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Taxation of savings vehicles in Brazil and a proposal of a "top-up" income tax

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**TAXATION OF SAVINGS VEHICLES IN
BRAZIL AND A PROPOSAL OF A
“TOP-UP” INCOME TAX**

PEDRO HUMBERTO BRUNO DE CARVALHO JUNIOR

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ABSTRACT

The study examines the shift in taxation of open-ended fixed-income funds in Brazil from a realization basis to an accrual basis (locally known as *come-cotas*), which was introduced in 1998 and more recently extended to include private closed-end funds and offshore trusts through the enactment of Law No. 14,754/2023. The study estimated the effective tax rates of various savings vehicles, including real estate, fixed-income funds and bonds, stocks, pension funds, real estate and agricultural funds, and venture capital funds, among others. It finds that individual investments in rental properties are subject to a higher effective tax rate compared to other investment vehicles, especially financial assets. Finally, the study proposes a 14% “top-up” Individual Income Tax aimed at reducing overall tax regressivity from income tax and social contributions for the top 2% of wealthiest taxpayers. This minimum tax would encompass all sources of income, including dividends, certain unrealized capital gains, and benefits currently exempt by legislation, potentially generating a maximum of R\$ 145.6 billion in revenue.

Keywords: capital gains; individual income tax; wealth concentration; inheritance tax; Brazil.

SINOPSE

O texto trata da mudança para tributação recorrente ou antecipada dos fundos abertos de renda fixa (sistema popularmente conhecido como *come-cotas*) introduzido em 1998, e mais recentemente perante os fundos pessoais fechados e as *trusts* localizadas no exterior através da Lei nº 14.754/2023. Através de simulações, o trabalho comparou a tributação efetiva de diversos veículos de investimentos, como imóveis, fundos e letras de renda fixa, ações, fundos de pensão, fundos imobiliários e do agronegócio, fundos de participação, entre outros. Estimou-se uma alta tributação do investimento individual em imóveis para aluguel em detrimento de outros veículos de investimento, sobretudo investimentos financeiros. Por fim, o estudo faz uma proposta para reduzir a regressividade da tributação conjunta do imposto de renda e contribuições previdenciárias perante os 2% mais ricos, introduzindo uma tributação mínima de 14% sobre a renda total do contribuinte, incluindo dividendos, certos ganhos de capital não realizados e benefícios atualmente isentos pela legislação. Com isso, estimou-se um potencial máximo de R\$ 145,6 bilhões em ganhos de receita.

Palavras-chave: ganhos de capital; imposto de renda da pessoa física; concentração da riqueza; imposto sobre heranças; Brasil.

1 INTRODUCTION

This study examines the recent changes in Brazil's income tax legislation resulting from the enactment of Federal Law No. 14,754/2023 (Brasil, 2023b), which introduced accrual basis taxation for two types of funds primarily held by wealthy individuals: private closed-end funds and offshore trusts. Additionally, this study provides an overview of the taxation of other savings vehicles in Brazil, analyzes the revenue outcomes resulting from the new law, discusses income tax regressivity on the wealthiest citizens, and proposes measures to mitigate this issue. Many studies have indicated that the effective income tax rate on the top 0.1% of earners has remained approximately 2% for several years (Gobetti, 2024; Gobetti and Orair, 2016; Introíni et al., 2018), with the current exemption for dividend income cited as a primary factor contributing to this scenario. However, even with a possible reintroduction of dividend taxation in Brazil, it is expected that wealthy individuals will exploit other existing loopholes within the tax system. Thus, understanding the taxation of other savings vehicles is essential to formulate tax policies to effectively tax the top richest.

Furthermore, this study analyzes not only the taxation of capital income and gains but also the applicable taxes on capital holding and their transfer through sale, donation, or inheritance across various savings vehicles. Since income tax exemptions and reductions are applied to each income category separately rather than considering the overall income of the taxpayer, the study highlights tax regressivity among the wealthiest individuals and proposes a "top-up" income tax that targets all sources of income, including those currently exempted for the richest individuals.

The significance of this paper arises from the global trend of low capital taxation, which tends to favor wealthy individuals. These individuals often exploit loopholes in both local and international legislation to minimize their tax liabilities or engage in aggressive tax planning. Brazil's 2023 reform concerning funds taxation aims to address one of the existing loopholes in the country's tax framework. This study takes inspiration from various publications, including works by Hebous et al. (2024), OECD (2018; 2022a), and Zucman (2024).

The study is structured into six sections, besides this introduction and conclusion. The second sections detail the current taxation framework across seven types of savings vehicles in Brazil: i) open-ended fixed-income funds and bonds; ii) real estate; iii) pension funds; iv) private closed-end funds and offshore trusts (those affected by Law No. 14,754/2023); v) real estate and agricultural funds and bonds; vi) equity funds and stocks; and vii) private equity and venture capital funds. Section three outlines the effective taxation levels associated with these seven savings vehicles, underscoring the significant burden imposed on rental real estate held by individuals, as previously demonstrated by OECD (2022a). Section four reviews Brazil's capital gains tax revenues since 1998, highlighting the revenue implications

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of Law 14,754/2023. Lastly, section five proposes a 14% “top-up” income tax for the top 2% wealthiest taxpayers to alleviate the disproportionate tax regressivity stemming from extensive capital income exemptions and existing loopholes in tax legislation.

2 TAXATION OF SAVINGS VEHICLES IN BRAZIL

This section provides a historical overview and analyzes the tax rules of the seven savings vehicles in Brazil: i) open-ended fixed-income funds, and government or corporate bonds; ii) real estate; iii) pension funds; iv) private closed-end funds; v) incentivized funds and bonds for the real estate and agricultural sectors; vi) equity funds and stocks; and vii) incentivized private equity and venture capital funds. The analysis covers the existing taxes and their regulations that may apply at all stages of capital holding: acquisition, ownership, income appropriation, transmission via inheritance or donation, and disposal through sale. Additionally, this section distinguishes the rules applicable to residents and non-residents and provides a brief overview of the tax rules applied to certain savings vehicles among some OECD countries.

2.1 Open-ended fixed-income funds and bonds

2.1.1 Capital income and gains of residents

In Brazil, the accrual-based taxation for open-ended fixed-income funds (*fundos de renda fixa*)¹ held by residents was introduced in 1998 through Provisional Executive Order (Medida Provisória – MP) No. 1,636/1997.² This change occurred during a financial crisis triggered by the Asian crisis, which put pressure on Brazil’s pegged exchange rate and caused the prime interest rate (*taxa Selic*) to rise to 45.9% in November 1997.³ MP No. 1,636/1997 established December 31, 1997, as the effective date for implementing accrual taxation, allowing income accrued before this date to continue being taxed upon realization. Additionally, the tax rate was raised from 15% to 20%, while the same law reduced the tax rate for equity funds (*fundos de renda variável*)⁴ from 15% to 10% to encourage investment in the domestic stock market.

1. In Brazil, fixed-income funds, which include more than 33% of fixed-income assets (such as government and corporate bonds, securities, certificates of deposit, and gold), are akin to money-market funds (*fundos de renda fixa*) and mutual funds (*fundos multimercado*).

2. This provisional executive order was annually renewed up to become definitive with the MP No. 2,189-49/2001.

3. Brazil’s annual prime rate (Tax Selic) increased from 19.0% to 45.9% in November 1997 due to effects of Asian crisis, decreased to 19.3% in July 1998, and increased again to 40.2% in September 1998 due to Russian crisis.

4. They must be composed of at least 67% equities, shares, stocks, asset-backed securities, options, forwards, futures contracts, or other securities traded on the Brazilian Stock Exchange (Bovespa).

During the financial crisis of the 1990s, upper-middle-class and wealthy individuals benefited from high interest rates on fixed-income funds, allowing them to accumulate wealth, which exacerbated inequality. Therefore, implementing accrual basis taxation on capital gains aimed to mitigate this trend (Hebous et al., 2024). The transition from realization to accrual basis for this common savings vehicle was popularly known as *come-cotas* (translated as “shares eater”). However, MP No. 1,636/1997⁵ modified Law No. 9,532/1997 to exclude closed-ended funds from receiving the same tax treatment as open-ended funds, meaning the former continued to be taxed upon to realization. The subsequent RFB regulatory instructions (*instrução normativa* – IN) further clarified that private closed-ended funds would be taxed upon realization according to the standard capital gains schedule. Additionally, for tax residents, the income from offshore trusts was also subject to taxation upon its redemption in Brazil.

In 2002, the Brazilian government launched a program to issue government bonds that individuals could hold directly, named as *Tesouro Direto*. These bonds are not subject to recurrent taxation under the *come-cotas* regime; instead, income tax is applied to accrued income upon early sale in the secondary market or at final maturity. Currently, the maturity of *Tesouro Direto* typically ranges from 3 to 30 years, some paying semestral interests and allowing to defer taxation. Therefore, direct investments in bonds have grown more significantly than those in fixed-income funds.

Laws No. 10,892/2004 and No. 11,033/2004 modified the *come-cotas* framework, introducing biannual tax collection for fixed-income funds and establishing long-term rates for both fixed-income funds and fixed-income bonds. Long-term fixed-income funds held by residents have been taxed biannually at 15% under *come-cotas*, but higher rates apply for redemptions made within two years.⁶ Short-term fixed-income funds are taxed biannually at 20% under *come-cotas* and incur a higher rate of 22.5% if redeemed within six months. This long-term taxation on redemption is deductible from what was collected by *come-cotas*. Fixed-income bonds, such as *Tesouro Direto* and corporate bonds, are subject to the same long-term rates; however, they continue to be taxed upon sale in the secondary market or at their final maturity.

Moreover, Law No. 11,033/2004⁷ confirmed that other funds taxed on a realization basis would remain subject to this rule. This includes all funds not classified as open-ended fixed-income or mutual funds, encompassing private closed-end funds (*fundos fechados*), private pension funds, equity funds (*fundos de investimento em ações* – FIA), private equity

5. Item II, art. 6, MP No. 1,636/1997.

6. These increased rates are 22.5% for redemptions made within six months, 20% for those between six months and one year, and 17.5% for redemptions between one and two years.

7. Paragraph 3, art. 1, Federal Law No. 11,033/2004.

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and venture capital funds (*fundo de investimento em participações* – FIP), real estate investment funds (*fundo de investimento imobiliário* – FII), agricultural funds (*fundo de investimento em cadeias agroindustriais* – Fiagro), over-the-counter stock investments, crypto assets, and other investments, many of which are traded on Bovespa.

It is also important to note that dividends in Brazil have been tax-free since 1993.⁸ Prior to 2015, all dividends accrued on funds were exempt, including equity funds (FIA) and mutual funds (*fundos multimercado*) whose only their fixed-income portions were biannually taxed under *come-cotas*. However, art. 21 and 22 of the RFB IN No. 1,585/2015 revised this interpretation, taxing the accrued dividends on mutual funds under *come-cotas* and accrued dividends on equity funds upon realization. Notable exceptions include dividends distributed by FIP, FII, and Fiagro, which remain exempt. In addition, dividends accrued on pension funds continue to be taxed only upon realization.

Regular savings deposits (*caderneta de poupança*), a popular fixed-income savings option for lower-income Brazilian families, are tax-exempt; however, their yields typically range from 60% to 70% of Brazil's prime rate (*taxa Selic*). In contrast, government bonds (*Tesouro Direto*), corporate bonds and debentures, which generally offer equal or slightly higher yields than the prime rate, are subject to long-term tax rates on the bonds' maturity or their sale on secondary market.

2.1.2 Capital income and gains of nonresidents

Fixed-income assets (funds and bonds) held by nonresidents are taxed only upon realization at a rate of 15%, unless they reside in low-tax⁹ jurisdictions, in which case their tax treatment aligns with that of residents. Since 2006,¹⁰ a specific class of fixed-income funds exclusively for foreign investors (*fundo de investimento exclusivo* – INR), composed of at least 98% Brazilian government bonds, has been tax exempted.

2.1.3 Capital transference by sale, donation or death

Inheritance tax imposed by state governments on fixed-income assets follows the same rules as other assets, with the tax base being the accrued income at the time of death. Tax rates may be progressive and are capped at 8%; however, they cannot favor children or closer relatives.

8. Art. 20, Law No. 8,541/1992, confirmed by art. 20 of Law No. 8,941/1995.

9. The countries considered low tax jurisdictions are those in the 1st article of the RFB IN No. 1,037/2010, available at: <http://normas.receita.fazenda.gov.br/sijut2consulta/link.action?idAto=16002> (in Portuguese).

