Tax Issues of
Doing Business in Brazil

41st Annual TEI-SJSU High Tech Tax Institute

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Brazilian Tax System Overview

Resident Corporations

- CIT: 34% on a worldwide basis.
- 2 corporate tax regimes:
  (i) Actual Profit – total revenues less costs/expenses + adjustments; or
  (ii) Presumed Profit – from 8% to 32% of gross revenues (available only to companies with annual gross revenues of up to BRL 78 million (approximately USD 15 million).

Non Resident Corporations

- Subject to WHT (from 15% to 25%) if income arises from Brazil or is paid by a Brazilian source.
- Services, Interests and Royalties: 15% WHT (25% if the seller is resident in a black-listed jurisdiction).
- Capital Gains (sale of assets in Brazil): Progressive Chart (15% up to 22,5%) - (25% if the seller is resident in a black-listed jurisdiction).
- Dividends: Exempt (Bill of Law 1,087 introduces a 10% rate on dividends paid to individuals or companies abroad – Currently under analysis of Brazilian Congress);

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Brazilian Tax System Overview

Other Taxes

- **CIDE:** social contribution tax on remittances of royalties, technical services and administrative assistance: 10%.
- **Inheritance and Gift Taxes:** from 4% to 8%, charged at States level.
- **VAT:** IPI (Federal) on manufactured products – rates vary
  ICMS (State): on the trade of goods – rates vary from 7% to 18%
- **PIS and COFINS:** 2 regimes: Non-cumulative regime (9.25% on gross revenues, inputs credits allowed); Cumulative regime (3.65% on gross revenues, no credits).
- **VAT Tax Reform:** in force as from 2026 (as a test, with symbolic rates). In the following years, VAT rates gradually increase.
- **IOF Tax:** on financial transactions, loans and currency exchange: rates vary from 0% to 5.38%.

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Brazilian Tax System Overview

Anti-avoidance Rules:

- **General Rule (regulation still pending)** – case-law applies "simulation" and "business purpose" criteria
- **Transfer Pricing (TP) Rules** – imports and exports of goods and services - New regulation aligned with the BEPS standards
- **CFC Rules (possibility of tax deferral for up to 8 years)**
- **Thin Cap Rules -** Limitation of interest deductibility
- **Black list and Grey list** (Privileged Tax Regime)

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Brazilian Tax System Overview

Tax Litigation System

Administrative Phase

- Starts with a tax assessment. The taxpayer can challenge it before tax authorities (up to 3 levels)
- Disputes are judged first by administrative courts (CARF – Administrative Council of Tax Appeals)
- No payment is required while the case is pending

Judicial Phase

- If unresolved administratively, parties may go to court
- Cases start at federal or state trial courts, depending on the tax
- During the lawsuit, tax debts remain enforceable. Their collection may be suspended by a judicial injunction or the provision of collateral
- Appeals can reach higher courts, including the STJ (Superior Court of Justice) and the STF (Supreme Federal Court), mainly for constitutional or federal law issues

Timeline (average duration)

- ~5-7 years in administrative phase
- ~8-10 years in judicial phase

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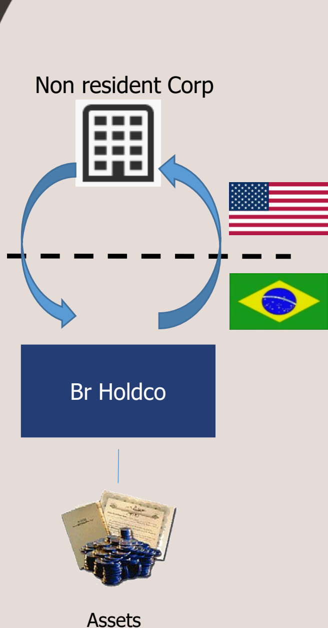
Case Study - Outbound Corporate Investment



Funding Options:
- Equity: 0% IOF tax.
- Debt: 0% IOF Tax if long term (+364d) / 3.5% of short term (-364d)

Level of the Brazilian Company:
- CIT: 34% on adjusted net income.
- Pis and Cofins: 9.25% on gross revenues.
- Services Tax: 2% to 5%.
- State VAT (ICMS): 7% to 18%.
- Federal VAT (IPI): rates vary.
- Loan interests: CIT deductible (subject to Thin Cap and TP rules).

