

# Global REIT Survey 2016

AMERICAS



## Brazil – FII



# 1 General introduction

	Enacted year	Citation	REIT type	REIT market
FII	1993	Federal Law 8.668/93, amended by Federal Law 9.779/99, and regulated by Rulings (ICVM) 206/94 and 472/08	Fund type	- 198 FII (162 listed) - BRL 68 billion NAV (approx. EUR 19 billion as at June 2015)

In Brazil, an investment fund for real estate endeavours is called a '*Fundo de Investimento Imobiliário*' (FII). This vehicle was introduced in 1993.

The FII is governed by the Federal Law 8.668/93, amended by Federal Law 9.779/99, and regulated by Brazilian Securities Commission (CVM – Brazilian equivalent to US SEC) under Rulings (*Instrução CVM*) 206/94 and 472/08.

As at June 2016, there were 198 FIIs in operation in Brazil with net asset value in excess of BRL 68 billion, 162 of which are listed on the São Paulo Stock Exchange – Bovespa.

## 2 Requirements

### 2.1 Formalities / procedure

Key requirements
<ul style="list-style-type: none"> <li>- Must be approved by the Brazilian Securities Commission (CVM)</li> <li>- Managed by a financial institution</li> <li>- Subscriptions for units must be registered with the CVM</li> </ul>

The FII is regulated and supervised by the Brazilian Securities Commission – CVM.

The FII must be formed and managed by financial institutions duly authorized by the CVM. Only financial institutions with investment portfolios, real estate assets, credit portfolios or other financial instruments are authorised to manage an FII.

The fund manager should seek CVM approval before setting up the FII by providing the following:

- request of the public offering of fund units or formal request to waiver such registration;
- fund by-laws and regulations;
- information on the fund's records with the Public Notary;
- appointment of an independent auditor and other service providers; and
- appointment of a director employed by the fund manager.

The fund operation depends on prior registration with the CVM, which should be filed with the fund's tax reference number (CNPJ), along with the documents above.

### 2.2 Legal form / minimum initial capital

Legal form	Minimum initial capital
Fund (Contractual agreement between investors and fund manager)	No

### Legal form

The FII is not a legal person but rather a contractual agreement between investors and a fund manager. The FII is close-ended with limited or unlimited duration.

### Minimum initial capital

There is no minimum initial capital requirement. Investors will be issued with fund units which may be acquired with cash or in exchange for contributions of real estate or *in rem* rights.

## 2.3 Unit holder requirements / listing requirements

Unit holder requirements	Listing mandatory
Construction companies may not hold more than 25% interest in an FII	No

### Unit holder requirements

Construction companies involved in the activities invested in by the FII may hold a maximum 25% interest in the FII. Where the 25% threshold is breached, the FII will lose its tax benefits and suffer tax as an ordinary corporation for income tax purposes.

Unit holders may be individuals or legal entities in Brazil or abroad and there is no discrimination between Brazilian and foreign investors.

### Listing requirements

FII units are tradable securities and may be traded on the Stock Exchange or on the private 'over-the-counter' market.

The FII does not allow redemption of units, so units can only be sold in the open market through the Stock Exchange or over-the-counter.

Where the duration of the FII is not determined, capital can only be returned to unit holders through a unanimous decision of the unit holders.

## 2.4 Asset level / activity test

Restrictions on activities / investments
The minimum real estate investment was previously set at 75% of an FII's total assets, although this requirement has been revoked by ICVM 472/08 effective from December 03, 2008
New regulations set out a list of authorised investments

Under the regulatory rules applicable before ICVM 472/08 (which became effective on December 03, 2008), FIIs were required to invest at least 75% of their total assets in real estate. ICVM 472/08 has revoked all previous regulation applicable to FIIs. However, it has not introduced a new requirement of a minimum level of investment into real estate. Instead, it has introduced a comprehensive list of real-estate related assets in which an FII may invest (see below). Nevertheless, it is not entirely clear whether FIIs may invest into any type of non-real estate assets (e.g. bonds, fixed-income funds etc.) under the new regulations.