10. Art. 1st, Law No. 11,312/2006.

2.1.4 Taxation of bonds and deposits among OECD countries

According to the OECD (2018, p. 29), as of July 2016, only Australia, Canada, Chile, Estonia, France, Hungary, Ireland, Korea, New Zealand, Norway, Spain, Switzerland, the United Kingdom, and the United States taxed bonds interest under the comprehensive income tax schedule. No country fully exempted bonds income; most OECD countries implemented a final withholding tax. Additionally, stamp duties on bond purchases were applicable only in Belgium, Ireland, and Italy. Bank savings accounts, similar to Brazil's *caderneta de poupança*, are taxed in all 37 OECD countries except Estonia. In 21 countries, savings accounts are subject to a final withholding tax, while Australia, Canada, Chile, France, Hungary, Lithuania, New Zealand, Norway, Spain, Switzerland, the United Kingdom, and the United States tax them under a comprehensive income tax regime. However, most of these countries provide some allowances for small savings.

2.2 Real estate

2.2.1 Capital ownership

Urban properties in Brazil are subject to the Municipal Urban Property Tax (Imposto sobre a Propriedade Predial e Territorial Urbana – IPTU), which has accounted for approximately 0.7% of the country's GDP in recent years. Rural properties are subject to the federal rural property tax (Imposto Territorial Rural – ITR), which generates minimum revenue. In the cities of São Paulo and Rio de Janeiro, effective property tax rate has been approximately 0.4% of the market value of most properties. In addition, Brazil does not impose a wealth tax that would tax the holding of real estate.

2.2.2 Capital income

Income from rental properties owned by individuals is subject to the standard progressive income tax, with rates reaching up to 27.5%. In contrast, imputed rents for owner-occupied residences are exempt. Companies with a turnover of up to R\$ 79 million under the “presumptive corporate income tax regime” generally face an effective tax rate ranging from 6% to 12%. As a result, establishing a real estate company can be a strategy for minimizing taxes for individuals who own multiple properties. Additionally, wealthy individuals have the option to invest in a FII or, before 2023, establish a private closed-end fund, which permitted tax-free dividends and capital gains tax only upon realization.

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2.2.3 Capital gains

Since 2017, capital gains from real estate and other sources (excluding exceptions defined by law) are taxed according to a progressive schedule with four tax rates ranging from 15% to 22.5%, with the second tax rate applicable from a substantial bracket. The 15% rate applies to capital gains up to R\$ 5 million (approximately US\$ 900,000 as of October 2024), while gains up to R\$ 35,000 from non-financial assets are exempt. Since 2005, individuals have been able to defer capital gains taxes if they purchase another residential property within six months. In addition, individuals selling their primary property (of any type) for less than R\$ 440,000 are exempt from capital gains tax once every five years. Furthermore, properties acquired before 1969 are fully exempt from capital gains tax, while those purchased after that date are subject to a 5% annual reduction up to 1988. In Brazil, there is no income tax relief for mortgage interest payments, but capital gains tax is based on a cash system. Consequently, paid mortgage interest increases property value; however, inflation does not adjust these values.

2.2.4 Capital transference by sale, donation or death

Property purchases (both rural and urban) are generally taxed by municipal governments at 3% of the market value, with notary fees typically around 1% of the purchase price (depending on the state), resulting in a total purchase tax of approximately 4%. In contrast, property transfers through inheritance or donation are taxed by state governments under a progressive schedule ranging from 2% to 8% of the value of the inheritance or donation. Notary fees and legal costs amount to about 2% of the inheritance value, meaning total taxation can reach 6% of the inheritance value in the São Paulo State. States may provide exemptions or reductions for low-valued primary residences. Additionally, in Brazil, there is no “step-up in basis” upon death, and accrued capital gains taxes can be deferred by the heirs until the property is sold.

2.2.5 Taxation of real estate among OECD countries

According to the OECD (2018, p. 32), as of July 2016, half of the OECD member countries provide some form of tax reduction or tax credit for mortgage interest expenses, even when the property is not a primary residence. Stamp duties are imposed in all countries except Chile, Colombia, Estonia, Japan, Lithuania, New Zealand, and Slovakia, while recurrent property taxes are levied in all nations.

Similar to Brazil, rental income from individuals is taxed in all countries, generally following a broadly comprehensive and progressive approach, except in Denmark, Iceland, Italy, and Slovenia, where a flat rate is applied. Imputed rents for owner-occupied properties are

taxed only in Denmark, Greece, the Netherlands, and Switzerland. Countries that impose a wealth tax, such as Norway and Spain, favor primary residences by reducing their tax base.

Surprisingly, capital gains on the sale of primary residences are taxed in only 13 of the 37 countries (Czechia, Colombia, Germany, Hungary, Israel, Italy, Japan, Korea, Lithuania, Slovenia, Spain, Sweden, and the United States). In contrast, capital gains on secondary properties are taxed in all countries except Chile, the Netherlands, New Zealand, Slovakia, and Turkey. However, in 13 out of 32 countries, the capital gains tax on secondary properties is reduced according to the holding period.

Among OECD countries, there are three approaches to the tax treatment of unrealized capital gains upon death. The first approach considers that a capital gain is realized when assets are transferred as a gift or inheritance, subjecting them to capital gains tax at that time. The second approach, as applied in Brazil, allows unrealized capital gains on gifts and inheritances to be passed to beneficiaries and taxed only upon realization; this mechanism is known as the *carry-over basis*. The third approach involves adjusting assets to their market value when transferred as inheritance, without incurring capital gains tax; this is known as the *step-up in basis*. The latter creates a strong incentive for holding assets until death, a phenomenon known as the *lock-in effect* (OECD, 2021, p. 120).

OECD (2021, p. 121) notes that the *stepped-up in basis* exists in some countries that generally impose inheritance taxes to offset the higher taxation that may occur after death. *Step-up in basis* is utilized in eleven countries: Chile, Finland, France, Hungary, Korea, Lithuania, Portugal, Slovenia, Spain, the United Kingdom, and the United States; however, Portugal does not impose an inheritance tax. Unrealized capital gains are taxed at death only in Canada and Hungary, while the *carry-over basis* applies in fourteen countries: Finland, Germany, Ireland, Italy, Japan, Luxembourg, Switzerland, Australia, Austria, Estonia, Israel, Mexico, Norway, and Sweden. Of these fourteen countries, the latter seven do not levy an inheritance tax.

2.3 Pension fund

2.3.1 Capital income and gains

Pension funds are taxed on their total accrued income upon realization (pension payments). Since 2005, beneficiaries have had the option to choose between the standard income tax regime and a regressive tax regime (*sistema regressivo*), which features long-term tax rates generally more favorable for long-term fund holdings. These rates vary from 35% for redemptions made within two years to only 10% for redemptions after ten years.

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Private pension funds may be structured as open-ended funds offered by financial institutions or closed-ended funds restricted to unions, employee groups, and sectorial associations. Private pension funds enjoy more favorable tax rules than other investment funds, making them attractive to wealthy individuals, particularly following the reform of private closed-ended funds in 2023. Taxpayers can deduct contributions to private funds from their annual income tax, up to 12% of their gross income. This deduction, combined with the reduced 10% tax rate upon realization, offers a large tax incentive for investing in pension funds in Brazil.

2.3.2 Capital transference by sale, donation or death

Some Brazilian states still levied inheritance tax for certain open-ended pension funds after death. Proposals are being made to exempt only the income accrued five years before death to avoid tax planning. There is no stamp duty on the participation of pension funds or wealth tax on holding pension funds' capital.

2.3.3 Taxation of private pension funds among OECD countries

According to the OECD (2018, p. 31), as of July 2016, private pensions are typically taxed using an expenditure approach, with most countries providing income tax deductions or credits for contributions. The investment returns of funds are exempt, and only the pensions in payment are taxed. In contrast, only six countries (Australia, Denmark, New Zealand, Italy, Latvia, and Sweden) tax pension funds during the holding stage. Furthermore, in another six countries (Austria, Colombia, Hungary, Israel, Lithuania, and Turkey) private pensions are completely tax-exempt during both accumulation and distribution phases and contributions can be deducted from income tax. Similar to Brazil, only a few countries apply a reduced flat tax rate to pension payments, including Belgium, Italy, Korea, Poland, and Portugal.

2.4 Private closed-end funds and offshore trusts

Law No. 14,754/2023 altered the taxation of private closed-end funds and offshore trusts held by residents (Brasil, 2023b). Private close-end funds are generally managed by Brazilian financial institutions and do not permit the entrance of new members. They have a pre-defined or no redemption period in their regulations; therefore, the number of shares and shareholders is fixed. They also require a high initial investment (on average R\$ 10 million) and have a high administration fee. Brazilian wealthy individuals and families used to allocate capital (especially fixed-income and rents) in private closed-end funds to minimize income tax, capital gains tax and inheritance tax. Until 2023, offshore

trusts held by wealthy Brazilian residents were used as a tax planning strategy to avoid recurrent taxation under *come-cotas* regime and inheritance tax.

2.4.1 Capital income and gains

Beginning in 2024, as established by Law No. 14,754/2023, accumulated income, dividends, and capital gains from private closed-end funds will be taxed on an accrual basis at 15% (Brasil, 2023b). This new policy is part of the government's agenda to close loopholes that favored wealthy individuals and enhance overall progressivity. It aims to prevent prolonged tax deferrals and reduce horizontal tax regressivity, as open-ended fixed-income funds have been taxed on an accrual basis since 1998.

Law No. 14,754/2023 also introduced accrual taxation on offshore accrued interests, dividends, rents, and other offshore income, which will be taxed annually at 15%, along with asset appreciation (capital gains), as discussed below (Brasil, 2023b). The law encompasses offshore fixed-income funds, mutual funds, trusts, savings deposits, redeemable insurances, pension funds, crypto assets, government and private bonds, shares, derivatives, equities, and over-the-counter investments. Additionally, it includes offshore non-redeemable dividends and interests. However, income from equity funds and capital gains resulting from exchange rate variations will continue to be taxed only upon realization.

2.4.2 Capital transference by sale, donation or death

Law No. 14,754/2023 has expanded the inheritance tax base to include private closed-end funds, offshore trusts, and other offshore investments, with tax rates established by states governments ranging from 2% to 8% (Brasil, 2023b). Article 16 of Constitutional Amendment No. 132/2023 (Tax Reform) also incorporates overseas assets and donors residing abroad into the inheritance and donation tax base. Prior to 2024, state governments were unable to tax these assets due to the absence of federal legislation. Additionally, there is no stamp duty on the purchase of financial capital in Brazil.

2.4.3 Taxation of investment funds among OECD countries

The OECD (2018, p. 30) provides data on the taxation of investment funds as of July 2016; however, the report does not distinguish between open-ended and closed-end funds. In six countries, investment funds were classified as clear structures and taxed on an accrual basis. This was done by treating the fund as a pass-through entity (in Australia, Canada, the United Kingdom, and the United States), by considering a distribution to have occurred each year if income was not actually distributed (in Germany), or by requiring

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annual distributions (in Korea). According to these rules, these six countries likely apply the same tax treatment for both open-ended and closed-end funds.

Ten countries (Austria, Czechia, Denmark, Germany, Latvia, the Netherlands, New Zealand, Portugal, Sweden, and Turkey) considered funds as opaque structures and applied a final withholding tax on accrued income. In contrast, eighteen countries taxed accrued income on funds only upon realization, either as interest, dividends, or capital gains, depending on the fund and the nature of the return.

Capital gains tax on the sale of fund shares was imposed in all countries except Australia (which already taxes fund returns on an accrual basis), as well as in the Netherlands, New Zealand, and Portugal (which apply a final withholding tax on fund returns on an accrual basis). In contrast, Belgium and Colombia fully exempt funds from taxation on both accrued income and capital gains. Furthermore, no country imposes transaction taxes on investment funds.

2.5 Real estate and agricultural funds and bonds

Real estate investment funds (FII) are closed-end funds with fixed or indeterminate shares that focus on the real estate sector. They were established by Law No. 8,668/1993 and are further regulated by Comissão de Valores Mobiliários (CVM) Instructions No. 472/2008 and No. 175/2022 (Annexure III). FIIs must invest in properties intended for rental, construction, or resale, as well as in shares of construction companies. They typically do not require a high minimum investment level and annual fees range from 1% to 2% of the invested capital. Foreign investors, even those residing in low-tax jurisdictions, are exempt from capital gains tax. By 2024, nearly 500 registered FIIs were traded on Bovespa, making them a popular savings vehicle among Brazilians, as they generally offer monthly tax-free dividends to individuals.