Return to shareholder:
- Interests and Royalties payments: 15% WHT.
- Services: 15% WHT, 9,25% Pis and Cofins, 10% CIDE, 5% Services Tax (see next slide).
- Dividends: exempt. (see BL 1,087 under debate in Congress)
- Interest on equity: tax deductible at 34%, 15% WHT on payment (Provisory Measure 1,303/25 may increase WHT to 20%)

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Brazilian Tax System Overview

Taxation on Foreign Services

Double Tax Conventions (network of 37 treaties – No treaty with the US, but reciprocal treatment)

General Services
- 25% WHT on general services such as labor income (salary, transport, accomodation, meals)
- 9.25% PIS and COFINS borne by the Brazilian company
- 5% Services Tax borne by the Brazilian company
- Subject to TP rules if intragroup

Technical/Administrative Services
- 15% WHT on technical services such as accouting, advisory, management
- 10% CIDE borne by the Brazilian company
- 9.25% PIS and COFINS borne by the Brazilian company
- 5% Services Tax borne by the Brazilian company
- Subject to TP rules if intragroup

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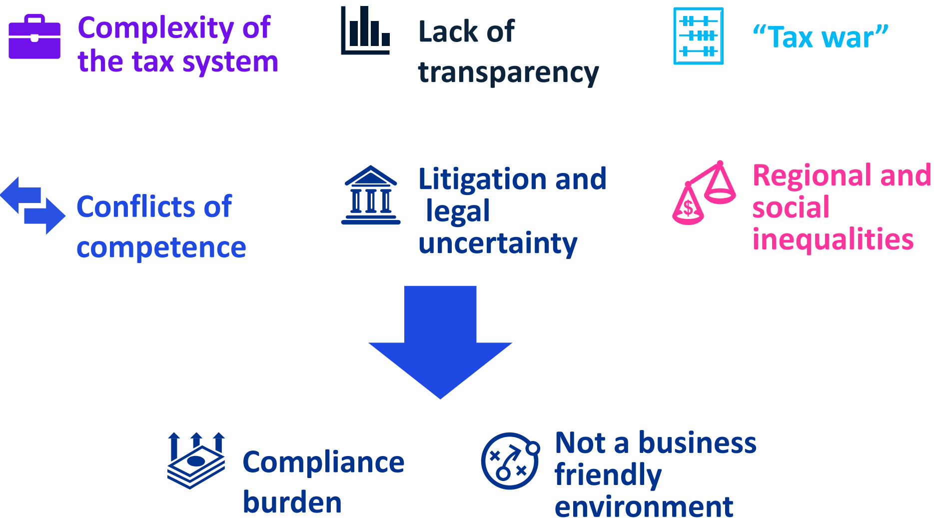
Tax Issues of Doing Business in Brazil

Brazil Tax Reform | The reasons for a change



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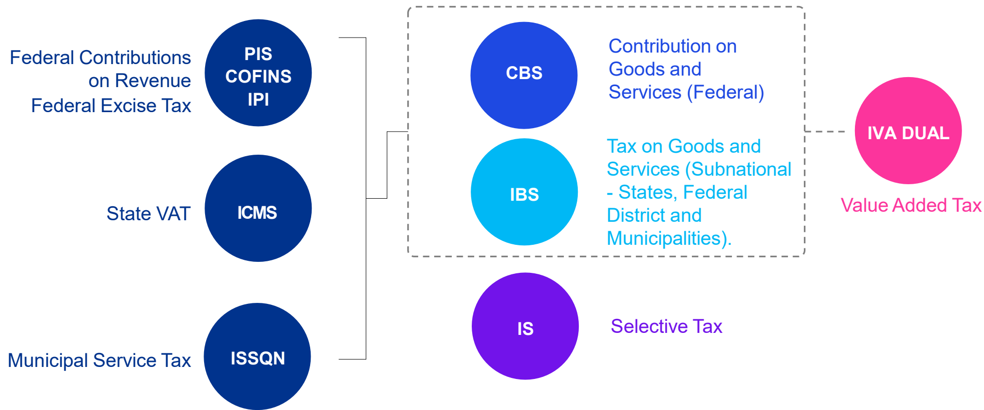
Brazil Tax Reform | Tax Simplification

The tax reform consists, among other aspects, in the unification of taxes on consumption, simplifying the Brazilian tax model. With this measure, the five main taxes that focus on consumption - PIS, COFINS, IPI, ICMS and ISS - will be replaced by a Dual Value Added Tax (VAT), a Selective Tax (IS), in addition to the possibility of the institution of contribution on primary and semi-manufactured products.



