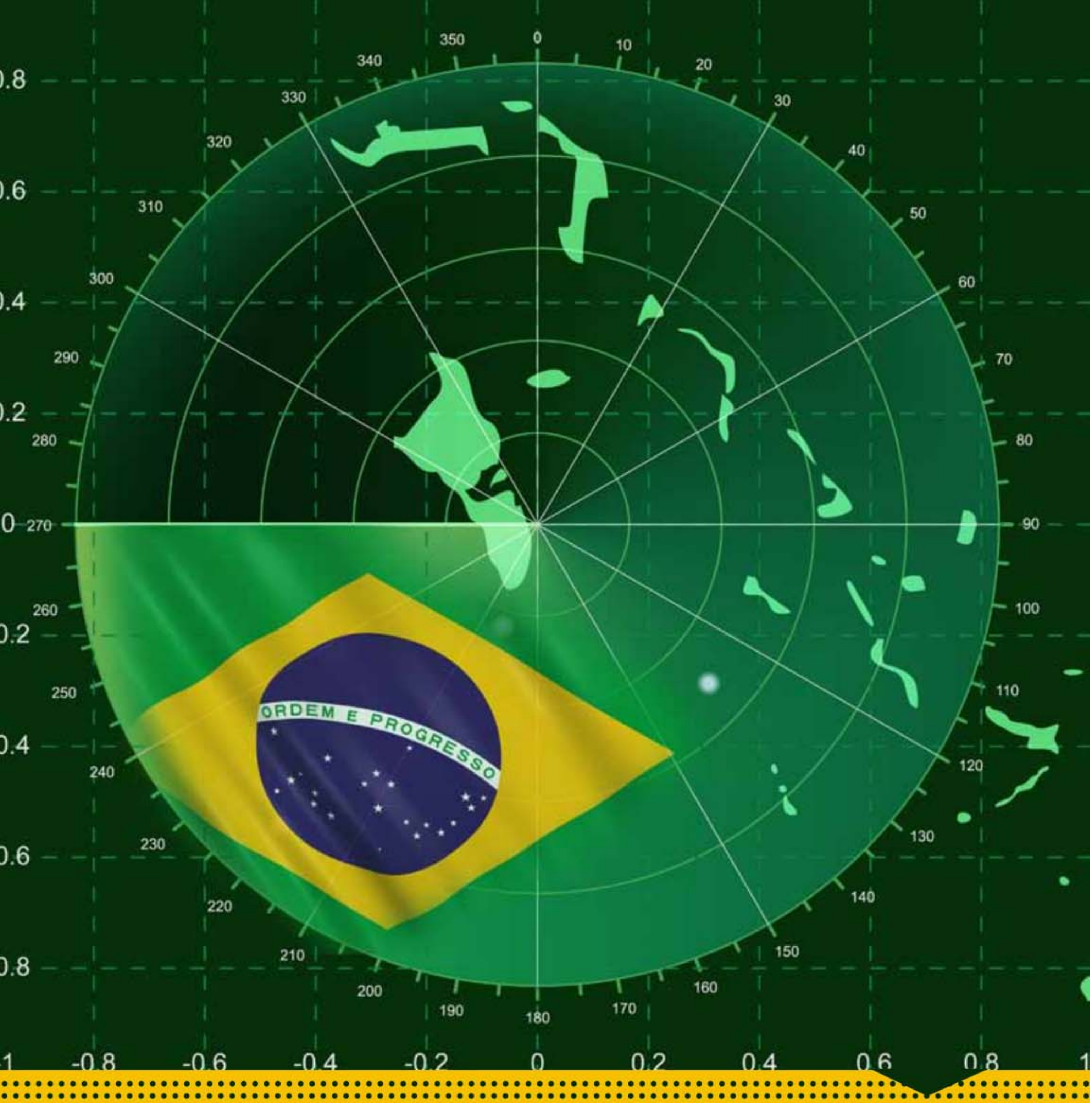

The Bahamas on the radar of Brazilian Investors

By Ana Cecília Manente & Daniela Rios

The Bahamas has become an attractive new alternative for investments made abroad by high net worth individuals, as well as Brazilian based investment funds and portfolio managers.

In the past, Brazilian regulation practically banned investments abroad for Brazilian investment funds, and there were very few exceptions allowed. In fact, before January of this year, The Bahamas was an off limits jurisdiction to Brazilian investment funds. After changes in 2007 and 2008 to Normative Ruling no. 409, dated August 18, 2004, issued by the CVM (Comissão de Valores Mobiliários – Brazilian Securities Commission)[1], the rules were made significantly more flexible. Investments abroad by Brazilian investment funds were allowed as long as the financial assets, object of the foreign investment, were either:

(a) admitted to negotiation in a stock exchange or commodities and futures exchange, or registered in the registry, custody or financial liquidation systems duly authorized in their original countries and supervised by a recognized local authority; or

(b) had their existence assured by the custodian of the Brazilian fund, who must hire, specifically for this purpose, third parties duly authorized for such activity of custody in signatory countries of the Treaty of Asunción (Mercosur) or in other jurisdictions, as long as, in such case, the third parties are supervised by a recognized local authority.

CVM considers a local authority as recognized either when it has signed a mutual cooperation agreement that allows the exchange of information for operations performed in the markets supervised by it, or if such authority is a signatory to the Multilateral Memorandum of Understanding (MMoU) of the International Organization of Securities Commissions – IOSCO. In January of this year, The Bahamas became a full signatory ("status A") of the IOSCO MMoU, allowing the jurisdiction to become an investment option for Brazilian investment funds under the applicable CVM regulation.