Agricultural investment funds (Fiagro) have rules similar to those of FII. They were established by Law No. 14,130/2021, which incorporated Fiagros under Law No. 8,668/1993. Fiagros can be either open-ended or closed-ended funds linked to the agribusiness sector. They invest in various assets related to agribusiness, such as credit rights, rural properties, securities, and related shares. They offer tax-free dividends for individuals, and there is no predetermined time for redemption; however, shareholders can sell their shares on the secondary stock market, *Bovespa*. Foreign investors, including those residing in low-tax jurisdictions, are exempt from capital gains tax. By 2024, nearly hundred registered Fiagros were listed on *Bovespa*, making them a popular savings vehicle among Brazilians due to the absence of *come-cotas* and the regular distribution of tax-free dividends.

In addition, real estate bonds such as certificates of real estate receivables (*certificado de recebíveis imobiliários* – CRI) and letters of credit for real estate (*letra de crédito imobiliário* – LCI) and agricultural bonds such as certificates of agricultural receivables (*certificado de recebíveis do agronegócio* – CRA) and agricultural credit letters (*letra de crédito do agronegócio* – LCA) are also sector-specific investments. LCIs are fixed-income securities issued by financial institutions to fund real estate companies, while CRIs are mortgage-backed securities issued by securitization firms. LCAs are fixed-income securities issued by financial institutions, backed by credit rights from the agricultural sector, whereas CRAs are specifically designed for agricultural financing. These bonds are considered more conservative investments, with returns typically slightly lower than the *Selic* interest rate; however, they are income tax exempt.

2.5.1 Capital income and gains

Dividends regularly distributed by FIs and Fiagros are tax-free for individual residents and nonresidents, even if they reside in low-tax jurisdictions. However, capital gains due to shares' sale in the secondary market are taxed at 20%. FIs are very low-taxed. At a corporate level, funds income (mostly property rents) and capital gains (due to resale of properties) are also tax exempted.¹¹ While local property taxes and stamp duties still apply to properties owned by FIs, they are generally low, stamp duties at 3% and an effective urban property tax rate of 0.4%. Fiagros also have slightly the same tax rules as FIs at the corporate level, which income and capital gains are tax exempted. As a result, only capital gains from the resale of shares by shareholders in the secondary market are effectively taxed.

2.5.2 Capital transference by sale, donation or death

Inheritance tax levied by state governments to FIs, Fiagros, and real estate bonds and agricultural bonds have the same rules as other assets.

2.6 Equity funds and shares

This section outlines the taxation of equity funds (FIA), and securities (stocks, shares, Brazilian Depositary Receipts – BDR) directly held by individuals and companies traded on *Bovespa*. FIAs are open-ended or closed-end funds with at least 67% of their capital comprised of securities, while fixed-income investments may represent up to

11. Art. 16, Law No. 8,668/1996.

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33%. Although FIAs cannot distribute regular dividends, their shares can be redeemed (if they are open-ended funds) or traded on a secondary market. BDRs allow investors in Brazil to indirectly own shares of foreign companies without engaging with foreign brokerages. BDRs are issued by foreign companies through a Brazilian depository institution and can be traded on *Bovespa*. However, the tax rules for BDRs differ from those for Brazilian stocks and equity funds.

2.6.1 Capital income and gains

Dividends received from direct ownership of shares and stocks are tax-free, while income from interest on net equity (*juros sobre o capital próprio*) is taxed at 15%. However, since 2015, accrued dividends on FIAs have been taxed at 15% upon realization, according to the interpretation of IN No. 1,585/2015 (Brasil, 2015). Prior to 2015, these accrued dividends on FIAs were exempt. Additionally, dividends from BDRs are considered offshore income and are taxed according to the standard progressive income tax schedule, which can go up to 27.5%.

Capital gains of FIAs and stocks are taxed on realization at 15% for residents and 10% for nonresidents. However, capital gains from day-trade operations in the stock market are taxed at a rate of 20%, and small capital gains up to R\$ 20,000 per year are exempt. Specific long-term equity funds held by nonresidents (not located in low-tax jurisdictions)¹² are capital gains exempted under certain conditions. They must have 100% of their shares held by nonresidents, and their capital must comprise at least 85% of stocks, equities or other related securities.¹³ Capital gains from BDRs are treated the same as those from Brazilian equities and are taxed at 15% (or 20% for day-trade transactions). However, there is no relief for low-value capital gains.

2.6.2 Capital transference by sale, donation or death

Inheritance tax levied by state governments on FIAs, stocks, BDRs and other related vehicles have the same rules as other assets.

2.6.3 Taxation of shares among OECD countries

According to the OECD (2018, p. 30), as of July 2016, dividends from equities were taxed under either a flat-rate capital income tax or a broadly comprehensive income tax. The

12. The countries considered low-tax jurisdictions are those in the 1st article of the RFB IN No. 1,037/2010, available at: <http://normas.receita.fazenda.gov.br/sijut2consulta/link.action?idAto=16002> (in Portuguese).

13. RFB IN No. 1,585/2015, art. 91, 6th par., II.

latter model was applied in Australia, Canada, Chile, Finland, France, Hungary, Ireland, Japan, Korea, Luxembourg, Mexico, New Zealand, Norway, Spain, Switzerland, the United Kingdom, and the United States. Only Estonia exempted dividends. Capital gains on equities were taxed upon realization in 31 out of 36 countries, while being exempted in Belgium, Colombia, the Netherlands, New Zealand, and Turkey. There was no taxation on unrealized capital gains from shares. Additionally, stamp duties on share purchases or sales were applicable in Belgium, Ireland, Italy, and Greece.

2.7 Private equity and venture capital funds

Private Equity Investment Funds (FIP) are incentivized closed-end funds. At least 67% of their capital must be allocated to sector-related equities, equity funds, debentures, securities, notes, and other assets traded on the stock exchange, while foreign investments are capped at a maximum of 33%. These funds are fixed-term and are divided into several categories, some of which offer significant tax benefits, as follows.

- 1) Closed-end equity funds for startups (FMA or FIA – Mercado de Acesso).
- 2) Small companies (FIP – Capital Semente), with an annual turnover of less than R\$ 20 million.
- 3) Emerging companies (FIP – Empresas Emergentes), with an annual turnover of less than R\$ 400 million.
- 4) Infrastructure or research and development – *fundos de participação em investimento em infraestrutura* (FIP-IE) and *fundos de participação em investimento em produção econômica intensiva em pesquisa, desenvolvimento e inovação* (FIP-PD&I) –, which are related to companies or projects in energy, transport, water supply, sanitation, irrigation or highly intensive research and development and innovation.
- 5) Multi-strategy (FIP – Multiestratégia) that is not tied to a specific sector.
- 6) The FIP-IE and FIP-PD&I were established in 2007 and 2011, respectively, and are exempt from taxes on dividends and capital gains. These funds must have at least five shareholders, and at least 90% of their assets must consist of shares, debentures, and other securities issued by corporations involved in developing new infrastructure projects in Brazil. They are part of Brazil's sectoral policies aimed at attracting private investments, particularly in the sectors specified in Law No. 11,478/2007, which includes energy, transport, water supply, sanitation, and irrigation. Law No. 12,431/2011 further broadened the scope of

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incentivized FIPs to encompass highly intensive research, development, and innovation sectors (FIP-PD&I). As of 2022, there were approximately 100 registered FIP-IEs, most related to energy projects.

2.7.1 Capital income and gains

All FIPs are tax-free for nonresidents, even if located in low-tax jurisdictions. Specifically, FIP-IE and FIP-PD&I have tax-free dividends and capital gains for individuals resident in Brazil,¹⁴ even with their share redemption in the secondary market. Capital gains of FIP-IE and FIP-P&D held by Brazilian companies and all other FIPs held by residents are taxed at 15% on realization.

2.7.2 Capital transference by sale, donation or death

Inheritance tax levied by state governments on FIPs have the same rules as other assets.

3 EFFECTIVE TAX RATES ON SAVINGS VEHICLES IN BRAZIL

This section estimates the marginal effective tax rates (ETR) on income generated and on total capital value for eleven types of savings vehicles in Brazil: owner-occupied houses, rental properties held by individuals, rental properties held by companies, real estate funds (FII), fixed-income funds, fixed-income bonds, stocks, private pension funds, equity funds (FIA), agricultural funds (Fiagro), and exclusive fixed-income funds for non-residents. The section aims to compare the ETR differences among these saving vehicles, demonstrating that taxes are far neutral and that create significant disparities in taxation across investments. It further seeks to confirm that rented real estate is more heavily taxed in Brazil, consistent with the findings of the OECD (2018).

3.1 Summarizing tax rules on savings vehicles in Brazil

Table 1 summarizing the taxation rules according to four tax events: capital purchase, holding, income appropriation, appreciation (capital gains) and transference by death or donation of the cited savings vehicles.

14. IN No. 1,585/2015, art. 33, par. 1st: “the gains from the sale of shares of referred investment funds will be taxed at: I – 0% rate if obtained by an individual in transactions carried out on or off the stock exchange”.

TABLE 1
Taxation of different savings vehicles in Brazil (2024)

Savings vehicle	Income	Capital gains	Purchase	Inheritance or donation	Holding
REAL ESTATE	<ul style="list-style-type: none">Rents received by individuals are under the standard progressive income tax (up to 27.5%). Imputed rents for owner-occupied are disregarded, and mortgage interests are not deductible for individual income tax.Rents received by real estate companies enjoy lower rates (6-11%).	<ul style="list-style-type: none">Taxpayers who own a single property valued at up to R\$ 440,000 (approximately US\$ 80,000 as of September 2024) are exempt.Progressive schedule from 15% to 22.5%, prevailing 15%. Taxation can be deferred if an individual buys another residence within 6 months.Capital gains tax is based on a cash method; however, expenses such as mortgage interest, renovations, and some taxes and fees can be used to adjust the property value.Since 1996, inflation has not adjusted to the acquisition value.	<ul style="list-style-type: none">2-3% Stamp Duty (ITBI), based on market value.Notary fees are about 1% of purchase value.	<ul style="list-style-type: none">Inheritances and donations have been taxed by state governments at rates capped at 8% since 1992.From 2024, tax rates must be progressive while the Federal Senate maintains competence to set the top rate. From 2024, Inheritance Tax includes estates or decedents located overseas.	<ul style="list-style-type: none">Urban Property Tax (IPTU)Rural Property Tax (ITR)Federal Marine Property Tax for Coastal PropertiesNo wealth tax.
EQUITIES FUNDS AND STOCKS	<ul style="list-style-type: none">Dividends of stocks/shares directly held by residents and non-residents are exempted.Dividends from BDRs are taxed according to the standard (progressive) income tax schedule (up to 27.5%).Interest on Net Equity: 15%.	<ul style="list-style-type: none">CG are taxed on realization at 15% for residents and 10% for nonresidents. It is a final withholding rate, not adjustable by the progressive income tax schedule.Redemptions of equity funds' shares: 15% for residents and 10% for nonresidents.Capital gains on financial assets up to R\$ 20,000 per year are exempt except for BDRs.			
REAL ESTATE & AGRICULTURAL FUNDS AND BONDS	<ul style="list-style-type: none">Regular dividends of FI and FIAGRO are exempted.Income related from Real Estate and Agricultural Bonds are exempted.	<ul style="list-style-type: none">CG of FI and Fiagro are taxed at 20% on realization.	<ul style="list-style-type: none">No stamp duties, fees may be applied.		<ul style="list-style-type: none">No wealth tax.
INCENTIVIZED EQUITY FUNDS (FIP)	<ul style="list-style-type: none">Exempted	<ul style="list-style-type: none">Exempted for individuals			

(Continues)

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(Continued)