Under ICVM 472/08, an FII can hold the following assets:

- I any rights *in rem* on real estate (e.g. freehold or leasehold);
- II stock, debentures, subscription warrants, subscription receipts and similar securities, provided their issuance or trade was registered with or authorized by the CVM, as well as any other securities, whose issuers have activities predominantly allowed to the FII;

- III shares in companies whose sole purpose fits into the activities allowed to the FII;
- IV shares in private equity investment funds ('FIP') where the investment policy of the FIP relates only to activities allowed to the FII or shares in stock investment funds ('FIA') which are divided into sectors and exclusively undertakes property development or investment activities;
- V some types of construction certificates;
- VI units in other FIIs;
- VII mortgage-backed securities and shares in CVM-registered investment funds in credit rights ('FIDC') where the investment policy of the FIDC relates only to activities allowed to an FII;
- VIII mortgage bills; and
- IX real estate credit bills.

A FII which predominantly invests in securities should observe the investment limits per issuer and type of financial assets set out in ICVM 409/2004.

## 2.5 Leverage

Leverage
No leverage restrictions applicable

## 2.6 Profit distribution obligations

Operative income	Capital gains	Timing
At least 95% of income arising on a cash basis	At least 95% of capital gains arising on a cash basis	Every six months

### Operative income

At least 95% of the net operating income must be distributed bi-annually (June 30 and December 31).

### Capital gains

At least 95% of the capital gains must be distributed bi-annually (June 30 and December 31). This requirement only applies to capital gains recognised on a cash basis.

## 2.7 Sanctions

Penalties / loss of status rules
Loss of tax exemption

Construction companies involved in the projects invested in by the FII may not hold more than 25% interest in the FII. Where this condition is breached, the FII will be taxed as a corporation for income tax purposes (34%).

Further sanctions by the CVM may be applicable on a case-by-case basis.

## 3 Tax treatment at the level of REIT

### 3.1 Corporate tax / withholding tax

Current income	Capital gains	Withholding tax
<ul style="list-style-type: none"> <li>- Income from real estate activities is tax-exempt</li> <li>- Income from other activities is subject to withholding income tax</li> </ul>	Capital gains are treated as income from real estate activities and therefore tax-exempt	Withholding tax suffered by the FII may be set against tax on distribution to investors

#### Current income

Income from real estate activities (e.g. rental income or income from certain real-estate related securities) is tax-exempt.

Income from fixed-income and variable-income investments is subject to withholding income tax. Exception is made to some particular securities such as Mortgage Notes (*Letras Hipotecárias*), Housing Financing (*Letras de Crédito Imobiliário*) and Agricultural Warrants (*Warrant Agropecuário*).

This withholding tax may be offset against the withholding tax payable on profits distribution to unit holders.

#### Capital gains

Capital gains are treated as income from real estate activities and therefore tax-exempt.

#### Withholding tax

Earnings from investments in fixed income are subject to withholding tax at a rate between 15% and 22.5%, depending on the length of the holding of the investment, and it can be set against tax payable on profits distribution from the FII.

Earnings from investments in variable income are taxed at a rate between 15% and 20% and can be offset against tax payable on profits distribution.

#### Other taxes

Transfers of real estate to an FII are subject to a real estate transfer tax (ITBI) imposed by the municipality in which the property is located. The rates vary according to the location and value of the property.

The ownership of property in Brazil is also subject to an annual property tax (IPTU) applied by the municipalities. Again in this case, the rates vary according to the municipality in which the property is located.

#### Accounting rules

The FII must produce its own financial statements, and its accounts should be segregated from the fund manager's. The financial statements should be produced under Brazilian GAAP which is entirely in line with IFRS for accounting periods ended after 2015.

The accounting period must have 12 months and the financial statements must be published within 90 days of the end of the accounting period.

The preparation of financial statements must:

- observe the specific rules provided by CVM;
- be audited annually by an independent auditor; and
- observe the rules governing the exercise of that activity.



### 3.2 Transition regulations

Conversion into REIT status
N/A

Existing entities cannot be converted into FIIs.

### 3.3 Registration duties

Registration duties
Municipal real estate transfer tax (ITBI) applicable

Transfers of real estate to an FII are subject to a real estate transfer tax (ITBI) imposed by the municipality in which the property is located. The rates vary according to the location and value of the property.

## 4 Tax treatment at the unit holder's level

### 4.1 Domestic unit holder

Corporate unit holder	Individual unit holder	Withholding tax
- Withholding income tax at 20% on distributions from the FII or capital gains on the disposals of units in the FII.	- Withholding income tax at 20% on distributions from the FII or capital gains on the disposals of units in the FII. Income may be exempt from withholding tax if special conditions are met.	- Corporate unit holders may credit for withholding tax applied by the FII on distributions.