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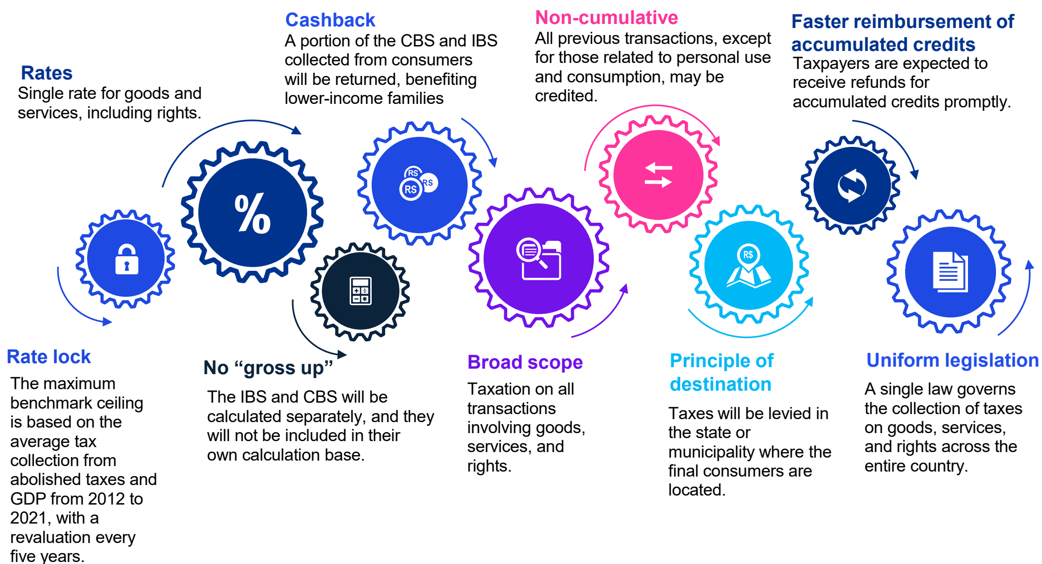
Brazil Tax Reform | What else is changing?



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Brazil's indirect tax system

Non-residents

- Foreign businesses cannot register for VAT in Brazil as non-residents
- Currently, there is no indirect tax compliance framework for non-residents
- All taxes are self-assessed by the importer of record
- Digital offerings:
  - B2C: In practice, there is widespread non-taxation of these supplies, either due to the payment method (e.g., credit cards) or because relying on self-assessment by the consumer is ineffective for B2C supplies.
  - B2B: The "onshoring" effect. Most major digital companies have established a local seller of record in Brazil. This decision is driven not only by indirect / consumption taxes (e.g., PIS/COFINS-Import, CIDE, ISS) but also by withholding income tax. From this perspective, Brazil has essentially implemented its version of Pillar One/Digital Service Tax (DST) years ago, although Brazil's withholding tax is not solely focused on digital offerings.

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Brazil's indirect tax system

Non-residents

- Due to the multiple indirect and consumption taxes in Brazil, it has always been crucial to properly classify a transaction—whether it involves the sale of goods, services, or rights.
- Transactions such as copyright, royalties, software licenses, SaaS, and similar services may trigger different tax implications based on their classification.
- Existing business models:
  - Reseller of technical services: high tax burden on importation of services
  - License model:
    - Lower tax burden as compared to the importation and resale of service
      - PIS/COFINS-Import and ISS are not due on royalties in general (PIS/COFINS-Import and ISS will now be replaced by the new Dual VAT and will be imposed on royalties)
    - CIT deductibility reasons: variable royalty is more common than a variable service fee
    - Better US tax treatment of royalties for FTC purposes

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Brazil's indirect tax system

Non-residents

- This will change with the tax reform. For the purposes of the levy of IBS and CBS, any operation that is not classified as an operation with goods is considered an operation with services (e.g. transfer of ownership, including purchase and sale, exchange or barter, and payment in kind; rental; licensing, granting, assignment; loan).
- Due to the multiple indirect and consumption taxes in Brazil, it has always been crucial to properly classify a transaction—whether it involves the sale of goods, services, or rights.
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Brazil Tax Reform | What does it mean for non-residents?

