

CAPITAL MARKETS TO BECOME INSTRUMENTS FOR INVESTING IN BRAZILIAN INFRASTRUCTURE PROJECTS

Infrastructure investing in Brazil poses several challenges since it involves long term risks and regulation is intricate, currency exchange is considerably volatile, and the political and legal environment may not offer much certainty. In this environment, capital markets can play a central role for new infrastructure projects thanks to recent changes in the regulatory framework and the tax benefits associated with such investments.

Brazil's sustainable development, economic growth and increased competitiveness are highly dependent upon investments to tackle the infrastructure bottleneck. The economic policy of the current administration seems to rely on lower interest rates, tightening fiscal policy and less subsidized loans, such as those granted by the National Bank for Economic and Social Development (*Banco Nacional de Desenvolvimento Econômico e Social* - BNDES), creating room for new sources of investment and other structured alternatives.

In these circumstances the Brazilian Securities Commission (*Comissão de Valores Mobiliários* – CVM) has recently issued a rule for Incentivized Infrastructure Investment Funds (*FI-Infra*) and Investment Funds in Shares of Incentivized Infrastructure Investment Funds (*FIC-FI-Infra*). The regulation creates an advantage for such funds in comparison to conventional funds.

In the case of funds distributed to unsophisticated investors, it allows for the allocation of up to 20% of the fund's total net worth to one single infrastructure project. This compares to conventional funds, which allocate generally only up to 5% of its total net worth to a single issuer. Additionally, qualified investors are authorized to allocate twice as much of retail investors to one single infrastructure project, while professional investors have no such limitations. These changes increase the ability of such infrastructure projects to raise capital through investment funds.

In addition, a set of fiscal benefits for securities related to infrastructure is in place to benefit those to be issued until the end of 2030. The priority sectors and requisites to be met by infrastructure projects subject to tax-free regime were established in 2011 and 2016 by the legal framework for investments in tax-free infrastructure debentures, certificates of real estate receivables and in Receivables Investment Funds (FIDC) by Brazilian or foreign investors. According to this legislation, logistics and transport, urban mobility, energy, telecommunications, water and basic sanitation are the priority sectors that can gain from these fiscal benefits.

As for foreign investors, the tax-free policy refers to the Withholding Income Tax (WHT) on

securities in general and FIDCs whose receivables are originated from non-financial institutions. Some of the pre-requisites imposed by law for new public offers are fairly restrictive, including pre-fixed interest rates, minimum time of weighted average maturity for the project, an extended minimum period for the payment of earnings, and prohibition of party-related transactions and repurchases.

Investments in debentures, certificate of real estate receivables and FIDC shares issued by Specific Purpose Companies engaged in infrastructure projects are also subject to tax benefits. Income earnings related to those investments are tax-free (i) for resident individuals and (ii) for foreign investments in funds investing at least 85% of its net worth in the incentivized assets, in so far as the investor holds 95% of its investments allocated to such funds. A WHT of 15% is charged for legal entities headquartered in Brazil.

In regards to the pre-requisite imposed by law for new public offers, the government has been persuaded by market representatives to take the opportunity to work on an update for the rules for pre-fixed interest rates and repurchases of public offers made in 2011 or 2012 due to a sharp decline in the basic interest rates since then.

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