Savings vehicle	Income	Capital gains	Purchase	Inheritance or donation	Holding
FIXED-INCOME FUNDS & BONDS <ul style="list-style-type: none"> • Money market funds (renda fixa) • Mutual funds (multimercados) • Brazilian government bonds • Certificates of deposit (CDB) • Corporate bonds (fundo CP) • OTC swaps • Gold • Private loans • Options and forward contracts • Savings deposits (poupança) • Fixed-income funds for nonresidents 	<ul style="list-style-type: none"> • Interests accrued on fixed-income funds of residents are taxed biannually at rates of 15% or 20%, depending on whether they are from long-term or short-term funds. • Dividends accrued on Mutual Funds (funds with more than 33% of fixed-income assets) are also taxed biannually. • Income from bonds is only taxed when redeemed at the time of maturity at long-term rates. Interests from regular savings accounts (poupança) are exempted. • Income from exclusive long-term fixed-income funds for nonresidents are exempted if government bonds are more than 98% of capital. 	<ul style="list-style-type: none"> • CG on bonds is taxed together with Income Tax if redeemed before their maturity at long-term rates. Long-term CG rates for fixed-income assets range from 15% (for more than 2 years) to 22.5% (for less than six months). • The IOF is levied if redemption for funds and bonds occurs within less than 30 days. 	<ul style="list-style-type: none"> • No stamp duties. 		<ul style="list-style-type: none"> • No wealth tax.
OFFSHORES ASSETS <ul style="list-style-type: none"> • Deposits • Money market funds • Mutual funds • Trusts • Rents • Insurance • Crypto assets • Others (except equity funds and stocks) 	<ul style="list-style-type: none"> • Since 2024, rents, dividends and interests, accrued on trusts, among other offshore assets will be taxed at 15%, regardless their redemption to Brazil. Tax base also includes other companies indirectly controlled by trusts. • Dividends from holding offshore stocks are exempted. • Accrued dividends from offshore equity funds are taxed only upon realization at 15%. 	<ul style="list-style-type: none"> • From 2024, capital gains will be taxed on an accrual basis at 15%, which includes the appreciation of cryptocurrency and dividends on mutual funds. • Exchange rate gains are taxed only upon realization. Taxpayers have the option to update their offshore capital value up to Dec 2023 at a reduced rate of 8%. • CG from offshore equity and equity funds will continue to be taxed only upon realization at 15%. 	<ul style="list-style-type: none"> • No Stamp Duties in Brazil. 	<ul style="list-style-type: none"> • Since 2024, assets and donors (including changes in the shares of offshore trusts) have been subject to the Inheritance Tax. • Since 2024, distributions from trusts involving the settlor or beneficiaries will also be subject to the Inheritance Tax. 	
LIFE INSURANCE	<ul style="list-style-type: none"> • Exempted on life insurance payout • CG tax of 15% is levied on the redemption of redeemable life insurances. 		<ul style="list-style-type: none"> • Tax on Financial Operations (IOF) at 0.38% on premiums 	<ul style="list-style-type: none"> • Exempted 	<ul style="list-style-type: none"> • No wealth tax.
PRIVATE PENSIONS	<ul style="list-style-type: none"> • Income is taxed only upon redemption. • Beneficiaries can choose between the standard progressive individual income tax (up to 27.5%) or long-term tax rates (generally the most favorable regime) that vary based on the redemption period (ranging from 35% for redemptions made in less than 2 years to 10% for those held for more than 10 years). • Contributions are deductible from income tax up to 12% of total income. 	<ul style="list-style-type: none"> • Exempted 	<ul style="list-style-type: none"> • No IOF 	<ul style="list-style-type: none"> • Pensions and benefits from closed-end pension funds are exempted. Some states tax open-ended pension funds. • The National Congress is discussing the exemption of income accrued from funds held for more than five years to prevent tax planning strategies. 	

Sources: Brasil (2015; 2023b) and other Brazil's tax legislation.

Author's elaboration.

3.2 Calculating marginal ETR

Table 2 was prepared to compare the ETR over five years for an investment of R\$ 1 million across different savings vehicles, as follows.

- 1) Owner-occupied property.
- 2) Direct investment in rental properties by individuals.
- 3) Rental properties indirectly held by individuals through companies.
- 4) Rental properties indirectly held by individuals through real estate funds (FII).
- 5) Fixed-income funds.
- 6) Fixed-income bonds.
- 7) Stocks.
- 8) Pension Funds.
- 9) Equity funds (FIA).
- 10) Agricultural funds (Fiagro).
- 11) Exclusive funds for nonresidents.

Considering the market situation as of October 2024, the table reflects the present values based on the following assumptions.

- 1) Present values will be adjustable using an average prime rate of 9% and an inflation rate of 4%, resulting in a net rate of return of 5%.
- 2) Annual rental income is equivalent to 7% of the property's market value, yielding a net return of 3%.
- 3) Property taxes and rent contracts in Brazil are adjusted for inflation and property taxes are paid by tenants. Therefore, only owner-occupied properties effectively pay property taxes.

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- 4) A stamp duty of 3% and notary fees of 1% apply to real estate purchase, while annual property tax and urban fees,¹⁵ equivalent to 0.4% of the property's market value are applied.
- 5) A marginal income tax rate of 27.5% applies to rental income for individuals, while real estate companies are subject to an effective rate of 12%.
- 6) Fixed-income assets and pension funds (net) yield 5% per year, whereas FIs, Fiagros, shares and equity funds (net) yield 8%. FIs, Fiagros and stocks have tax-free dividends while accrued dividends on equity funds are taxed at 15% upon realization. In addition, capital gains tax is levied at 15% on the nominal difference between the purchase value and the sale value, but in the case of FIs and Fiagros, the rate is 20%.
- 7) The taxpayer will have an annual income equivalent to 1,800% of the average salary (R\$ 600,000 per year, adjusted by inflation) and will deduct 12% of their total income for contributions to pension fund. Accrued income from pension funds is taxed at 20% if withdrawn within five years of investment and at 10% if withdrawn after ten years.¹⁶
- 8) An inheritance tax of 4%, along with notary fees of 1%, is applicable after death as established in the State of São Paulo. According to legislation, the inheritance tax base is the total capital value including the accrued income for fixed-income and equity funds, while it is the asset's market value for real estate, FIs, stocks, and Fiagro.
- 9) It is assumed that after five and ten years, real estate, FI, Fiagro and stocks will experience nominal appreciation of 33.8% and 79.1%, respectively, reflecting an inflation rate of 4% alongside an average annual GDP growth of 2%. It is important to note that, according to capital gains tax rules, asset values are not adjusted for inflation or interest.

15. Urban fees are those charged together with urban property tax by municipalities and generally comprises garbage collection fee or public cleaning fee.

16. In the case of pension funds, the initial investment is reduced to allow for a maximum deduction of 12% of individual income. For example, for a 10-year investment, the initial investment will be R\$ 470,074 instead of R\$ 1,000,000, as with other investments. This adjustment will not affect the comparisons among different savings vehicles.

TABLE 2

ETR on accrued income and capital for an investment of R\$ 1,000,000 over five years, considering purchase, holding, income, inherited and realization, market conditions for 2024, 5% net rate of return, present values

Stage	Year	Real estate			Financial assets						
		Primary ¹	Rented individual ²	Rented company ²	FII and Fiagro ^{2,3}	Fixed income funds ⁴	Fixed income bonds	Stocks ^{2,3}	Pensions fund ⁵	Equity fund ²	Non-residents ⁶
Purchase Stamp duties	Y0	40,000	40,000	40,000	-	-	-	-	-	-	-
	Y0	4,000	-	-	-	-	-	-	-	-	-
	Y1	3,810	-	-	-	-	-	-	-	-	-
Holding Property tax	Y2	3,628	-	-	-	-	-	-	-	-	-
Urban fees	Y3	3,455	-	-	-	-	-	-	-	-	-
	Y4	3,291	-	-	-	-	-	-	-	-	-
	Y0	-	7,857	3,429	-	7,143	-	-	-18,857	-	-
	Y1	-	7,483	3,265	-	7,091	-	-	-17,959	-	-
Income Income Tax	Y2	-	7,127	3,110	-	7,041	-	-	-17,104	-	-
	Y3	-	6,787	2,962	-	6,991	-	-	-16,290	-	-
	Y4	-	6,464	2,821	-	6,941	-	-	-15,514	-	-
Inheritance Inheritance tax ⁷	Y4	41,941	41,941	41,941	41,941	38,592	40,000	41,941	-	46,050	-
Disposal Capital gains ⁸	Y4	33,460	33,460	33,460	44,613	-	32,471	33,460	43,295	48,252	-

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(Continued)

Stage	Year	Real estate			Financial assets						
		Primary ¹	Rented individual ²	Rented company ²	FII and Fiagro ^{2,3}	Fixed income funds ⁴	Fixed income bonds	Stocks ^{2,3}	Pensions fund ⁵	Equity fund ²	Non-residents ⁶
Total Tax	Y0 – Y4	133,585	151,120	130,988	86,555	73,800	72,471	75,401	-42,429	94,302	–
Accrued income ⁹	Value	129,884	94,166	114,298	346,358	234,718	238,095	346,358	238,095	346,358	238,095
	ETR	75.4%	122.6%	83.4%	15.3%	15.0%	13.6%	11.5%	-17.8%	15.9%	–
	Value ¹⁰	1,178,419	1,142,701	1,162,833	1,394,893	1,234,718	1,238,095	1,394,893	1,238,095	1,346,358	1,238,095
Final Capital	ETR ¹¹	11.3%	13.2%	11.3%	6.2%	6.0%	5.9%	5.4%	-3.4%	7.0%	–

Author's elaboration.

Notes: ¹ Imputed rents for owner-occupied properties.

² Nominal asset values increase by 6% per year, resulting from an inflation rate of 4% and an average GDP growth rate of 2%.

³ FIIs, stocks, equity funds, and Fiagro net yield 8% per year.

⁴ Fixed-income investments net yield 5% per year.

⁵ The pension fund is held for 5 years and net yields 5% per year, with a 20% tax in payment.

⁶ Exclusive fixed-income funds for nonresidents that are tax exempt.

⁷ An inheritance tax of 4% and notary fees of 1% are levied on market value.

⁸ Capital gains tax base is not adjusted by inflation or interests. The value considers the deduction for inheritance tax.

⁹ ETR on accrued income only, does not consider inheritance tax, and capital gains tax is levied in full.

¹⁰ The final capital value is equal to the sum of the original capital, accrued income, and capital gains.

¹¹ ETR on final capital includes inheritance tax and notary fees, which are deductible from the capital gains tax.

As indicated by the last line of table 2, throughout the processes of asset purchase, holding, income generation, inheritance, and final disposal, real estate rented by individuals (Reri) is significantly overtaxed compared to other savings vehicles. If a property valued at R\$ 1 million is owner-occupied or rented by a company, its ETR on capital will be 14.4% lower than if it were rented by an individual. Additionally, if the property is held by a Real Estate Fund (FII), the tax burden is reduced by 53.0%.

In contrast, if the same amount is invested in fixed-income vehicles, the tax level is approximately 55% lower than for a Reri. Additionally, direct investment in stocks incurs a tax burden that is 59.1% lower than that of Reri. However, investing in pension funds offers a negative ETR, which is 125.8% lower than Reri, because the deductions on annual income tax exceed the total amount taxed. Furthermore, if the holding period increased from five to ten years, the tax rate on withdraws would be reduced from 20% to 10%, increasing this gap in 145.9%. Indeed, data of income tax declarations (Brasil, 2023a) shows that the top 2% richest taxpayers accounted for 32% of the total deductions for private pensions funds, which represented 0.5% of their total income.

Investing in equity funds results in an ETR that is 38.3% higher than direct investments in stocks. This difference arises because accrued dividends from equity funds are taxed at 15% upon realization, while dividends from stocks are tax exempt. Nevertheless, the taxation on equity funds is still 47.0% lower than Reri.

The ETR gap among different savings vehicles becomes even more pronounced when focusing solely on the taxation of accrued income, excluding inheritance tax. In this context, for five years, Reri has an effective tax rate on income of 122.6%, whereas investing in financial assets has rates that are, on average, 88% lower.