#### Corporate unit holder

Withholding income tax at 20% applies to distributions made by the FII to companies resident in Brazil and on capital gains arising from the disposal of units in the FII. The withholding tax can be offset against the unit holder's own corporate income tax liability.

#### Individual unit holder

Final withholding income tax at 20% applies to distributions made by the FII to individuals resident in Brazil and on capital gains arising from the disposal of units in the FII.

The Law 11.033/2004 sets out that individuals may be exempt from withholding tax on income provided:

- Units are negotiated exclusively on the stock exchange or over-the-counter;
- The fund has at least 50 unit holders;
- The individual benefitting from the tax exemption does not hold 10% or more of the fund's units, or is entitled to more than 10% of the fund's earnings.

#### Withholding tax

Corporate unit holders may credit for withholding tax applied by the FII on distributions and capital gains. However, for individual unit holders who do suffer withholding tax (i.e. individual unit holders who are not compliant with Law 11.033/04) there is no tax credit and the withholding tax is final.

## 4.2 Foreign Unit holders

Corporate unit holder	Individual unit holder	Withholding tax
<ul style="list-style-type: none"> <li>- Withholding tax at 20% as a general rule.</li> <li>- Withholding tax at 15% on income, providing some conditions are met.</li> <li>- Capital gains at 0%, providing some conditions are met.</li> </ul>	<ul style="list-style-type: none"> <li>- Withholding tax at 20% as a general rule.</li> <li>- Withholding tax at 15% on income, providing some conditions are met.</li> <li>- Capital gains at 0%, providing some conditions are met.</li> </ul>	Questionable whether tax treaty relief available.

### Corporate unit holder

A reduced withholding tax rate of 15% applies to income and capital distributions made by the FII where the foreign investment is registered with the Brazilian Central Bank (*Resolução 4.373*) and the beneficiary is not resident in a low-tax jurisdiction.

Capital gains arising to the foreign unit holder from the disposal of units in the FII are not subject to tax in Brazil provided:

- the unit is traded on the stock exchange;
- the investment is registered with the Brazilian Central Bank; and
- the beneficiary is not resident in a low-tax jurisdiction.

If either of the conditions above are not met, withholding tax will apply at 20%.

### Individual unit holder

The same beneficial tax rates as described above (corporate unit holder) apply to individuals providing the conditions are met.

### Withholding tax

It is still not clear whether non-resident unit holders in a Brazilian FII may be able to rely on double tax treaties to further reduce the rate of withholding tax on distributions made by the FII. As the legal nature of the FII is a contractual relationship between the fund manager and the investors, the Brazilian tax authorities may argue that the FII is not a 'person' for the purposes of applying double tax treaties.

## 5 Tax treatment of foreign REIT and its domestic unit holders

Foreign REIT	Corporate unit holder	Individual unit holder
Taxed with 15% withholding tax on income and capital gains.	Income and capital gains arising to a corporate unit holder taxed at 34% (40%-45% if the beneficiary is a financial institution, insurance or related company).	Income and capital gains arising to an individual unit holder taxed at rates from 7.5% to 27.5%.

### Foreign REIT

A foreign REIT is only taxable in Brazil in respect of its income arising from a Brazilian source (e.g. rental income or capital gains related to a Brazilian property). Such income will be subject to 15% withholding tax in Brazil.

**Corporate unit holder**

Income (including capital gains) arising from a foreign REIT to a corporate unit holder resident in Brazil is subject to Brazilian tax at a combined rate of 34% (40%-45% if the beneficiary is a financial institution, insurance or related company). Any withholding tax suffered by the Brazilian unit holder on the distribution from the foreign REIT may be set against the Brazilian unit holder's own tax liability in Brazil, limited to the amount of Brazilian tax due on such distribution.

It is not clear whether the Brazilian resident investor may also claim a credit for any other underlying taxes suffered by the foreign REIT (e.g. withholding tax on rental income).

**Individual unit holder**

Income (including capital gains) arising from a foreign REIT to an individual unit holder resident in Brazil is subject to Brazilian tax at rates varying from 7.5% to 27.5% (in practice, individual investors in foreign REITs are likely to be higher-rate taxpayers so the 27.5% should apply). Any withholding tax suffered by the Brazilian unit holder on the distribution from the foreign REIT may be set against the Brazilian unit holder's own tax liability in Brazil.

It is not clear whether the Brazilian resident investor may also claim a credit for any other underlying taxes suffered by the foreign REIT (e.g. withholding tax on rental income). ■

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