

# Global Tax Alert

News from EY Americas Tax

## Brazil enacts law to strengthen the legal framework for investment funds

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On 20 September 2019, Brazil enacted Law 13,874 (the Law), known as the *Economic Freedom Right Act*. The Law amended the Brazilian Civil Code to strengthen the legal framework for investment funds, which are regulated by the Brazilian Capital Market regulator (CVM), and bolster investment by foreign investors into Brazil. Before the passage of the Law, the body of applicable law was not unified, requiring application of both the Civil Code and other legislative sources to questions raised about the legal status of Brazilian investment funds. This uncertainty resulted in increased costs and litigation for investment fund managers.

As an example, a previous court decision defined a distressed asset investment fund as a "bank," raising concerns in the industry about the potential regulatory and tax impacts if this definition was sustained. However, under the Law, investment funds are now treated as a "condominium" by definition, which in essence is defined as a collective investment vehicle that facilitates ownership of a pool of assets by its investors.

Amendments under the Law that are relevant to investment managers include:

- ▶ **Limited liability to investors.** Investment funds may confer limited liability to investors through a change to their bylaws. The ability to grant investors limited liability will require analysis of the ramifications for US check-the-box elections made with respect to the investment fund.

- ▶ **Limited liability to service providers.** Investment funds may confer limited liability to service providers through a change to their bylaws. This change may reduce fees and costs associated with service providers, since limiting their liability creates a more stable legal framework.
- ▶ **Share classes with different rights and obligations.** Investment funds may create share classes with different rights and obligations, as well as segregated equity for each share class.

Investment managers should analyze the impact of the legislation (including, e.g., consideration of entity classification for US tax purposes) and, in consultation with Brazilian investment fund administrators, consider implementing the changes set out in the Law to their existing investment fund structures.

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