Having surpassed this significant milestone, Brazilians now turn their heads towards The Bahamas and begin to assess the characteristics of the jurisdiction as an alternative for offshore structuring. It should be noted that The Bahamas is shortlisted as a tax haven by Brazilian tax authorities, which could in certain circumstances bring adverse tax implications to the involved parties. With proper structures, however, there will be no negative tax consequences for Brazilian funds or resident individuals investing in tax havens.

Brazilian individuals that invest directly in a fund abroad, regardless of the place of incorporation of the fund, are taxed for the income received from the fund. If the income is received as dividends, the income taxation will be levied at progressive rates varying from zero up to 27.5%; but very easily reaching the 27.5%, since brackets are extremely compressed (this same taxation applies to dividends paid to Brazilian by foreign companies). In the case of sale or redemption of the investment, the taxation will be of 15% over the capital gain. Additionally, Brazilian individuals, when investing abroad directly, will have to pay a tax (IOF) over the conversion into foreign currency of amounts being remitted abroad as well as over the amounts being sent back to Brazil, at the rate of 0.38%.

On the other hand, Brazilian individuals that invest indirectly in a fund abroad by means of investing in a Brazilian fund that in turn invests in a fund abroad can be subject to a more favorable or deferred taxation. Specifically, when a Brazilian individual invests in a fund abroad through a Brazilian fund, the taxation of the Brazilian individual will vary from 22.5% to 15% over income received from the Brazilian fund, depending on the composition of its portfolio and the amount of time during which the individual holds the investment. For Brazilian funds investing abroad, the foreign exchange tax mentioned above is reduced to zero. Also, a Brazilian fund is not taxed on the returns received from the offshore fund, and it can reinvest all amounts received, adjourning the delivery of the return to the investor - and, thus, the related Brazilian taxation. The taxes due by the individual investor will be deferred until his investment in the local fund is redeemed (in total or in part) or sold.

Considering that the taxation mentioned above does not change if the foreign investment is in a tax haven or not, the fact that a particular jurisdiction is shortlisted in Brazil as a tax haven should not be a major concern for Brazilian high net worth individuals, investment funds and managers when opting for a jurisdiction to set up an off-shore fund. What should be evaluated, actually, are economic and political stability, the legal system and regulatory framework of the jurisdiction under consideration, as well as the available infrastructure (good telecommunications, for example), and quality of service providers; effectively, the costs involved, the flexibility allowed and the trustworthiness the jurisdiction offers.

Among the options offered by The Bahamas are SMART (Specific Mandate Alternative Regulatory Test) Funds, which stand out with advantages such flexibility in structuring, expedited approvals, streamlined reporting, and low costs. There are seven distinct templates of SMART Funds that vary in characteristics such as number of investors, risk profile, minimum subscription values, requirement for auditing and the initial incorporation documents – with some models not requiring a term sheet or offering memorandum to be set up.

One of the models of SMART Funds recently created that can be particularly useful, and with characteristics that can give Brazilian investors an ideal product for their needs in wealth management, is the SMART Fund 007, specifically tailored for "super-qualified investors". The SMF007 can be set up through a simple term sheet instead of a full offering memorandum and allows the flexibility of having from one single investor to up to fifty investors, with each making a minimum initial subscription of US$500,000. The SMF007 also permits a significant decrease in maintenance costs since it is possible to waive the auditing of the financial statements, if all investors agree. Also, the SMART Fund 007 does not require an administrator, allowing the operators to administrate it directly.

The Brazilian fund industry now has the opportunity to start testing these funds. The regulatory framework recently created by The Bahamas seems adequate to reduce bureaucracy to a minimum without compromising the credibility, transparency and reliability of the jurisdiction.

These funds can be a particularly good alternative for investment managers of Brazilian "409 Funds" that want to invest abroad, and to sophisticated high net worth individuals who wish to benefit from investing via a regulated fund structure but do not need a complex hedge fund structure, or are more sensitive to costs. ::

[1] CVM Normative Rulings no. 450, dated March 30, 2007; no. 456 dated June 22, 2007 and no. 465 dated 1 February 20, 2008.

Ana Cecília Manente
Partner, Levy & Salomão Advogados

Ana Cecília Manente is a Partner of Levy & Salomão Advogados, Brazil. Her practice concentrates on managed funds, foreign investment, and M&A deals. Ms. Manente also has extensive experience with structured finance, lending and venture capital, as well as securities and general corporate matters. She works regularly with both foreign and Brazilian private equity investors and hedge funds on fund formation and administration and investment structuring, and she serves as principal Brazilian counsel to many large international corporations doing business in Brazil. She holds a Bachelor of Laws degree from the University of São Paulo and a specialist degree in International Finance from the Foundation Institute of Economic Research of the University of São Paulo – FIPE/USP.

Daniela Rios
Associate, Levy & Salomão Advogados

Daniela Rios is an Associate, Levy & Salomão Advogados, Brazil. She advises domestic and international clients in connection with a wide range of corporate matters, including the establishment and maintenance of corporate entities in Brazil, the review of contractual obligations, due diligence investigations, M&A and other corporate transactions, and dispute resolution involving corporate entities. Daniela also advises clients with respect to real estate and environmental matters, assisting clients on both an advisory basis and with due diligence investigations in such areas. Daniela is an LL.M candidate at Columbia Law School, holds a Bachelor of Laws Degree from the Universidade Presbiteriana Mackenzie and a Post-Graduate Degree in Corporate Finance and Investment Banking from Fundação Instituto de Administração.