Non-residents conducting taxable activities in Brazil would face an indirect tax compliance obligation for the first time, being required to register, collect, and remit the new taxes.

- This obligation would apply to both B2C and B2B transactions.
- However, the proposal also states that the buyer would be jointly liable for the payment of IBS/CBS on the acquisition of immaterial goods (including rights) and services from a nonresident seller.

New IBS/CBS liability on transactions conducted through **digital platforms**, whether Brazilian or nonresident.

- Digital Platforms will be liable for all in-scope transactions performed by:
  - Non-resident sellers that are not registered for IBS/CBS;(*)
  - Brazilian Sellers not registered for IBS/CBS or whose transactions are not recorded through an e-invoice.
- Digital Platforms would be defined as an intermediary that controls one or more of the following key elements: Collection / Payment / Setting of terms and conditions / Delivery.
- Entities solely providing internet access, processing payments, advertising or searching for / comparing suppliers **would not** be considered as Digital Platforms.

(*) Nonresidents selling exclusively through a digital platform would not be required to register for IBS/CBS

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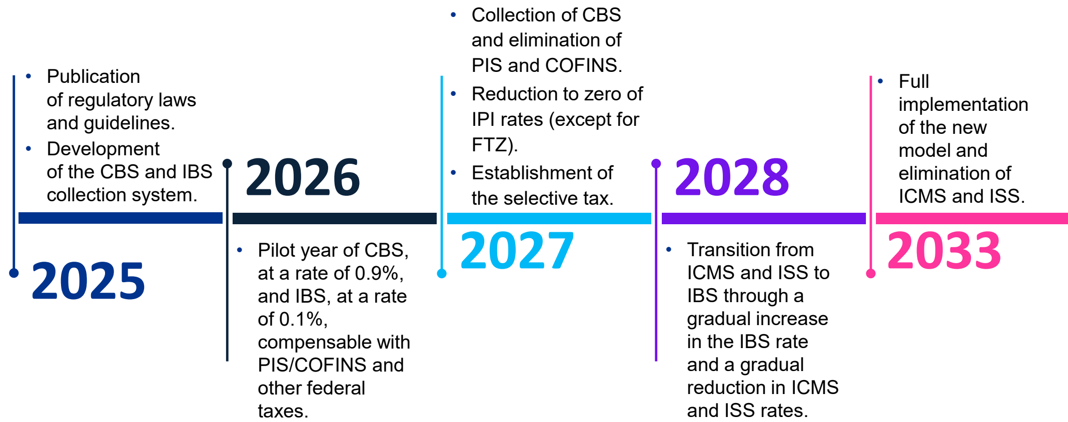
Brazil Tax Reform | Transition Timeline



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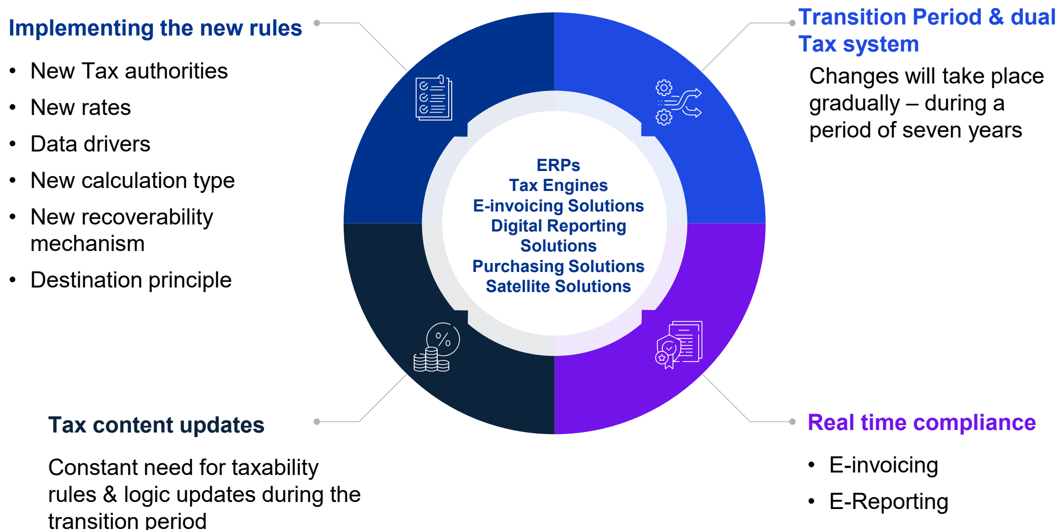
Brazil Tax Reform | Technology and Impacts