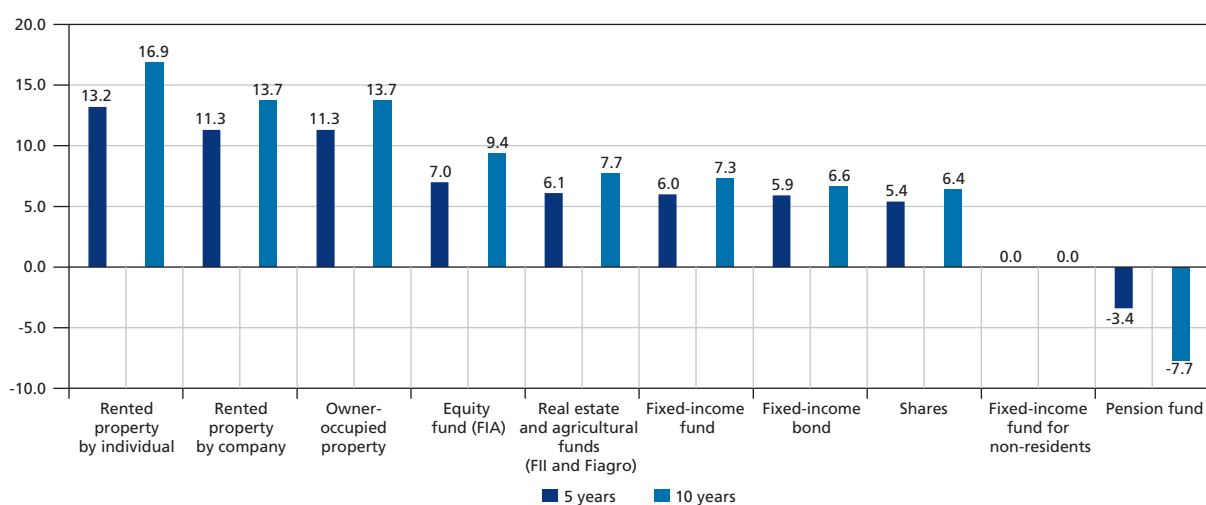
Indeed, the primary reasons why the ETR on Reri is approximately twice as financial assets can be summarized in three key factors. First, rental properties typically yield a net return of only 3%, which is lower than the returns of other savings vehicles as of October 2024 (the payment of annual property taxes by tenants also impacts the net return from rents). Second, Brazil operates a dual income tax system, featuring a progressive regime for labor and rents alongside an exemption or final withholding tax generally set at 15% for capital income. Consequently, rental income for individuals is taxed under the standard progressive income tax, with a marginal rate of 27.5% applied to a modest monthly income bracket from only R\$ 4,665 (approximately US\$ 830 as of September 2024). Lastly, dividends from stocks, FIIs and Fiagros are tax exempted, while income from other financial assets is taxed at 15%. Figures 1 and 2 better highlight these tax level disparities among savings vehicles verified by table 2.

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FIGURE 1

Effective tax rates on *total capital* across savings vehicles in Brazil: cycle of acquisition, ownership, income, inheritance or donation, and disposal, estimated as of October 2024, five and ten years

(In %)

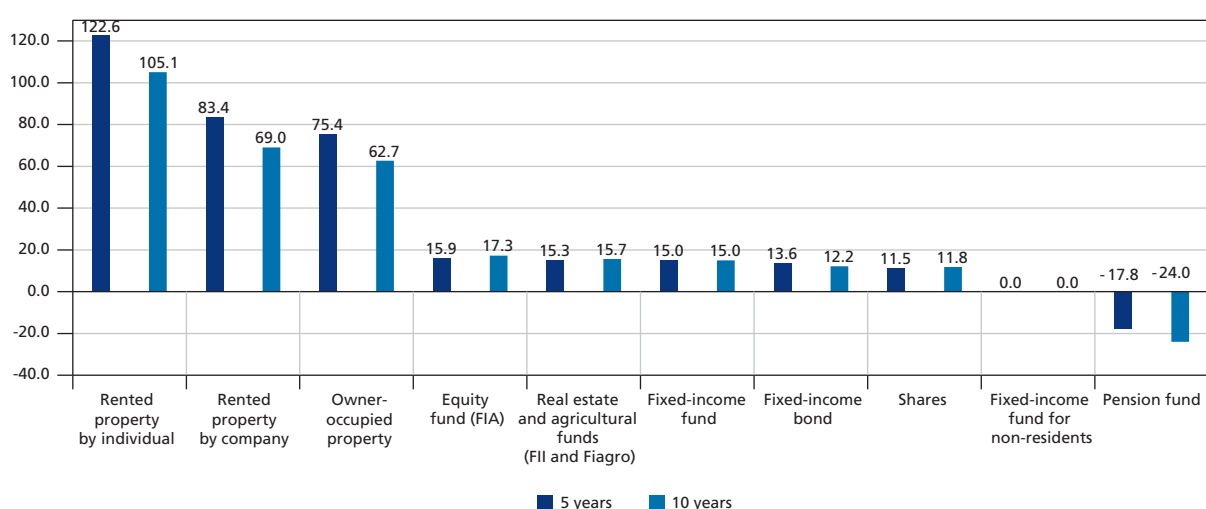


Author's elaboration.

FIGURE 2

Effective tax rates on *accrued income* across savings vehicles in Brazil: cycle of acquisition, ownership, income, and disposal, estimated as of October 2024, five and ten years

(In %)



Author's elaboration.

3.3 Effective tax rates among some OECD countries

OECD (2018) provides the marginal effective tax rates on income for various taxes associated with different savings vehicles in its member countries as of July 2016. The study established a 3% net rate of return for all countries and a holding period of five years, except for real estate and pension funds, which were set at 20 years. Table 3 extracts data from the OECD (2018, p. 66) regarding effective tax rates for individuals earning 500% of the average salary in 14 countries, and compares this estimate with Brazil's, using the same parameters but setting Brazil's rate of return at 5%, consistent with the previous simulation. The cited study considers all taxes discussed in table 2, excluding inheritance taxes.

TABLE 3

Marginal ETR on income by asset: personal tax rate, 500% of average wage (2016)
(In %)

	Property rented by individuals ¹	Primary property ¹	Deposits	Pension funds ^{1,2}	Investment funds ³	Private bonds	Government bonds	Shares ⁴
Australia	100.9	76.9	75.0	-13.7	83.0	75.0	75.0	29.1
Canada	105.2	97.7	81.9	0	80.3	82.0	82.0	60.1
Chile	43.5	43.0	35.2	0	39.7	35.2	35.2	-12.4
France	129.4	102.4	99.9	-15.9	82.7	99.9	99.9	74.8
Germany	47.5	51.1	40.4	0	36.7	40.4	40.4	40.4
Italy	76.4	13.2	41.4	-56.5	27.1	41.4	20.8	40.8
Japan	40.8	12.8	30.7	-43.0	21.4	30.7	30.7	30.7
Korea	81.2	57.1	58.1	-13.3	58.1	58.1	58.1	65.7
Mexico	63.4	13.6	45.9	-20.6	16.7	45.9	45.9	15.3
Netherlands	49.8	-14.5	40.0	0	40.0	40.0	40.0	40.0
Portugal	85.2	56.9	42.8	-25.0	37.9	42.8	42.8	42.8
Spain	59.7	45.7	35.2	0	25.6	35.2	35.2	35.2
United Kingdom	86.2	81.4	69.0	-34.1	73.5	69.0	69.0	72.7
United States	51.3	33.7	56.3	0	28.3	56.3	56.3	28.8
Average OECD (14)	72.9	47.9	53.7	-15.9	46.5	53.7	52.2	40.3
Brasil ⁵	97.0	56.9	0.0	-25.5	15.9	13.6	13.6	11.5

Source: OECD (2018, p. 67 and 72).

Author's elaboration.

Notes: ¹ The maturity for real estate and pension funds was set as 20 years, while the other vehicles was set as five years, following the same approach as OECD (2018).

² Pension funds with deductible contributions. In Brazil, 500% of the average salary results in R\$ 168,000 per year, as of October 2024.

³ Investments funds was defined as equity funds (FIA) for Brazil.

⁴ Shares with 100% of distribution. In Brazil, dividends are tax-free; however, capital gains from the resale of shares in the secondary market are taxed at 15%. For Brazil, it was established that shares appreciate at 6% per year at nominal values, based on the average inflation rate (4%) plus GDP growth (2%).

⁵ The income derived from deposits in Brazil is established as come from *caderneta de poupança*.

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According to table 3, among 14 selected OECD countries, ETR on deposits and bonds is 25% lower than that on Reri. The ETR of owner-occupied residences, which benefit from deductions or credits on mortgage interests in some countries is 38% lower than Reri, which is almost the same percentage for investment funds. Similarly, ETR on shares averaging 45% lower than that on Reri, while pension funds enjoy a negative ETR due to the deductions or tax credits available in most OECD countries. However, the ETR of shares and financial assets in Brazil is significantly lower than OECD due to tax-free for dividends and reduced rate for capital gains.

4 REVENUES OUTCOMES OF THE TAX REFORMS ON FUNDS

This section aims to analyze the revenue impact of the tax reforms on funds, particularly those introduced by the Provisional Executive Order No. 1,636/1997 which established *come-cotas* for open-ended fixed-income funds in 1998; the RFB IN No. 1,585/2015, which began taxing dividends accrued on mutual funds and equity funds; and Law No. 14,754/2023, which initiated taxation on private closed-end funds, offshore trusts and other offshore assets on an accrual basis. It is important to view any potential revenue increase with caution, as investments in fixed-income funds can vary significantly according to Brazil's prime rate and macroeconomic expectations. A historical overview of these tax reforms is described next.

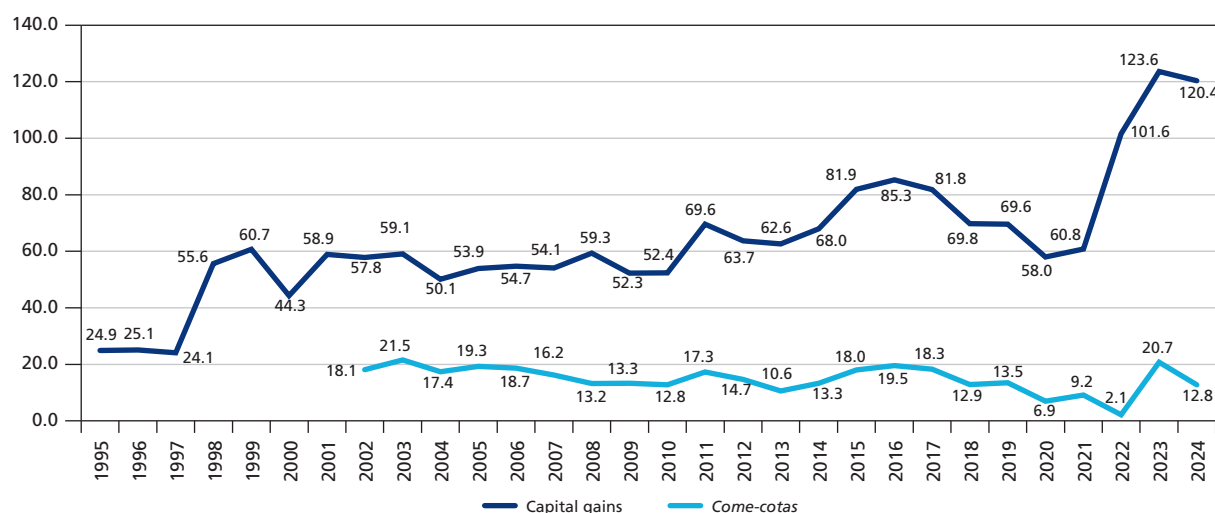
- 1) From 1995 to 1997, income for fixed-income funds was just taxed upon realization at a rate of 15%.
- 2) From 1998 to 2004, open-ended funds held by residents were taxed quarterly at 20% on an accrual basis, through a mechanism known as *come-cotas*.
- 3) From 2005 to 2015, the tax rate on open-ended funds was reduced to 15% and applied biannually.
- 4) Since 2015, dividends accrued from mutual funds, pensions funds and equity funds are subject to taxation. Mutual fund dividends are taxed on an accrual basis, while the others are taxed upon realization.
- 5) From 2017 to 2023, capital gains from the realization of private closed-ended funds were subject to a progressive tax rate ranging from 15% to 22.5%. However, the initial bracket was set at a high threshold (R\$ 5 million or approximately US\$ 1 million), making the 15% rate the most common.
- 6) Starting in 2024, private closed-ended funds and offshore trusts will be taxed on an accrual basis at a rate of 15%, similar to open-ended funds. Additionally, taxpayers will have the option to update their capital value up to December 2023, with this adjustment taxed at a reduced rate of 8%.

Figure 3 presents the revenues from the income tax on capital gains in Brazil from 1995 to 2024. It highlights revenues generated from the *come-cotas* since 1998 and the revenue impact of Law No. 14,754/2023.

FIGURE 3

Revenues from capital gains tax and *come-cotas*, inflation adjusted to December 2023

(In R\$ 1 billion)



Source: Brasil (2024).

Author's elaboration.

Obs.: 1. *Come-cotas* revenues from funds were estimated by subtracting the revenues from these funds collected in June and December (the months when *come-cotas* is applied) from the average capital gains revenues of the other months.

