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Taxation of high net worth sports persons in Brazil

By Prof. Luís Eduardo Schoueri*

It sounds quite nostalgic to remember that some years ago, sportsmen used to play enthusiastically, dreaming about the honor of representing their countries in international competitions. Sports have become a quite profitable business, and athletes have understood that they are entitled to get a share thereof. Salaries reach unimaginable levels, and athletes usually get further remuneration from marketing activities. No matter which specialization, sportsmen will usually:

- Concentrate their remuneration in a very short period of their lives (although there are some exceptions, like the Brazilian Pelé, who seems to earn even more from his image today, as he did as a player);
- Derive their income from different sources and for several titles (active playing; training; image etc.);
- Share part of their earning with their agents.

Although from an international perspective, taxation of sportsmen has been specifically addressed in tax treaties, Brazilian internal tax law does not foresee specific regulation in this field. Thus, one notes that Brazilian sportsmen usually try to look for some tax structure which could minimize/postpone their taxation, even if such structure is not specifically designed for their needs.

This article will present an overview of Brazilian taxation, specifically addressing those structures which are usually employed by athletes.

1. The sportsman being taxed as an individual

Brazilian taxation of individuals has a comprehensive spectrum: although one could mention some specific schedules, like capital gains or financial income, one can say that as a matter of rule, Brazilian income tax is not scheduler: income is taxed independent from its nature. In this sense, it is irrelevant whether the sportsman earns salaries, royalties for his image or any other kind of income. There is also no difference between local or international income: all income received in a month will be subject to a withholding tax (if income is paid by a local company) or prepayment, according to the progressive rates of the following table:

1- Monthly Income	2- Tax Rate	3- Deductible Amount
Up to BRL 1,499.15	Exempt	-
BRL 1,499.16 to BRL 2,246.75	7.5%	BRL 112.43
BRL 2,246.76 to BRL 2,995.70	15.0%	BRL 280.94
BRL 2,995.71 to BRL 3,743.19	22.5%	BRL 505.62
Above BRL 3,743.19	27.5%	BRL 692.78

Basically, the calculation of the Individual Income Tax is made by the formula:

[(Monthly income (-) Deductions) X Tax Rate] (-) Deductible Amount

As a rule, the Brazilian tax law does not authorize relevant deductions to the monthly tax base of the Individual Income Tax. One of the exceptions is the monthly deduction for dependents, which, however, is not realistic (BRL 150.69 per dependent) and shall make no difference in case of the huge amounts sportsmen usually earn.

Every year, the taxpayers are obliged to submit an Individual Income Tax Return ("Declaração de Imposto de Renda da Pessoa Física"), where the deduction of other expenses incurred during the year is allowed by the tax legislation. In this final return, the tax effectively due by the taxpayer is calculated, and compared with tax paid in the year. In the end, the taxpayer may be entitled to a refund of the tax paid in excess, or will have to pay the difference.

Some of the expenses which can be deducted from the annual income tax base:

- Alimony payments;
- The amount of BRL 1,808.28 per year, per dependent;
- Social Security Contributions (INSS);
- Payments to Brazilian private pension plans;
- Medical expenses paid by the taxpayer for himself or dependents, without limits;
- Educational expenses paid by the taxpayer for himself or dependents, up to BRL 2,830.84 per person.

Alternatively to the complete tax return, with the deduction of all the mentioned expenses, the taxpayer may opt for the simplified tax return, with the allowance of a presumed deduction of 20% (twenty percent) of the taxable income, limited to BRL 13,317.09.

The annual progressive table is the following:

1- Annual Income	2- Tax Rate	3- Deductible Amount
Up to BRL 17,989.80	Exempt	-
BRL 17,989.81 to BRL 26,961.00	7.5%	BRL 1,349.24
BRL 26,961.01 to BRL 35,948.40	15.0%	BRL 3,371.31
BRL 35,948.41 to BRL 44,918.28	22.5%	BRL 6,067.44
Above BRL 44,918.28	27.5%	BRL 8,313.35

Again, the formula to the calculation of the Individual Income Tax due in the year reads as follows:

[(Annual income (-) Deductions) X Tax Rate] (-) Deductible Amount

From the deductions above, one which seems relevant for sportsmen are pension funds. Accordingly, Brazilian tax law provides for investment in private pension plans. There are two main possibilities, which are the PGBL and VGBL plans, with different tax consequences.

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By choosing the PGBL ("Plano Gerador de Benefício Livre") plan, the investor may deduct the contributions made to the plan of the annual income tax base, until the limit of 12% of his annual gross taxable income. In the redemption of the plan, all the amounts received will be taxed by the progressive tax rates of the Individual Income Tax, or by regressive tax rates (from 35% to 10%), which vary according to the period of the application. The investor has the option of electing one of these ranges of tax rates, in the moment of the creation of the plan.

On the other hand, in the VGBL ("Vida Gerador de Benefício Livre") plan, the taxpayer is not allowed to deduct the contributions to the plan from the annual tax base. But in the redemption, only the earnings accrued to the original amount are taxed by the progressive rates of the Individual Income Tax or by regressive rates.

