PROVISIONAL MEASURE NO. 806/2017 AND THE IMPACTS ON INVESTMENT FUNDS.

Brazil is facing an economic scenario of fiscal crisis, leading the Federal Government to devote its efforts in order to mitigate the severe consequences of this situation. What happens is that the measures taken in times of crisis are not the same as those adopted in times of stability, which alters the activity of the Executive Branch, demanding the adoption of actions to minimize the impact of the public deficit, both the one calculated by the Central Bank and that by the Treasury. The picture is even more aggravated when the Executive Branch itself and the Legislative and Branch are hit by political crises.

Thus, the measures that the Executive and the Legislative Branch have taken to tackle the economic crisis unfortunately lead to an increase in the tax burden, which is very often carried out in the last minutes of the year. The Government, increasingly pressed by the need for funds, has been adopting attitudes, however, that exceed constitutional limits. This is the example of Provisional Measure no. 806, published on December 30, 2017, which addresses the income tax on closed-end investment funds.

Such funds have an important particularity: they do not accept redemption before the date previously set to mature, as determined in article 4 of Instruction no. 555 of the Brazilian Securities and Exchange Commission – CVM – published on December 17, 2014. In other words, the fund unitholders may only recover the investment money at the end of the term established by the fund in a general meeting.

According to the new model proposed, the taxes will be levied on the positive difference between the book value of the fund's share on May 31, 2018, which includes the earnings allocated to each unitholder and the respective acquisition cost, adjusted for the amortization throughout the fund's term.

As of June 1, 2018, the charge will occur every half year, on the last business days of May and November of each year, at the time of amortization, of the redemption of shares on account of the end of the term or expiration of the fund. The tax basis will be the same as that set for the levy on May 31: the positive

difference between the book value of the share, including the earnings allocated to each unitholder added to the fund in the calculation period, and its acquisition cost, adjusted for the amortization, or the share value; here, however, on the date of the latest levy of the tax.

The text also includes the case of a spin-off, takeover, merger or transformation of investment funds, in which the earnings equivalent to the positive difference between the book value of the share, including the income allocated to each unitholder, will be deemed to have been paid or credited to the unitholders on the date of any of the abovementioned events, and the respective acquisition cost deemed adjusted for the amortization, or the share value on the date of the latest levy of the tax.

The tax management will be carried out by the administrator of the fund, also responsible for withholding the income tax.

The fiscal tension of the Executive Branch is so clear that leads it to enact a provisional measure with a number of violations of the national tax system, mainly the Federal Constitution, as shown further in this article.

The Constitution of the Republic expressly prohibits provisional measures from seeking the withholding or sequestration of financial assets. This is what article 62, in its paragraph 1, item II, sets forth. Furthermore, the use of provisional measures is only possible in cases of relevance and urgency, emphasizing that they are cumulative and indispensable requirements, since they are also expressed in the heading of article 62.

In this sense, the taxable event of the Income Tax is provided for in the Federal Constitution, article 153, III, and in article 43 of the National Tax Code – a statutory law received as complementary law – which established that the event capable of generating the tax liability to pay the mentioned tax is the acquisition of economic or legal availability of income or earnings. Well then, if the closed-end investment fund, tautologically, as it is closed, does not allow the release of the invested amount nor of the allocated income, there is no economic and legal availability, for which reason there is no taxable event. Thus, the provisional measure cannot change a complementary law in order to bring a new levy event.

The equivalence between closed and open-end funds, for income tax withholding purposes, does not justify the maintenance of these two different legal models of investment. Quid juris, what is the stimulus for an investor to maintain a given capital and its resulting effects stalled for a long period of time if the respective taxation will be the same as that provided for the open-end investment funds, which allow the redemption of shares?

As already mentioned, the event capable of generating the liability to pay the Income Tax is the acquisition of legal or economic availability of income or earnings. What has not been clarified is that said availability still depends on an element

recognized by the Federal Supreme Court as indispensable: equity increase. That is, it is only possible for the State to charge the Income Tax in cases in which the taxpayer has obtained equity gain and has economic and legal availability thereon. We do not see such elements in the model proposed by Provisional Measure no. 806/2017, since, in the cases of closed-end funds, this increase clearly occurs at the time of amortization or redemption of the shares, which makes taxation impossible. It should be repeated that the close-end or condominium funds, as a rule, only allow the redemption at the end of the contracted term or at the expiration of the fund, for whatever legally accepted reason, therefore legitimizing the imposition of the income tax. In other words, there will only be economic availability at the time of redemption, and only at such time will it be possible to verify whether there was any equity increase or decrease. The text of the new model presupposes such elements on the last business day of May and November. There is no taxation on presuppositions, pursuant to article 116 of the National Tax Code.