2. For 2024, capital gains tax revenues presented are those projected for 2024.

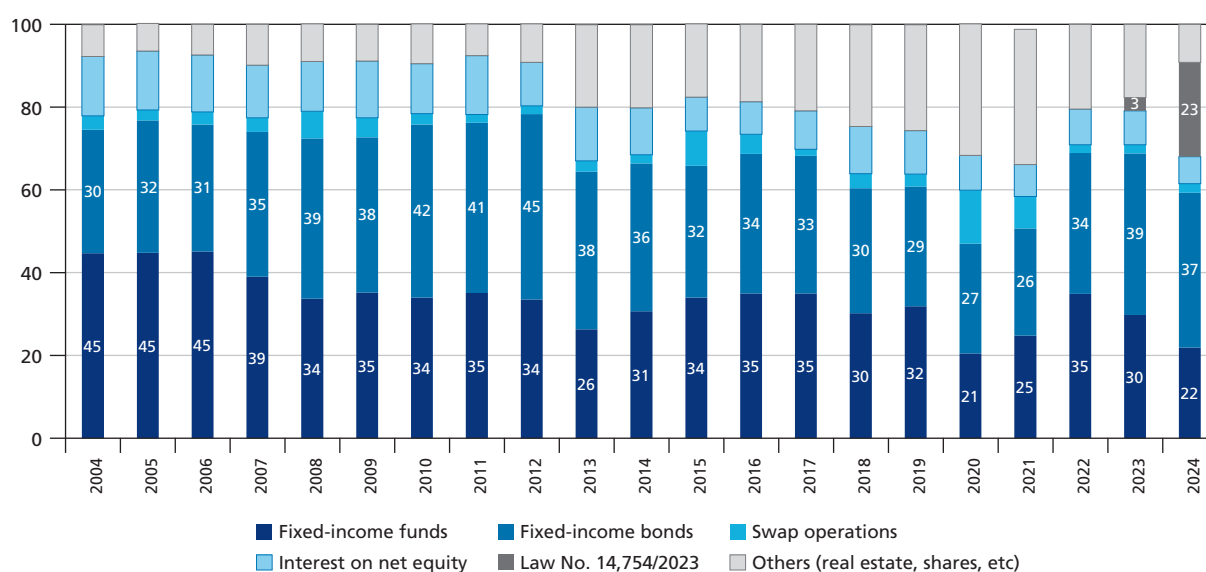
Figure 3 illustrates that in 1998, capital gains tax revenues increased 130.5% in real terms, following the introduction of the *come-cotas*. In 2015, capital gains total revenues rose by 20.5% due to IN No. 1,585/2015, in which revenues derived from *come-cotas* grew by 35% when dividends accrued on mutual funds (*fundos multimercados*) became taxed. In 2022, revenues from *come-cotas* surged by 131.8% since Brazil's annual prime rate (Tax Selic) rose from just 2% in January 2021 to 13.75% in August 2022. From January to November 2024, capital gains tax increased by 17.3% compared to the same period in 2023, reflecting the effects of Law No. 14,754/2023.

The proportion of revenues derived from *Come Cotas* in relation to total capital gains tax revenues averages 34% between 2002 and 2006 but steadily declined to 22% between 2008 and 2019. By 2024, it made up only 11% of capital gains tax revenues, attributed to the increasing popularity of directly holding government bonds.

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Figure 4 shows the revenues from various sources of capital gains from 2004 to 2024, including fixed-income open-ended funds, direct holding of fixed-income bonds, other funds and investments, swap operations, interest on net equity, income derived from Law No. 14,754/2023 and other sources (for example, capital gains tax on real estate, equity funds and stocks).

Figure 4 indicates that income from fixed-income assets accounted for approximately 75% of total capital gains tax revenues between 2004 and 2012. This percentage decreased to 65% between 2012 and 2023 and further reduced to 60% in 2024 due to the rise of revenues from other sources. Indeed, revenues generated due to Law No. 14,754/2023, amounted to R\$ 20.7 billion, representing 23% of total capital gains tax revenues collected from January to November 2024.

FIGURE 4**Capital gains tax revenues per source of income¹**

Source: Brasil (2024).

Author's elaboration.

Note: ¹ Total = 100.

Obs.: 1. Capital gains derived from offshore trusts, closed-end funds and the update of offshore assets, according to Law No. 14,754/2023.

2. For 2024, values are from January to November. In 2024, the collection of R\$ 20.7 billion derived by Law No. 14,754/2023 is divided into R\$ 13 billion from private closed-end funds and R\$ 7.7 billion from the update of offshore assets.

5 PROPOSALS TO REDUCE REGRESSIVITY: A TOP-UP INCOME TAX

5.1 Tax avoidance related to residence status

The enactment of Law No. 14,754/2023 was a way to close some existing loopholes in Brazil's tax system. Dividends have been tax-free since 1993, which is the main reason for income tax regressivity (Gobetti, 2024). From 1998 to 2023, very wealthy individuals could create private closed-end funds or offshore trusts to manage their capital with taxation only on realization. Less wealthy individuals biannually pay *come-cotas* on open-ended fixed income or mutual funds. The Law brought a new way to tax the capital of wealthy individuals in the same way as general citizens. However, Brazilian legislation still has loopholes that enable wealthy individuals to avoid the accrual taxation on their capital. As shown by section 2, the pensions funds are taxed only on realization under long-term tax rates, with a reduced rate of 10% if the redemption occurs for more than 10 years. Real Estate Funds (FII) and Agricultural Funds (Fiagro) are dividend-free funds that may have a higher dividend yield than fixed income and, despite the risks, investments can be flowed to them due to the Law No. 14,754/2023. Equity Funds (FIA) do not provide recurrent dividends, but their accrued dividends are totally taxed on realization, which may be an alternative for private closed-end funds.

However, the better strategy to avoid taxes and continue investing in Brazil is to change country of residence. If it is not classified as a "low-tax jurisdiction" according to the list of countries in RFB IN No. 1,037/2010 (Brasil, 2010), the investor can benefit from complete tax exemption on exclusive foreign investors' equity funds (which must consist of at least 85% in stocks and other securities) or fixed-income funds (which must contain at least 98% in government bonds). This study highlights six countries that are not considered tax havens by Brazilian legislation but do provide large tax incentives for new residents: Switzerland, Portugal, Uruguay, Spain, Italy, and Greece.

Switzerland provides a lump-sum tax agreement (Forfait Fiscal) available to expatriates and high-net-worth individuals who are not Swiss citizens or do not have a permanent residence. Instead of taxing expatriate's actual worldwide income and assets, the lump-sum tax amount is based on their living expenses and standard of living in Switzerland.

Portugal introduced the Non-Habitual Resident Regime – NHR (Regime Especial para Residentes não Habituais) in 2009, which was enhanced in 2020. The applicant must not have been a tax resident in Portugal in the five years prior to their application and must stay a minimum of 183 days in the year or have a permanent home in the country. Specifically, expatriates' capital income and gains are tax exempted.

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Uruguay also has a special tax regime for new residents: individuals who become tax residents after residing in another country may be exempt from income tax on foreign-source income for the first three years of residency in Uruguay.

In Spain, the Royal Decree No. 687/2005, called *Beckham Law* (footballer David Beckham became one of the first foreigners who applied), provides several incentives for wealthy individuals who decide to become a Spanish resident if they did not reside in the country in the five years prior to their application. They must have an employment under a contract or a relevant investment (Golden Visa Program). Spanish-sourced income is taxed at 24%, but foreign income is exempted.

In 2017, Italy introduced a “lump-sum tax” on foreign-sourced income for new residents. Prior to 2023, this value was 100,000 euros but was increased to 200,000 euros in 2024. Greece has a similar policy: in 2022, the “Non-Domiciled Tax Regime” was created with a 100,000 euros lump-sum tax on foreign-sourced income. In addition, Paraguay, which is a country that borders Brazil and residence of many Brazilian nationals, does not provide a specific incentive for new residents, but its income tax rate is only 10%.

Conclusively, it can be noted that providing residence incentives is a growing global trend after the pandemics, especially in European countries that can offer high quality of life for their residents. Wealthy Brazilian nationals can reside in these countries, manage companies and investments remotely and enjoy tax-free capital income derived from Brazil. Therefore, Brazil must have more strict rules of residency status. For example, cataloguing countries that provide such incentives and adding them in RFB IN No. 1,037/2010 (Brasil, 2010). They will be considered as residents of a “low-tax jurisdiction” for personal income tax rules.

5.2 Three approaches that can effectively tax wealthy Brazilians

This study has demonstrated that capital income is highly undertaxed compared to labor income. This section explores three proposals to effectively tax wealthy individuals whose capital income is the main component of their total income and, therefore bear a low effective tax rate. The first two proposals can be considered more classical, while the third is more contemporary, based on studies of OECD (2020) and Zucmann (2024).

The first proposal is to implement a tax on dividends, which are currently exempt in Brazil. This could be designed as a 15% final withholding tax, similar to that applied to other savings vehicles discussed on section 2. Alternatively, as argued by Gobetti (2024), dividends could be incorporated into a comprehensive income tax framework, allowing

for a partial deduction of the corporate income tax paid at the firm level, including those under favorable presumptive regimes,¹⁷ thereby enhancing horizontal progressivity. However, focusing solely on dividend taxation overlooks existing loopholes related to exempted or unrealized capital gains, as well as the low taxation of inheritances and donations, which are significant sources of income for the wealthiest individuals. Additionally, there are various exemptions, caps, and allowances that can benefit them, including exemptions for income derived from stock bonuses and fringe benefits given to company directors or executives, as well as income tax deductions for pension funds and uncapped medical allowances. Wealthy individuals are more likely to engage in tax planning strategies that exploit these legislative loopholes.

The second proposal is a more traditional approach: a net wealth tax. This could be implemented more easily since Brazil's Constitution already includes a provision (art. 153, VII) for a Tax on Large Fortunes (IGF). However, it has never been implemented despite two voting sessions in the National Congress, held in 2000 and 2008. Considering experiences of European countries that currently have or have previously implemented wealth taxes, it appears that wealth taxes require minimal exemptions and a relatively broad taxpayer base to yield significant revenue outcomes. Their main challenges involve the capital valuation and the lack of liquidity of certain assets. The tax would likely rely on self-declared values, purchase prices, or book values, which can often be outdated. Additionally, owner-occupied residences and family businesses may encounter liquidity and valuation difficulties and consequently have been historically exempted from wealth tax.

The third proposal is inspired by some elements and mechanisms of the OECD model for the minimum corporate income tax, the Pillar 2 (OECD, 2020), the report by Zucman (2024) defending a minimum tax on the world's billionaires, the proposal by Hebous et al. (2024) for taxing unrealized capital gains, and the study by Gobetti (2024) on individual income tax reform in Brazil. This study main proposal consists of a Top-Up Individual Income Tax (TUIIT) on wealthy taxpayers' total income, without applying any exemption, exclusion or reduction. TUIIT would be implemented through the following steps.

17. According to Gobetti (2024), although Brazil has a standard corporate income tax rate of 34%, 99% of registered companies operate under presumptive tax regimes with effective rates ranging from 6% to 14% of total turnover. He estimates that 70% of distributed dividends come from companies subject to these presumptive tax regimes.

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- 1) An analysis would be conducted of the effective individual income tax rates with mandatory social contributions across different income strata, using data from income tax declarations.
- 2) The highest effective tax rate among all strata would be identified as the “top-up” rate, with its corresponding income level serving as the tax threshold.
- 3) Consequently, all upper-income strata that are currently subjected to lower effective taxation would have their income tax liabilities “topped-up” by the new tax.