For sportsmen, PGBL could be an interesting tax planning, in order to reduce their present tax burden. As mentioned above, sportsmen tend to concentrate their income in a relatively short period of their lives. PGBL could be a manner of postponing taxation to a later period, when the taxpayer actually benefits from his income. In other words, PGBL would be a way of not being taxed when income is received, but rather when it benefits the taxpayer.

However, the 12% limit shows that this alternative is not enough for avoiding a very high taxation upon receipt of income. If one considers that deductions are very limited, one could summarize by saying that in case sportsmen derive their income in their capacity as individuals, their tax burden will be roughly 27,5% of the gross amount received.

2. The sportsman being taxed as a legal entity

In principle, Brazilian athletes hired by local teams would be subject to the Individual Income Tax, in line with the provisions previously mentioned. However, it is a common tax planning by which sportsmen constitute a legal entity, taxed by the regime of deemed profit, to render services to the team, receiving their salaries thorough such enterprise, and being taxed in a more favorable way.

There are three methods to determine the tax base of a company in Brazil, which are: actual profit; deemed profit; and arbitrated profit. A company can either choose between the deemed or the actual profit system, unless the law imposes the use of the actual profit system. The arbitrated profit is not eligible by the taxpayer, since it is imposed by the tax authorities in certain situations, as inadequate or unreliabl e record keeping.

The actual profit is derived from the book profit, which is adjusted by additions and exclusions allowed or required by the tax law. The Corporate Income Tax is levied at a 15% rate, with an additional rate of 10% to the amount of profit that surpasses BRL 60,000.00 in a period of three months, and the Social Contribution on Net Profit is levied at a 9% rate. Both Corporate Income Tax and Social Contribution on Net Profit have basically the same tax base. Other social contributions, called PIS and COFINS, are usually charged in the so-called non-cumulative regime, which means that the taxpayer is allowed to recognize tax credits for the contributions levied on certain inputs. These contributions are levied on the gross revenues and their rates under this system, as a rule, are respectively, 1.65% for PIS and 7.6% for COFINS.

On the other hand, the deemed profit system consists in the application of a certain percentage over the gross income. This percentage is determined by law, which takes into account the activities performed by the taxpayer. The percentages to Corporate Income Tax and Social Contribution on Net Profit are the following:

Activity	Corporate Income Tax	Social Contribution on Net Profit
Retail of fuels	1.6%	12%
Sale and transportation of goods	8%	12%
Transportation (except of goods)	16%	12%
Services rendering	32%	12%

Thus, under the deemed profit system, the taxpayer applies a certain percentage (e.g. 32% for service revenue) over his gross incomes, that will result in the deemed profit to be taxed. The Corporate Income Tax rate is also 15% (and the additional tax rate of 10% also applies), and the Social Contribution on Net Profit is levied at a 9% rate.

However, the rates for PIS and COFINS are lower than the rates of the same contributions in the real profit system. Such rates are 0.65% for PIS and 3% for COFINS, but the taxpayer is not allowed to keep the credits on the inputs, since this is a cumulative regime, with a clearly cascading effect.

The deemed profit system may result in a lower tax burden than the one achieved under the actual profit system if the enterprise does not have many deductible expenses. As a matter of fact, the deemed profit system will always represent a tax economy to those companies whose profit rate is higher than the deemed profit percentage determined by the tax authorities.

As previously mentioned, some high net worth sportsmen constitute legal entities taxed under the deemed profit system to render services to their teams, so the total tax burden on their earnings is lower.

As an example, we can imagine a sportsman who earns BRL 1,000,000.00 a month. Being taxed as an individual, the total tax burden would be approximately **BRL 275,000.00** (disregarding the possible expenses of this athlete).

If this same sportsman constitutes a legal entity to render services to the team, taxed according to the deemed profit system, the total tax burden would be:

Corporate Income Tax	BRL 1,000,000.00 (x) 32% (profit percentage to services rendering) = BRL 320,000.00 (x) 25% (tax rate plus additional) = **BRL 80,000.00**
Social Contribution on Net Profit	BRL 1,000,000.00 (x) 12% (profit percentage to services rendering) = BRL 120,000.00 (x) 9% (tax rate) = **BRL 10,800.00**
PIS and COFINS	BRL 1,000,000.00 (x) 3.65% (tax rate of PIS and COFINS) = **BRL 36,500.00**
Total Tax	BRL 80,000.00 + BRL 10,800.00 + BRL 36,500.00 = **BRL 127,300.00**

As one may see, the second option is clearly more favorable to the sportsman. Of course, one could consider more sophisticated situations, where sportsmen must pay business expenses (e.g. for their agents) which could lead to a favorable taxation according to the actual profit. Usually, however, the deemed profit system would be the most interesting.

Although this structure is quite normal in Brazilian reality, one should mention that at least once it has been challenged by the Brazilian tax authorities. Quite discussed in Brazil is the Luiz Felipe Scolari case, judged by the administrative court. Luiz Felipe Scolari is not properly a sportsman, since he works as a football coach, but his case represents the position of Brazilian authorities when it comes to this kind of tax planning.