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LatAm Venture Capital Structure: The "Cayman Sandwich"

A look at the investment vehicle for US investors funding startups in Latin America

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INTRODUCTION

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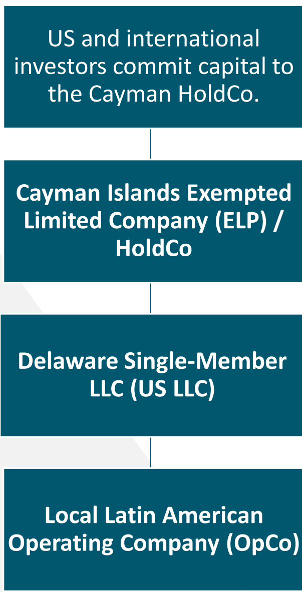
The Cayman Sandwich: A Three-Tiered Structure

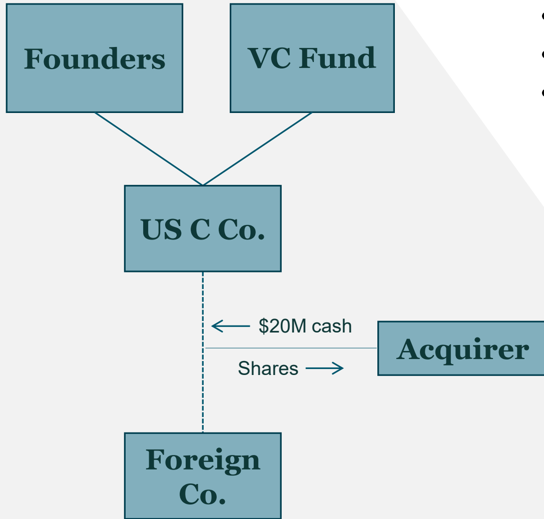
*The Cayman HoldCo (electing 8832 partnership classification for US purposes) wholly owns the Delaware LLC

*The disregarded Delaware LLC wholly owns the operating entity in the target country (e.g., Brazil, Colombia, Argentina).

*Local OpCo, where the core business, employees, and IP typically reside.



Why not a US C Corp?



- US C Corp owns foreign OpCo
- Investors invest in US C Corp (US and Foreign)
- Acquiror wants to buy OpCo not US C Corp

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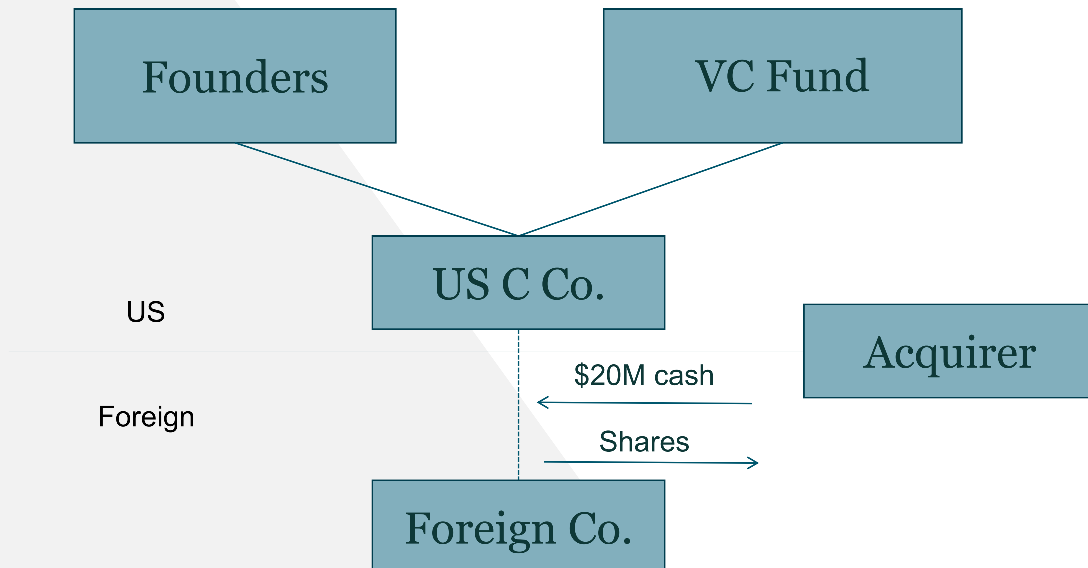
Exit Via Sale of Foreign Co.