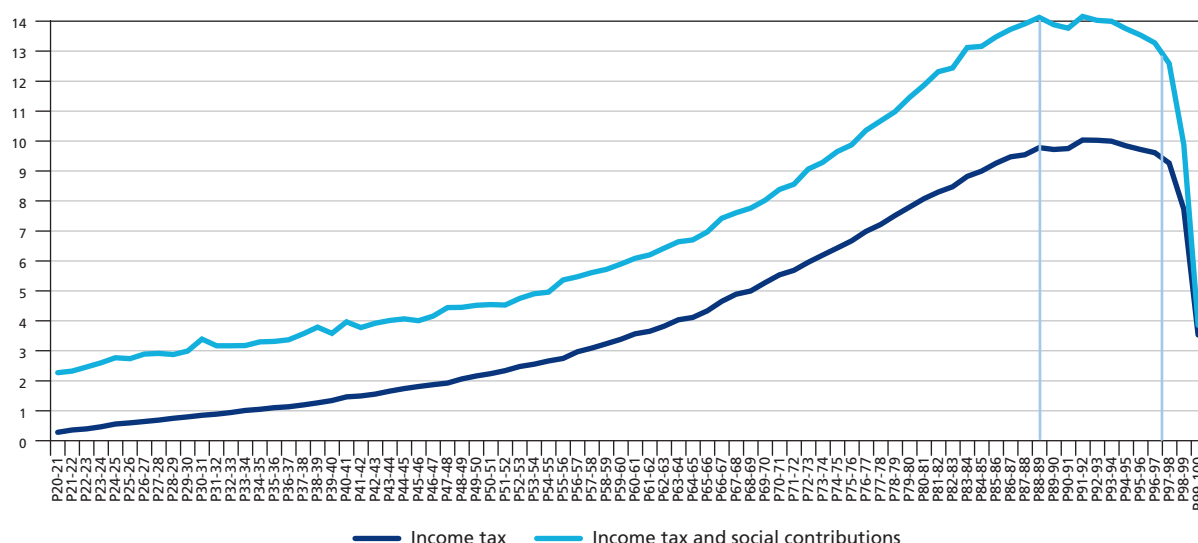
5.3 Designing a TUIT for Brazil

Unlike other articles that analyze income tax regressivity in Brazil using income tax declaration databases (Gobetti, 2024; Gobetti and Orair, 2016; Introíni et al., 2018), this study introduces an innovative approach by including mandatory social contributions as part of the effective taxation on income, given that both Brazil’s government and the OECD (2022b) classify social contributions as a tax. In Brazil, social contributions are mandatory for everyone; however, they are only partially linked to the benefits received and resemble a tax more than a “contribution” to a private fund. Additionally, this study considers income derived from inheritances and donations received within a year as part of taxpayers’ total income. It will be assumed that state governments effectively taxed 2% of inheritances and donations, and consequently 98% of their reported values will be included in the analysis.

Figure 5 illustrates the effective tax rate of taxpayers’ gross income (including inheritances and donations) in 2022, including income tax alone as well as combined with mandatory social contributions. The figure indicates that the top effective tax rate (without social contributions) is equal to 10%, and it is reached within the income percentiles P91 to P94. This rate slightly decreases to 9.3% in percentiles P97 to P98, and then falls more sharply, dropping to only 3.5% among the top 1%.

FIGURE 5

Effective tax rate on taxpayers' total income¹ between income strata (P20-P100) with and without social contributions (2022)
(In %)



Source: Brasil (2023a).

Author's elaboration.

Note: ¹ Total income includes inheritances and donations. The study establishes an effective taxation on inheritances and donations of 2%, considering the 4% statutory rate in state of São Paulo, but it can vary from 2% to 8% among states.

Regarding the combined taxation from income tax and mandatory social contributions,¹⁸ the highest effective tax rate is equal to 14% and it is observed within the income percentiles P86 to P95, beginning at a monthly income level of R\$ 14,343 (P86). This rate slightly decreases to 12.6% between percentiles P97 to P98, declines to 9.9% from P98 to P99 and then falls more sharply, dropping to only 3.9% among the top 1%.¹⁹ The reason for this decrease is that exempt capital income is much more prevalent among the wealthiest individuals, in contrast to labor income, which is subject to both income tax and capped social contributions. Based on the 2022 income tax database (Brasil, 2023a), the proposed TUIT rate would be set at 14% for the top 2% richest taxpayers. Figure 6 presents a scenario reflecting this proposal.

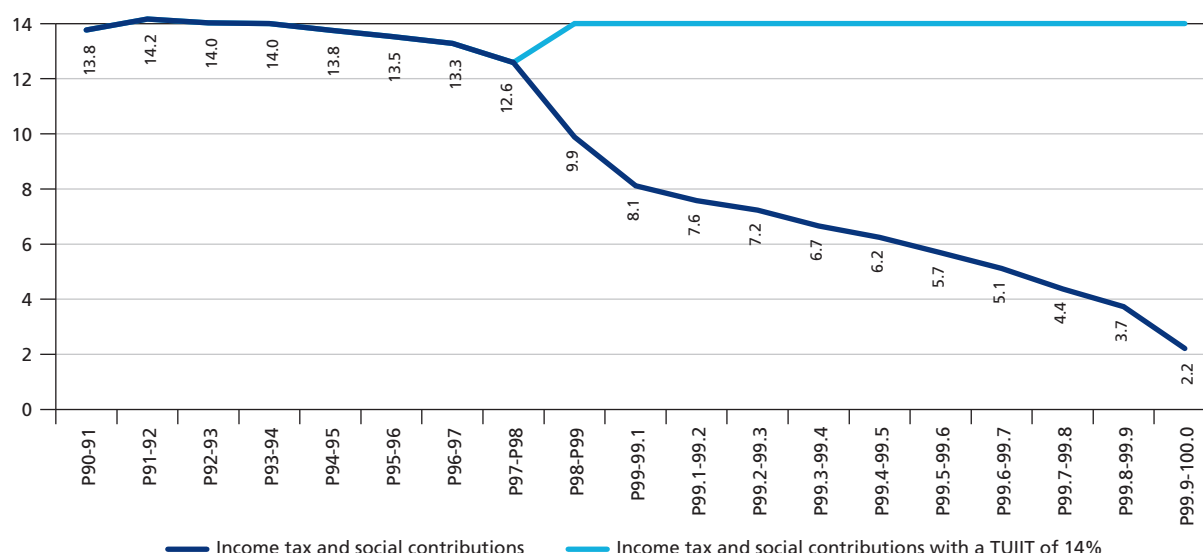
18. For private workers, the monthly cap for public pensions (INSS) is R\$ 7,786, with a maximum deductible contribution of R\$ 877, or 11%. For public workers, the cap is R\$ 44,008, with a top deductible contribution of R\$ 7,205, or 16%.

19. The effective tax rate (including social contributions) among the top 0.1% and 0.01% richest was 2.2% and 1.4%, respectively.

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FIGURE 6

Effective taxation with and without a 14% TUIT on the wealthiest 2% taxpayers
(In %)



Source: Brasil (2023a).
Author's elaboration.

5.3.1 Who are the top 2% richest taxpayers?

According to the official database of income tax declarations for 2022 (Brasil, 2023a), the top 2% richest taxpayers consist of 768,355 individuals with gross monthly income (including received inheritance and donations) higher than R\$ 52,504, taxable income above R\$ 28,534 and net wealth exceeding R\$ 2.14 million.²⁰ However, there is a limitation regarding wealth values in the database, as they may be outdated, often reflecting only the purchase price. This discrepancy highlights the significant gap between gross and taxable income, which tends to widen as total income increases, primarily due to the exemption on dividends. For instance, the top 0.5% richest taxpayers report a total income greater than R\$ 121,058 and a taxable income exceeding R\$ 50,680 (42% of total income).

Table 4 presents the average total income and net wealth values among the top 10% richest taxpayers, while table 5 details the sources of income, including labor and pensions, dividends and interest on net equity, taxable fixed-income, taxable capital gains, inheritances, and other sources.

20. Most bills in the National Congress regarding the Tax on Large Fortunes propose a threshold of R\$ 50 million, which is significantly higher than the reported wealth of the 98th income percentile.

TABLE 4**Gross income and net wealth values among the top 10% richest taxpayers (2022)**

Strata	Average value (R\$)				Share on total value (%)			
	Taxpayers	Monthly gross income	Effective tax rate	Net wealth	Strata	Taxpayers	Total income	Total net wealth
P90 – 95	1,920,838	22,732	14.0%	675,667	Top 10%	3,841,676	51.5	58.5
P95 – 98	1,152,503	37,202	13.1%	1,363,306	Top 5%	1,920,838	40.6	49.8
P98 – 99	384,168	60,745	9.9%	2,648,139	Top 2%	768,335	29.8	39.1
P99 – 99.5	192,084	93,960	7.2%	4,190,221	Top 1%	384,167	23.9	32.2
P99.5 – 99.9	153,667	195,498	4.7%	9,834,036	Top 0.5%	192,083	19.4	26.8
P99.9 – 99.99	34,575	752,523	3.0%	38,813,268	Top 0.1%	38,416	11.9	16.5
P99.99 – 100	3,841	5,542,811	1.4%	285,815,548	Top 0.01%	3,841	5.3	7.4

Source: Brasil (2023a).

Author's elaboration.

According to table 4, in 2022, the top 2% richest taxpayers accounted for 29.8% of total income and 39.1% of total net wealth. In contrast, the top 0.1%, those with approximately monthly gross income exceeding R\$ 384,501 and net wealth over R\$ 17.55 million, held 11.9% of total income and 16.5% of total net wealth.

Regarding income composition, table 5 indicates that labor remains the primary source of income up to the top 2% earners. Beyond that threshold, the share of labor income begins to decline, while exempt dividends significantly increase, reaching 50.7% among the top 0.1% richest taxpayers. In addition, other income sources, which include exempt capital gains, rents, and insurance payouts, comprised 15.7% of their total income.

TABLE 5**Gross income composition among the taxpayers' income strata (2022)**

(In %)

Source	P20 – 50 ¹	P50 – 90	P90 – 98	Top 2%	P98 – 99	P99 – 99.5	P99.5 – 99.9	Top 0.1%
Labor and pensions	83.3	79.7	62.9	19.8	43.4	30.5	17.3	5.6
Rural business	0.6	1.7	2.7	6.1	3.9	5.3	7.8	6.4
Dividends, INE and bonus ²	2.7	6.5	16.3	41.4	26.7	34.0	42.6	50.7
Taxable capital gains	0.0	0.1	0.7	5.6	1.6	2.4	3.9	9.8

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Source	P20 – 50 ¹	P50 – 90	P90 – 98	Top 2%	P98 – 99	P99 – 99.5	P99.5 – 99.9	Top 0.1%
Fixed-Income	1.2	2.4	4.5	7.9	6.5	7.4	8.3	8.4
Inheritances and donations	2.5	2.2	2.5	3.4	3.2	3.7	3.8	3.2
Others ¹	9.6	7.4	10.4	15.8	14.7	16.6	16.2	15.7
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Brasil (2023a).

Author's elaboration.

Notes: ¹ The strata P0-20 was excluded because there are some outliers.² INE – Interest on Net Equity and Bonus – Incorporation of Capital Reserves and Stock Bonuses.³ Among the top-richest, the most relevant sources of income reported as “others” by RFB database are “Exempted capital gains”, “Rents”, “Insurances”, and “Income from overseas”. This was verified by another RFB database, which does not provide the data divided into income strata.

5.3.2 A Top-up income tax: two mechanisms

In the first approach, given that a direct top-up tax on individual income may be deemed unconstitutional in Brazil, the Tax on Large Fortunes (IGF), as provisioned by the Constitution, could be implemented with a high rate and a low wealth threshold – such as a tax rate of 3%²¹ applied to a threshold of R\$ 2 million, *but* with a cap of 14% on total income. This would function as a TUIT for high earners, following a similar framework proposed by Zucman (2024), but with a broader base since it would not be restricted to billionaires.

Under this proposal, income tax, mandatory social contributions and inheritance tax²² effectively paid by taxpayers with at least R\$ 2 million in net wealth would be deductible from their 3% IGF, which would be capped at 14% of their total income. This approach aims to equalize taxation across high-income strata. However, the implementation faces a political challenge due to its low wealth threshold. The top 2% richest taxpayers are those with reported net wealth exceeding R\$ 2.14 million, which may be considered politically too low for a wealth tax threshold, even if adjustments to wealth valuation could raise this threshold. In addition, individuals with relatively higher income but lower reported wealth would benefit, which undermines horizontal equity.

The second approach would be more straightforward: it involves amending individual income tax legislation to introduce an additional top-up tax rate of 14% on total

21. It is expected that cases in which 3% of taxpayers' wealth exceeds 14% of their total income will be very rare.

22. This may encourage states to effectively tax inheritances since exemptions or reduction would be compensate by a higher TUIT.

income that exceeds the threshold for the top 2% richest taxpayers, which was R\$ 52,504 (or approximately R\$ 50,000) in 2022.²³ This total income includes inheritances, certain currently exempted capital gains, and other exempt or deductible income.

This proposal presents a challenge: if the threshold is set at R\$ 50,000, some individuals with total income slightly below this amount may experience an effective tax rate significantly lower than 14%, which undermines horizontal equity. Therefore, this proposal would benefit from implementing a final withholding tax on dividends, which may be a significant source of income for some of the top 5% richest taxpayers. This would enhance horizontal equity, with a TUIT serving as a residual tax applied to other currently exempt income of the top 2%, minimizing tax avoidance. The TUIT rate would be applied to the tax schedule starting from the income level of R\$ 50,000, as outlined in the proposed schedule shown in table 6.