To tax a supposition is an act that violates the basic principles of Tax Law, from legality to contribution capacity, fiscal justice, and briefly addressing the prohibition of seizures. In addition, such an act has even more worrying impacts on the financial and investment markets. The reason is that the State should encourage the maintenance of wealth in the country, and this encouragement is a direct consequence not only of the application of constitutional parameters, but also of fully acknowledged economic concepts. By taxing closed-end investment funds in advance, before verifying whether there was any available wealth, the State produces a different effect and provides a clear deterrence to the investor, since the latter can suffer economic loss, at the time of the redemption, with an income that was not earned.

What's worse: the rule does not provide for cases of rebate of any losses incurred in the period expected for the expiration or redemption of the closed-end and condominium funds, implying constitutional violations, mainly seizure and the failure to abide by the contribution capacity. In practical terms, the losses incurred in the subsequent periods are absolutely "forgotten", and the unitholder may, at the end, incur losses and have paid the income tax, under the withholding method. That is to say, the advance feature, which is inherent to the withholding income tax, is totally distorted, since there is no certainty, also considering the current economic situation, that the unitholder will eventually obtain any gain.

In turn, legal certainty is a vector related to the stability of the Public Administration in its relations with the population. Society needs to believe that the State will follow the rules and observe the law in order to conciliate life in common. In the case of the mentioned Provisional Measure, the reduction of the distortions between investment in investment funds and increase in federal revenues is discussed. The investor, when investing their assets in closed-end investment fund

shares, believed that taxation would be imposed thereon at the closing or amortization of the fund, whether due to time or to the expiration of the fund itself. This agreement is based on legal rules, such as the regulations made by the State, and more specifically, by the Brazilian Securities and Exchange Commission - an autonomous government agency tied to the Ministry of Treasury. Along the same lines, the taxation of the Income Tax related to these funds is regulated by various laws, such as the National Tax Code.

Likewise, even if considering there is a legal possibility of taxation, the principle of legal certainty is overlapped by the principle of non-retroactivity, that is, the State, in order to achieve them, cannot cause new legal provisions to have effect in facts or acts already performed pursuant to the previous law. The reason is that non-retroactivity is linked to the principle of non-surprise, which prohibits new rules from applying to acts already practiced and the new norm from being applied to new cases, subject to a reasonable period of cognizance and adaptation for its validity. Thus, Provisional Measure no. 806/2017, from this aspect, when changing the taxation of the Income Tax on closed-end or condominium Funds already formed, irrefutably violates the confidence in the legal immutability that the investor had before becoming a unitholder, and it is evident to see the breach of the principles mentioned above, leaving the investor at a point of instability in which they cannot clearly decide what to do, what to invest in, how much to invest, and how redemption will take place.

Considering that all branches of law intersect, regardless of their specificities, it is clear that, as already recognized by private law, there will be the insertion or acknowledgment of a minimal non-retroactivity, which, in synthesis, is a norm in order to attain a fact or an act which began under a specific legislation, but has not yet been substantially amended by subsequent legislation.

Therefore, the system sought by the Provisional Measure is unconstitutional and should not produce concrete effects, otherwise, it will overlap the principles of taxation mentioned above and the precious vector of the normative order: legal certainty.

To have an idea of the seriousness of this Provisional Measure, it is necessary to broaden the view of the consequences. In case the State changes the rules of investment funds as it sees fit, what will the investor do when they consider investing their capital in investment funds? Will they choose another investment? But which investment will they choose? Will their new investment be subject to State changes over time? The investor's answer is uncertain. Moreover, still in the extended aspect of the consequences of the legal uncertainty in the various sectors of the economy, uncertainties of this sort result in a cascade effect: reduction of economic activity (due to the absence of stable capital for investment), implying a reduction in tax collection and, consequently, public investments that are implicit in

activities of the State, mainly the essential ones (health, education, basic sanitation, etc.), which undoubtedly represent a negative impact on the population. Furthermore, we must consider the impacts of this situation on the notorious political instability.

The inevitable conclusion is the unconstitutionality and illegality of the Provisional Measure, owing to the violation of the maximum constitutional and legal parameters. Thus, the investor and the unitholder can, with clear and strong arguments, object in court to the possible effects of the new rule for the compliance with tax law vectors, by correctly applying the constitutional principles, especially legal certainty.