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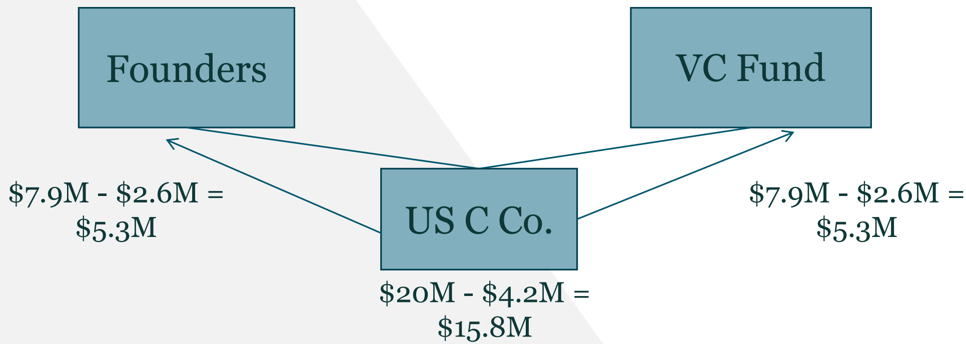
Tax Impact of Exit – Double Taxation

Step 1

- Capital Gains Tax is imposed at 21% at the US C Corp Level
- (Assuming $0 in basis for presentation purposes)

Step 2

- Funds are distributed via dividend and suffer second level of tax at the VC level at a blended rate of 32.8%, or foreign tax rate for foreign founders/investors
- (23.8% Federal and 9% State)
- After tax cash to investors of $10.6 million (effective tax rate of 47%)



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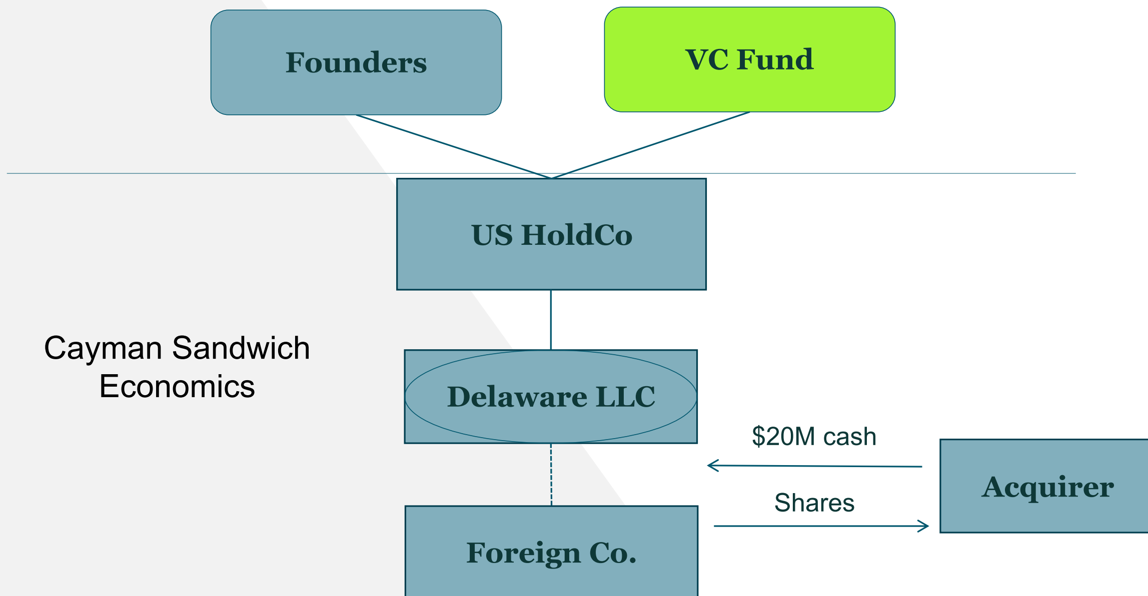
Exit Via Sale of Foreign Co.



