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From complexity to execution

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Brazil's Income Tax Reform: 10% Withholding income tax on Profits and Dividends, Exemption range increase for Income Tax and "Minimum Taxation" for certain Investors

On March 18, 2025, the Federal Government submitted to the House of Representatives the Bill No. 1,087/2025, which proposes relevant changes to the Income Tax for individuals (IRPF) and for non-resident individuals and legal entities that invest in Brazil.

At first glance, the Government's proposal would only amend the Individual Income Tax (IRPF) rules, as from 2026, increasing the IRPF "exemption" range and introducing a Minimum Income Tax (IRPFM) for the so called "high-income" individuals domiciled in Brazil. However, it also introduced a new WHT on profit and dividend distributions to foreign investors, subject to subsequent assessment upon the annual individual income tax return.

Due to an urgency request, the Bill must be assessed by the Lower House within a 45-day period, as from March 19, 2025. Subsequently, it will be forwarded for further considerations by the Federal Senate.

Please find below the main changes provided for in Bill No. 1,087/2025.

New phase of the income tax reform

We are facing a new phase of the "segmented income tax reform" in Brazil, first addressed in our Tax Intelligence (TI) No. 22. An example of this is the various changes recently introduced in our income taxation rules, including the following:

- transfer pricing: Law No. 14,596/2023, effective as from 2024 (early adoption allowed for 2023);
- exclusive investment funds and investments abroad: Law No. 14,754/2023. As from 2024, individuals domiciled in Brazil have to deal with the new rules for "come-cotas" taxation of closed-end funds and the taxation of income from abroad;
- tax credit for investment subsidy: Law No. 14,789/2023. Significant change in the tax treatment of subsidies as from 2024;
- new rules for Interest on Net Equity (JCP): Law No. 14,789/2023. As from 2024, new rules reduced the JCP calculation basis, as well as the payment limits; and
- Additional Social Contribution on Net Income (CSLL) (equivalent to the Pillar 2 QDMTT): Law No. 15,079/2024. This rule came into effect in 2025 (see TI No. 42).

Therefore, the recently filed Bill, which aims to introduce a new 10% tax on the distribution of profits and dividends, uncovers another phase of such phased income tax reform in Brazil. It now includes aspects related to both legal entities and individuals.

Aspects out of the Bill No. 1,087/2025 scope

Despite the need for regulation on various issues concerning income taxation, especially with regard to legal entities, the Bill did not address relevant and still pending matters, such as:

- issues related to the amortization of tax goodwill and the enhancement of incentivized accelerated depreciation;
- creation of tax consolidation rules for economic groups;
- enhancement of Interest on Net Equity - INE ("JCP") aiming to adapt this mechanism to international standards (allowance for corporate equity) and avoiding its inadvertent treatment as a "hybrid instrument";
- reconsideration of federal and subnational incentives and subsidies in light of the Additional CSLL (Pillar 2), especially incentives for R&D (research and development);
- convergence of Universal Taxation rules (TBU) to Controlled Foreign Companies (CFC) standards with full alignment to Pillar 2, as provided for in Law No. 15,079/2024.

Furthermore, the new taxation of dividends was not regulated in the same manner as Bill No. 2,337/2021. Thus in Bill No. 1,087/2025 there is a specific treatment aimed at individual beneficiaries domiciled in Brazil and another for individuals or legal entities domiciled abroad, considering a reduction factor in certain circumstances.

“Exemption” of Income Tax for individuals (IRPF)

Monthly and Annual Taxation

From a strictly technical perspective, the Bill proposes a new table with reduction factors for the due IRPF instead of an exemption. Thus, if the Bill is approved, the original progressive table will remain in effect. However, it will consider new reduction factors, applicable as from 2026.

Monthly income	Discount (%)	Full tax (no discount)	Final tax due (R$)
R$ 5,000.00	**100%**	R$ 312.89	R$ 0
R$ 5,500.00	**75%**	R$ 436.79	R$ 202.13
R$ 6,000.00	**50%**	R$ 574.29	R$ 417.85
R$ 6,500.00	**25%**	R$ 711.79	R$ 633.57
R$ 7,000.00	**0**	R$ 849.29	R$ 849.29

In summary, the reduction exclusively applies to those who earn an annual taxable income below R$ 84,000(R$ 7,000 per month). For individuals who earn amounts above this threshold, the progressive table will continue to apply, without monetary correction and without any interference from the new reduction factors.

