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The trusted solution in wealth structuring

## SMART funds

### A tax deferral and estate planning opportunity for Brazilian residents

#### The Brazilian tax system

Brazil operates a residence based tax system, so regardless of your citizenship or domicile, if you are resident in Brazil you will be subject to tax there.

In looking at how a SMART fund structure can help a Brazilian resident defer the incidence of tax, we are focussing on income tax and capital gains tax.

Income tax rates for individuals range from 0% to 27.5%, whilst the rate of tax on capital gains is 15%.

A capital gain for Brazilian tax purposes is the increase in value of an asset on sale from its cost, but can also include a reduction of a company's paid-up capital and redemption of an interest in an investment fund.

#### How do funds help?

Quite simply, by investing in a fund, an individual or family can consolidate their wealth into a single entity.

For tax purposes, the income and gains made by the fund are not treated as accruing to the individual. Income tax and capital gains tax will only be taxed on the individual if he or she receives a dividend from the fund, or makes a capital gain on a redemption of their interest, although it may be possible to mitigate this with appropriate planning.

Although there are similarities in its tax treatment with the way an offshore company is taxed, a fund can offer a way of reducing the amount of tax that is paid on profit distributions. There may also be stamp duty benefits in certain jurisdictions. The key is to ensure that the fund is structured properly, and Nerine will work closely with the client's tax advisers to create the most tax efficient structure.

#### What is a SMART fund, and what advantages does it offer?

The SMART Fund – the Special Mandate Alternative Regulatory Test Fund – is a fund established and licensed under the Bahamas' Investment Funds Act 2003. The regulatory approach to supervision of SMART funds is risk-based, and was specifically designed to offer private investors a much more flexible and lower cost licensed fund product.

There are a number of alternative "models" of SMART fund that investors can choose, but for a private individual or family, the most common model is the Model 004 SMART fund. The features of this model are:

- No offering memorandum is required – a term sheet is optional, but not mandatory
- No more than five individual investors

- Operates as a private investment company
- Subject to an annual certification to the Securities Commission
- Investors can waive requirement for an annual audit
- Can be set up as a segregated account company, allowing segregation of assets into separate cells
- Can have an ISIN Code and Bloomberg page

In essence, the aim of the SMART fund regime is to offer the benefits of a licensed fund in a well regulated environment, but with a fraction of the regulatory restrictions that are necessary for traditional funds.

Where a more stringent regime is preferred, often that is regarded as “best advice” for certain tax-driven structures, then Nerine can offer a fully regulated service from the BVI.

## Ownership of the fund

Whilst the client or members of the family can invest directly into a SMART fund, there are a number of reasons to consider using alternative ownership structures:

- The limit of 5 investors into a Model 004 fund may not suit the family circumstances
- Complexities and possible tax consequences involved in transferring units to other family members
- Probate and succession issues on death of the investor and possible tax consequences
- Brazil’s forced heirship rules will dictate to whom, and in what proportions, the client’s interest in the fund will pass on death.

We would recommend that a discretionary, irrevocable trust is used as the vehicle to invest into the fund. This avoids the issues noted above, and in our understanding, does not lead to any additional tax issues. Beneficiaries will be taxed on what they receive from the trust. The client’s tax advisers will be able to discuss the merits and tax implications and work with Nerine to provide the most appropriate structure. For more information on the use of trusts, please ask for our International Trusts factsheet.