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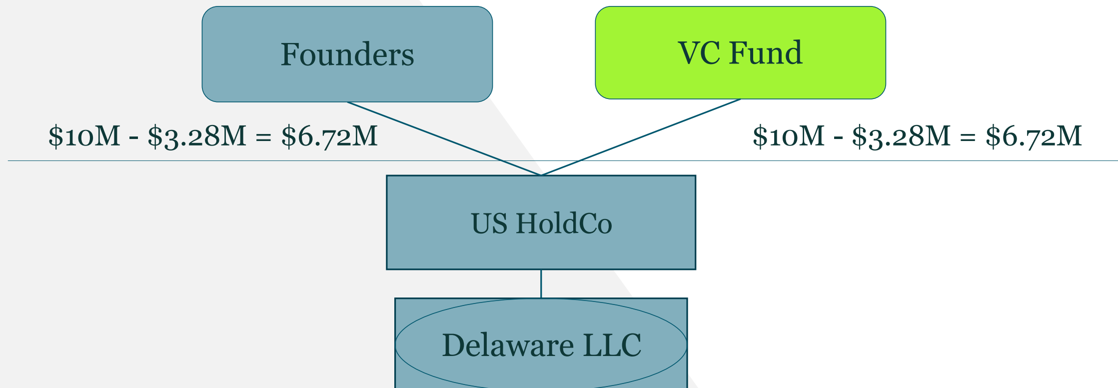
Tax Impact of Exit – Single Level of Tax

Step 1

- Funds "pass through" holding companies and is taxed once at the VC level at a blended rate of 32.8% (assuming local jurisdiction doesn't impose WHT on sale)
- (23.8% Federal and 9% State)

Optimal structure increases after tax return by 35% and reduces tax expense by 58%
After tax cash to investors of $13.44 million



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LatAm Venture Capital Structure Overview

Cayman Sandwich Structure

— This three-tiered structure facilitates capital flow from US investors to Latin American startups through Cayman and Delaware entities.

Legal Predictability

— The structure is favored for its clear legal framework, providing stability and reducing investment risks for cross-border ventures.

Tax Efficiency

— Structure provides exit tax efficiency for both US and non-US shareholders (with CTB in place US shareholders get LTCG treatment regardless of whether a) They sell shares of Cayman; or b) Cayman sells LLC or LLC sells OpCos).

— Tax benefits are a key advantage, optimizing returns by leveraging favorable tax regulations in intermediary jurisdictions.

Investor Familiarity

— The structure is widely recognized and trusted by investors due to its established use in cross-border Latin America ventures.

Why This Structure? Benefits for Investors

Why the Cayman Sandwich? Driving Forces

- **Investor Familiarity and Confidence:**
  - The structure uses jurisdictions and legal frameworks (Cayman, Delaware) that US VCs know and trust.
  - This streamlines due diligence and deal execution.
- **Tax Efficiency (for non-US investors and exits):**
  - While US investors are still taxed at their home country rate, the structure provides tax neutrality on exit for foreign investors.
  - CTB only applies to US taxpayers, but remains tax advantaged for non-US investors. The Cayman Islands are tax-neutral, with no corporate income tax, capital gains tax, or withholding tax on distributions from the Cayman HoldCo.
  - Additionally, Cayman HoldCo provides an intermediary structure with flexibility to pivot into the US, or elsewhere, as business and investor factors may dictate (subject to local and US tax analysis and considerations).
- **LLC Purposes include:**
  - Tax: Brazilian/ LatAm capital gains tax on non-residents reduced because Cayman is blacklisted as tax haven in Brazil/ LatAm (LLC cleanses Cayman).
  - "Legal": LLC can insulate identities of Cayman shareholders from local country regulators.
    - *E.g. Cayman would have had to disclose identities of all Cayman shareholders to the LatAm anti-trust officials if LLC had not been in the structure.