Minimum Income Tax (IRPFM)

Monthly taxation: profits and dividends exceeding R$ 50,000 per month

Starting from January 2026, a monthly taxation by the IRPFM at a **rate of 10%** is expected for individuals domiciled in Brazil who earn, within a month, profits and dividends from a legal entity in an amount exceeding R$ 50,000. The new tax will be **withheld** by the paying company, with no deductions allowed from the tax base.

The Bill also determines that if the same paying source carries out more than one payment to the same individual within the same month, the amount withheld for the IRPFM must be recalculated to consider the total amounts within that month.

It is important to stress that the amounts withheld for the monthly IRPFM can be deducted from the annual IRPFM. Thus, it is an anticipation (and not an exclusive withholding income tax).

Annual Taxation: income exceeding R$ 600,000 per year

According to the Bill, as from 2026, individuals domiciled in Brazil will be subject to a minimum withholding tax (IRPFM) at a **rate of <u>up to</u> 10%** if they earn income exceeding R$ 600,000 per year.

For the purposes of framing this income range, even income subject to exclusive taxation and those exempt or taxed at a zero rate must be included, **except for**:

- capital gains, except for stock exchange transactions;
- income cumulatively earned and subject to exclusive withholding income tax (including exempt income); and
- inheritance advance or inheritance.

The rate will be progressive, **ranging from 2.5% to 10%**, according to the table below:

Annual income	Minimum rate calculation	Final rate (%)	Minimum tax due
R$ 600,000.00	(600,000 – 600,000) /600,000 – 10%	**0%**	R$ 0
R$ 750,000.00	(750,000 – 600.000) /600,000 – 10%	**2,5%**	R$ 18,750.00
R$ 900,000.00	(900,000 – 600,000) /600,000 – 10%	**5%**	R$ 45,000.00
R$ 1,050,000.00	(1,050,000 – 600,000) /600,000 – 10%	**7,5%**	R$ 78,750.00
R$ 1,200,000.00	1,200,000 – 600,000) /600,000 – 10%	**10%**	R$ 120,000.00

Exclusions of annual IRPFM tax computations

What makes the IRPFM an effective taxation on profits and dividends is the relevance of the exclusions from its tax computations, namely:

- savings income;
- various indemnities, except for lost profits;
- retirement income in specific exempt cases; and
- income from exempt or zero-rate taxed securities, except for income from equity and other corporate participations.

Taxation of profits or dividends distribution to abroad

As for profits or dividends paid, credited, delivered, employed, or remitted to **individuals or legal entities** abroad, regardless of the amount and the jurisdiction of the recipient, it will be subject to the withholding income tax (IRRF) at a rate of 10%, with no provision for the exclusion of profits accumulated until December 31, 2025, and without a corresponding reduction in the Corporate Income Tax (IRPJ) or CSLL levied on such profits.

In other words, the new 10% IRRF would apply to the "accumulated" profits already taxed by the nominal IRPJ and CSLL rates, raising the nominal Brazilian CIT rates on multinational profits to 40.6% (or 46%-50.5% for Financial Institutions).

It should be noted that Brazilian international treaties historically allowed for a rate of up to 15% and more recently authorized the proposed rate of 10%. Thus, there are indications that the network of treaties in force will not limit the referred IRRF taxation.

Reductor or credit

There is a provision that determines that if the sum of the effective tax rate on the profits of the legal entity, combined with the effective rate of the IRPFM exceeds the combined IRPJ/CSL nominal rates (34%, 40%, or 45%, as the case may be), a reduction of the IRPFM must be established by the Executive Branch, to be regulated, applicable to high-income individuals domiciled in Brazil.

Furthermore, the Executive Branch will grant the beneficiary domiciled abroad a "credit" in the form of regulation in case of effective taxation exceeding the nominal rates, considering the same rationale attributed to individuals domiciled in Brazil. It is worth noting that, for foreign investors, the new minimum taxation exceeds the Additional CSLL (Pillar 2) of 15% and effectively establishes a new 25% "floor", subject to a cap of 34%, 40%, or 45% in effective terms.