Indeed, preliminary calculations estimate that a 14% TUIT has maximum potential of R\$ 127.5 billion in revenues if a withholding tax on dividends was not implemented, representing 44.6% of the individual income tax levied in 2022. However, this is an initial estimate of its maximum potential, and a more detailed assessment, including possible exclusions and arbitrage opportunities, will be necessary. Nonetheless, the potential for arbitrage is smaller compared to dividend taxation alone, as the proposal encompasses all sources of income. Additionally, it is essential to establish an “exit tax” for wealthy taxpayers who choose to change their residence status, similar to the United States, where an exit tax applies to unrealized capital gains in the event of a taxpayer changing citizenship.

TABLE 6

Proposed individual income tax schedule with a TUIT

Bracket (R\$)	Percentile	Rate
0 – 2,259	0-9	Exempted
2,259 – 2,827	9-18	7,5%
2,827 – 3,751	18-35	15.0%
3,751 – 4,665	35-47	22.5%
4,665 – 50,000	47-98	27.5%
Over 50,000	98-100	TUIT 14.0%

Author's elaboration.

23. It is important to note that not everyone earning more than R\$ 50,000 would be subject to TUIT. For instance, some high-earning public servants are subject to a 16% rate on social contributions, which likely results in an effective income taxation that exceeds 14%.

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5.4 Needed changes on the current income tax

Table 7 outlines the main needed changes in the tax treatment of each source of income. It is important to highlight that only individuals with a monthly income exceeding R\$ 50,000 would fall under the scope of the TUIT of 14%.

TABLE 7

Proposed changes in the current taxation with a TUIT on top 2% richest

Labor – Including all labor-related income and capping medical allowances	
Social contributions	Mandatory social contributions for private and public employees (INSS and RPPS) will continue to be deductible from TUIT.
Private pension funds	Income and unrealized capital gains annually accrued from open-ended pension funds will be taxed at a rate of 10%, which will be deductible from TUIT. The final reduced rate will apply only to redemptions made after 20 years; early redemptions will be subject to short-term rates. Additionally, contributions to private pension funds will remain deductible from income tax but will be capped at R\$ 68,653 per year (equivalent to 12% of the RPPS ceiling), instead of being limited to 12% of the taxpayer's total income.
Exempted labor income	All current exempted income related to labor, for example, scholarships, travel allowances, fringe benefits, and maintenance reimbursements, would be taxed by TUIT.
Medical Allowances	Unlimited deductions for medical expenses would be capped or replaced with a non-wastable tax credit, benefiting lower-income taxpayers.
Immovable properties – Taxing all exempted capital gains upon realization	
Rents	Rents derived from individuals, real estate companies or properties under real estate funds (FII) would be subject to a final withholding tax of 15%.
Capital gains	Capital gains of immovable properties should continue to be taxed upon realization but updated by inflation. The current exemption for real estate up to R\$ 440,000, and non-financial gains up to R\$ 35,000 must be included on TUIT tax base. Capital gains would no longer be deferred by making another residential purchase within six months, and mortgage interest would no longer increase property values for capital gains tax purposes.
Property tax	Urban and rural property taxes effectively paid may be deducted from TUIT.
Financial income – Withholding tax of 15% on all financial income and unrealized capital gains	
Dividends	All dividends from stocks, shares, private business and funds would be subject to a final 15% withholding tax.
Fixed income vehicles	Fixed-income funds and offshore trusts would continue to be taxed on an accrual basis at 15%. Currently exempt agricultural bonds (LCA & CRA) and Real Estate Bonds (LCI & CRI) would be subject to a 15% tax upon maturity or sale in the secondary market, similar to corporate and government bonds.
Funds: FII, Fiagro and FIP	The existing dividend exemption for certain funds, such as real estate funds (FII), agricultural funds (Fiagro), and infrastructure funds (FIP-IE), will be replaced by a final withholding tax of 15%. As their dividends will no longer be exempted, the capital gains tax rate will be reduced from 20% to 15%.
Stocks and securities	Unrealized capital gains on stocks and equity funds traded on <i>Bovespa</i> will incur a 15% final withholding tax (accrual basis). The current exemption for financial asset gains up to R\$ 20,000 will be included in the TUIT base. Asset values, however, would be updated by inflation.
Foreign investor funds	Exclusive foreign investor funds would be taxed at 15%, as final withholding.

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(Continued)

Inheritance and donations – Inclusion in taxable income with deduction of the State Inheritance Tax	
Inheritance and donations	Income from inheritances and donations received in a given year will be included in the TUIT tax base, with a deduction for inheritance taxes effectively paid at the state level. Capital gains accrued after death will be taxed without deferment.
Notary fees	Notary fees, which typically consist of a combination of flat amounts and percentages of inheritance values, often range from 1% to 2% of those values, discouraging property legalization among lower-income individuals. State governments must implement policies to simplify notary services and reduce the associated costs.

Author's elaboration.

6 CONCLUSION

The study outlines the different tax mechanisms among saving vehicles in Brazil. The taxation of open-ended fixed-income funds on an accrual basis (known as *come-cotas*) was an innovation introduced by the Brazilian government at the end of 1997 due to Asian crisis, which increased capital gains tax revenues by 131% in 1998. Twenty-five years later, in 2023, this was extended to private closed-end funds and offshore trusts, generating an additional R\$ 20.7 billion in revenue, which accounted for 23% of total capital gains tax revenues collected from January to November 2024. Therefore, *come-cotas* has minimized the distributive impacts of significant fluctuations in interest rates in Brazil.

Wealthy individuals, however, have found loopholes in the legislation and redirected their investments towards other vehicles to avoid accrual taxation. The study highlights that incentivized sectorial funds, – real estate funds and agricultural funds – serve as alternatives to avoid accrual taxation of capital gains while also providing tax-free dividends. Additionally, corporate and government bonds represent another option for investing in vehicles that are taxed only upon realization.

Today, the most advantageous option for redirecting investments from closed-end funds may be to invest in private pension funds. The study provides an example illustrating that a taxpayer with an annual income of R\$ 600,000 (the 98th percentile of taxpayers) will experience a negative capital taxation of -7.7% after 10 years of investing in a pension fund. This occurs because contributions can be deducted up to 12% of the taxpayer's total income, which primarily benefits high earners. Data from the 2023 income tax declarations reveals that 32% of the total reported deductions for pension funds came from the top 2% richest taxpayers. Open-ended pension funds offered by financial institutions in Brazil come with very flexible rules, allowing for capital redemption without age or time restrictions. Indeed, only long-term income tax rates are applied as incentives for saving over the long term. Therefore, reforming the taxation of open-ended pension funds should be a priority on the reform agenda, as they are likely not being utilized to provide age pensions but rather as regular low-taxed long-term investments.

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Income tax deductions for pension contributions should be capped at a certain value to prevent excessive benefits for the wealthiest taxpayers, while a 10% accrual-based taxation (*come-cotas*) should be implemented on pension funds.

Capital gains from stocks, shares, and equity funds (including offshore equity funds) are taxed only upon realization at 15%. Their distributed dividends are tax-free, primarily benefiting shareholders of Brazilian companies operating under the presumptive tax regimes (with an annual turnover of up to R\$ 79 million). The effective tax rate (ETR) in these presumptive regimes averages 10% of companies' profits, resulting in a very low overall taxation for shareholders in Brazil. Equity funds and mutual funds, however, are an exception. Since 2015, dividends accrued on mutual funds have been taxed on an accrual basis, whereas dividends from equity funds are taxed upon realization. This discrepancy encourages investors to pursue riskier direct investments in assets rather than opting for more stable and professionally managed investment funds.

On the other hand, similar to trends observed among OECD countries (OECD, 2018), rental properties held by individuals are overtaxed in Brazil. They are subject to stamp duties, local property tax, income tax on rental income, and capital gains tax upon sale. In addition, capital gains tax on real estate in Brazil includes various rules that can either reduce or expand the tax base. For instance, exemptions for properties valued up to R\$ 440,000, tax deferral associated with the subsequent purchase of a residence, and deductions on mortgage interest erode the tax base, while failure to adjust capital values for inflation or interest can increase it. Using a hypothetical example, the study compares the effective tax rate (ETR) on rental properties to that of other savings vehicles. Simulations estimated that capital taxation on rented properties held by individuals after ten years (16.9%) is 125% higher than that on financial assets (bonds, funds, shares etc.).

This study highlights the existing loopholes in Brazil's tax legislation that primarily benefit the wealthiest individuals, while analyzes the ETR of taxpayers according to their total income level, including social contributions paid by workers. The findings reveal that the ETR is progressive up to approximately 14% between percentiles 86 and 97. From there, it slightly decreases to 10% at percentiles 98 and 99 and sharply drops to 4% between percentiles 99 and 100. Consequently, the study proposes two alternatives to increase ETR among the wealthiest individuals, who receive mostly of their income from tax-free dividends, as well as other sources of exempt income. The proposal aims to maintain at least the ETR achieved on percentile 86, which is predominantly composed of labor income, at the uppermost income strata.

Incorporating workers' social contributions into the overall tax burden on income is an innovative approach that enhances the existing regressivity in total income taxation.

Brazil's pension system faces a significant deficit that needs to be addressed through other federal revenues, and workers' contributions are only partially correlated with the pensions they will receive in the future. Therefore, neglecting to consider capped social contributions when analyzing the distribution of direct taxes across income strata would overlook a critical factor contributing to regressivity.

The first proposal is to simply tax dividends; however, other loopholes in Brazil's tax legislation must also be addressed to prevent wealthy individuals from exploring other sources of exempt income. The second proposal aligns with the OECD's Pillar 2 approach, which emphasizes that the "effective rate is what really matters", and suggests a top-up corporate income tax for large multinationals that fall below the established minimum threshold of 15%, even when statutory tax rates are higher. Thus, the study proposes implementing a TUIT of 14% on the total income of taxpayers to ensure this minimum level among the wealthiest individuals, who currently carry a much lower ETR. This could be achieved by either reforming income tax legislation, which might face legal challenges, or by imposing a comprehensive wealth tax capped at 14% of individual income. The latter option may pose fewer legal risks, given that the Tax on Large Fortunes is provided for in Brazil's 1988 Constitution, although it has never been implemented.

Nevertheless, all these proposals are better applicable if that dividends were taxed at 15%, aligning their treatment with other sources of financial income to prevent ETR disparities among taxpayers for whom dividends are a significant source of income but fall below the stipulated TUIT threshold. Indeed, if dividends are taxed, TUIT would function more as a residual tax on exempt income to address the regressivity of income tax among the wealthiest individuals. If the proposed TUIT were implemented without a withholding tax on dividends, it would have a maximum potential of R\$ 127.5 billion in revenues, representing 44.6% of the individual income tax collected in 2022. Adjusting this figure for accumulated inflation and GDP growth, the potential for 2024 would increase to R\$ 145.6 billion. While this estimation represents a maximum potential, it is expected that the impact of arbitrage will be lower when the tax base encompasses total individual income rather than just dividends.

Given that Brazil offers significant tax incentives for foreign investors and that relocating one's country of residence may be easier for affluent individuals – especially with several European countries providing golden visas in exchange for lump-sum payments to replace income tax on offshore income – it is imperative to strengthen multilateral agreements and automatic exchange of information (AEOI) to effectively tax the

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wealthiest individuals. Additionally, the implementation of an exit tax – similar to that of the United States – for individuals who change their country of residence is essential.

From a political standpoint, it is essential to assure stakeholders that this proposal does not imply that all taxpayers' exempt income will be taxed. Instead, for the top 2% of the wealthiest individuals, a minimum effective tax rate (ETR) of 14% will be applied as a top-up on their total income. This ETR is similar for who earn between R\$ 14,023 and R\$ 38,550 (between percentiles 86 to 97). Consequently, individuals who already bear an ETR close to or exceeding this threshold will not be significantly impacted.

For future studies, two topics need to be addressed. First, it is essential to refine the estimate of TUIIT revenue potential. *Ceteris paribus*, using data from income tax declarations and maintaining the exemption for dividends, estimates suggest that TUIIT could generate R\$ 127.5 billion in revenues in 2022. However, it is crucial to consider how economic agents may respond to such changes. Second, further research is needed to enhance the proposal for taxing dividends in Brazil while taking into account the income tax paid at the corporate level. On one hand, the proposed withholding tax rate of 15% is relatively low; on the other hand, despite existing tax gaps and favorable presumptive regimes, the statutory corporate income tax rate of 34% in the standard regime is quite substantial. As noted by Gobetti (2024), 70% of distributed dividends in Brazil originate from private companies operating under presumptive tax regimes with ETRs on profits lower than 10%. Therefore, it is necessary to analyze the possibility of allowing certain deduction for income tax paid at the corporate level on dividend taxation, particularly if it is levied at a high rate or falls under a comprehensive income tax regime.

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