Why This Structure? Benefits for Investors

Why the Cayman Sandwich? Driving Forces

- **Legal Predictability and Flexibility:**
  - Cayman corporate law is based on English common law, offering a sophisticated and reliable legal framework.
  - Using US-style legal agreements at the Cayman and Delaware layers provides certainty and strong investor protections.
- **Risk Mitigation:**
  - The Delaware LLC and Cayman HoldCo create a buffer, insulating investors from some of the legal and political risks of the local LatAm jurisdiction.
- **Simplified Exits:**
  - The structure makes the startup more attractive for future acquisitions or IPOs, which often prefer a US or Cayman-domiciled entity.

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US Tax Treatment: The Flow-Through

US Tax Implications for Investors

— **Cayman Fund Treated as a Partnership**:
- For US tax purposes, the Cayman limited company is typically treated as a partnership (via CTB election), and the Delaware LLC is a "disregarded entity".
- This means that the structure (Cayman/ US LLC) is not subject to tax at the entity level.

— **Pass-Through for US Taxpayers**:
- The Cayman/ US LLC's income, gains, losses, and credits "pass-through" to the US investors (limited partners), non-US investors considered as investing in a corporation though (per investor residence local law).
- Investors report their share of any Cayman/ US LLC's taxable income on their personal US tax returns (via a Schedule K-1). These items should normally be nominal (subject to PFIC, CFC or GILTI inclusions).

— **Distributions and Taxable Events**:
- Investors are taxed when Cayman/ US LLC realizes gains, if any, not when they receive cash distributions.
- Sale of local operating company at an exit will typically be the primary taxable event (again subject to PFIC, CFC or GILTI inclusions.

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The Downside: Issues for US Investors

Associated Issues for US Investors

— **Controlled Foreign Corporation (CFC), GILTI, and Passive Foreign Investment Company (PFIC) Risk**:
- If the LatAm OpCo is a CFC and a PFIC, special rules apply, potentially creating current income inclusions or, in the absence of proactive steps, converting capital gains into higher-taxed ordinary income.
- This can lead to additional US tax liabilities and complex reporting requirements for certain US shareholders.

— **Effectively Connected Income (ECI)**:
- Cayman/ US LLC should not have operations in the US directly lest their activities create a US "trade or business" which can generate ECI for Cayman/ US LLC and their US and non-US investors.
- This could trigger tax withholding obligations and filing requirements for Cayman and its investors, even if a foreign entity is involved.
- Simple fix: All US activities to be conducted in a US corporation.

— **Complexity and Cost**:
- Despite the attraction of the three-jurisdiction structure it does involve slightly higher setup and ongoing operational costs than a single-entity structure.
- It also requires ongoing reliance on expert legal and tax advisors across multiple jurisdictions.

— **Local Market Perception**:
- Some local LatAm investors may view the structure less favorably than local investment vehicles (but typically the “Sandwich” is put in place to attract foreign/non-local VCs and investors).

Managing the Risks

Mitigating Issues & Best Practices

- **Legal and Tax Counsel**:
  - Engage experienced legal and tax advisors from the start, especially those familiar with US/ LatAm cross-border structures—Corporate, Tax, IP and employment.
- **Proper Entity Classification**:
  - Carefully manage US tax elections to ensure the desired pass-through treatment and avoid unintended consequences.
- **Operational Management**:
  - Ensure all operating expenses are properly managed at the OpCo level to avoid negative tax consequences.
  - Cayman should be pushing down invested funds to OpCo as debt and equity.
- **Exit Planning**:
  - Plan for various exit scenarios (M&A, IPO) and their tax implications from the outset.
- **US Domestication?**
  - Restructuring requires domestication planning in advance of profitability.
- **Regular Compliance Reviews**:
  - Conduct regular reviews to ensure ongoing compliance with US and local tax and regulatory requirements.
  - Standard Investor Rights Agreements include CFC, GILTI, PFIC, ECI, UBTI, and other representations and annual reporting to investors.

Conclusion

Key Takeaways

- The **Cayman Sandwich** is the market-standard structure for LatAm startups raising international VC.
- It offers significant benefits, including **investor familiarity, legal predictability, and risk mitigation**.
- The pass-through tax treatment benefits US investors, but requires careful navigation and management to avoid pitfalls.
- US investors must be vigilant regarding **potential CFC/ GILTI/ PFIC issues, ECI/ UBTI exposure, and the slightly higher costs** associated with the structure.
- A robust team of **legal and tax advisors** is critical for successful navigation and mitigation of associated risks.

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Q&A

Questions & Discussion

Thank you for your time.

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