Takeaways

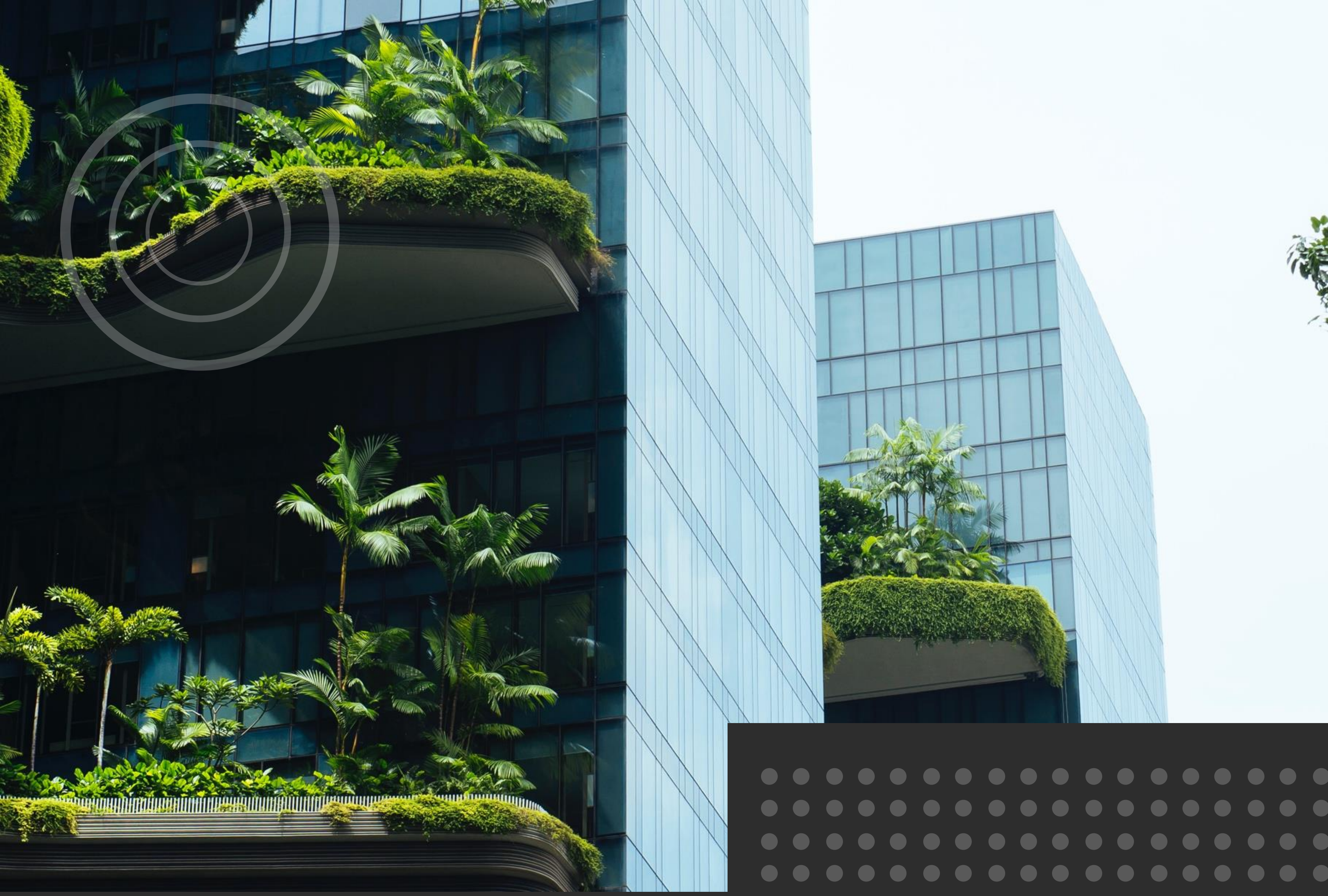
The Federal Government's proposal is likely to be amended during the legislative process, as it possibly burdens productive investment, especially direct foreign investment in Brazil.

The complexity and inconsistencies, related to the verification of the effective CIT (IRPJ and CSLL) taxation and to the assessment of the potential application of the reducer/IRPFM credit, are likely to increase the compliance costs. Besides the complexity of calculating the effective rate (including situations involving investments in companies where there is no corporate control), the 10% withholding mechanism subject to subsequent calculation of the reducer/credit, with the inherent challenges of its reimbursement, represents an impact on the investors' cash flow. Therefore, it should be carefully observed, including possible discussions that may lead to litigation.

Furthermore, although the Government's position that the Bill is tax neutral, having in mind they are granting a credit/reduction conditioned to the company taxation after the 10% withholding tax (IRPFM or IRRF), actually no effective tax rates would correspond to the nominal ones. Therefore, in fact, the introduction of the new IRPFM and the 10% WHT on profits and dividends distributions to abroad, with the challenges inherent to its refund, indeed is likely to represent a relevant increase in the Brazilian tax burden on productive investments.

Additionally, it is worth remembering that the Bill wording, as proposed by the Federal Government, may result in the taxation of dividends whose respective profits were earned before the potential new law comes into effect.

Various enhancements are necessary to mitigate the adverse effects of the new proposal. Companies are recommended to engage in the legislative process through representative entities, and in parallel, to conduct tax modeling exercises and treasury planning, with a review of their investment and repatriation plans.



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