemed part of the beneficiaries' net worth. Often, the trust agreement provides the trustees with discretion in distributing property: hence any individual beneficiary may or may not receive a portion of such property, and such distribution may happen only at a future date. Further, it is not uncommon for a trust to be created without the beneficiaries' knowledge. In this case, disclosure of the trust's existence by the trustee to allow the beneficiaries to file the DERCAT could constitute a violation of the trust's terms and conditions and a breach of the trustee's fiduciary duties.

Finally, it is important to consider the impact of the amnesty program and the payment of taxes to the Brazilian authorities against the disclosure and filing requirements in other countries, such as the USA. In the absence of a tax treaty (which is the case with the USA), this could generate the obligation to pay taxes on the declared assets in both countries.

Comment

The RERCT is a good alternative that allows Brazilian citizens and residents to regularize their situation with the Brazilian IRS. It still, however, brings uncertainty to the treatment of foreign instruments that were not acknowledged by Brazilian regulators until now, such as trusts. Therefore, careful planning must be employed before joining the program to allow the continuity of the structures implemented abroad and proper compliance with local regulations, as well as broader cross-border regulatory issues and risks such as those related to money laundering.

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Footnotes

1 See http://www.planalto.gov.br/ccivil_03/_Ato2015-2018/2016/Lei/L13254.htm

2 The requirements also include the (i) amendment of the Report of Foreign Assets (DCBE) for the calendar year of 2014; (ii) disclosure of documents that support the lawful origin of the assets, if required by the authorities; (iii) request and authorization for the foreign financial institutions holding assets in excess of USD100,000 to remit information regarding the balance of such assets on December 31, 2014.

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