2.1. The Luiz Felipe Scolari case

The traditional tax planning by which sports persons constitute a legal entity for the purpose of receiving their payments was faced by the Administrative Council of Tax Appeals, which is Brazilian highest administrative tax court, on the occasion of the judgement of the so-called Luiz Felipe "Felipão" Scolari case.

Accordingly, the tax authorities imposed tax on Luiz Felipe Scolari, former coach of the Brazilian national football team, in respect of the income derived from the agreement that his enterprise (a legal entity under the name of "L. F. Promoções, Serviços e Participações") had signed with a Brazilian football club ("Sociedade Esportiva Palmeiras") for the coaching of the Palmeiras professional football team, as well as the supervision of all of its amateur teams.

Under the provisions of the agreement signed between Sociedade Esportiva Palmeiras and L. F. Promoções, Serviços e Participações, the coaching should be undertaken exclusively by the partner Luiz Felipe Scolari.

Taking into account such circumstance, the tax authorities understood that the coaching services were rendered in an individual and personal way by Mr. Scolari, thus deeming the agreement signed between his enterprise and the football club as a sham transaction performed for the purpose of tax avoidance. According to the tax authorities, the income derived from activities which were rendered in a personal way by Mr. Scolari as a coach of the Palmeiras football team – none other of his partners in the enterprise was allowed to perform the coaching contracted with the Palmeiras football society. Therefore, the income derived from such activity should not be taxed by the Corporate Income Tax as income of the enterprise, but rather by the Individual Income Tax as Mr. Scolari's personal income.

As understood by the tax authorities in the case, all the partners must perform the same activity, and not render services individually and in their personal name, in order for the income to be regarded as belonging to the enterprise. This would not be the case in the present situation, since, as verified by the tax authorities, the agreement signed between the football team and Mr. Scolari's enterprise provided that the latter would be "mandatorily represented by its partner Luiz Felipe Scolari, independently of any other professionals, in the performance of this agreement"; for the tax authorities, such provision would exclude the services rendered by any other partners or employees of the enterprise, what is characteristic of the services rendered by a legal entity.

Moreover, in the tax authorities' understanding, there would have happened a joint action between the Palmeiras football society and the taxpayer with the intention of avoiding the levy of the Individual Income Tax on Mr. Scolari's income by means of the interposition of an enterprise in the deal. Therefore, the referred arrangements would evidence a sham transaction for the purpose of tax avoidance.

The taxpayer, then, appealed to the Administrative Council of Tax Appeals. In the reasoning of his appeal, Mr. Scolari claimed that his enterprise was regularly constituted and that there was no provision in Brazilian Law establishing the individual taxation of the partner which renders the service – to this effect, he argued that "while the Law does not provide for the activities which must be mandatorily taxed on the individual, the option for the constitution of a legal entity, to undertake lawful activities, for any reason, has legal support". Moreover, Mr. Scolari claimed that the tax authorities disregarded the legal entity without any authorization from the Judiciary, as required by Brazilian Law.

The majority of the judges of the Council, following the understanding of the reporting judge José Ribamar Barros Penha, stated that there was no disregard of the legal entity in the present case, remaining Mr. Scolari's enterprise intact. Nevertheless, they adopted the understanding whereby whether it was the coach, as an individual, who rendered the services, the correspondent remuneration was due to him, and thus it must be taxed by the Individual Income Tax.

According to the majority of the judges, the constitution of legal entities for the purpose of services rendered is allowed, provided that all the partners act in the activity and under the name of the company – in the case, L. F. Promoções, Serviços e Participações did not have a structure in which all of its partners worked under its name, but, on the other hand, the coaching activities were performed personally by Luiz Felipe Scolari. In such circumstance, the income derived must be taxed by the Individual Income Tax.

In spite of deciding for the taxation by the Individual Income Tax, the judges understood that there was no sham in the case. For the judges, the constitution of legal entities by football players (and the same would be applicable for coaches) is quite common, and, moreover, it is usually required by the football clubs, since it supposedly avoids the player from claiming, in the future, his rights under the provisions of the labor law – the relation between the football club and the legal entity would be a service rendered, and not an employment: in other words, a contract for services not a contract of service.

Therefore, as stated by the judges, the constitution of a legal entity by Mr. Scolari was not aimed at tax avoidance, but was rather an outcome of the practice of football clubs in not hiring coaches due to the high burdens under the labor law. Moreover, for the judges, evidence that the Mr. Scolari's enterprise and the Palmeiras football club were not involved in a sham transaction would be the distance, in time, between the constitution of L. F. Promoções, Serviços e Participações and its agreement with the club.

One must mention that a sham transaction was recognized by the Council in a posterior case involving the coach Luiz Felipe Scolari. In this case, differently from the previous, the coach, as an individual, signed an agreement with Cruzeiro football club for the granting of his image rights. Nevertheless, Mr. Scolari did not receive his remuneration from the club, which rather paid it to an enterprise ("GOL - Consultoria") in which the coach was a partner during his time as a coach in Cruzeiro football club.

Taking into account the difference between the two circumstances (in the first case, it was Mr. Scolari's enterprise which signed the agreement, as well as it was the same legal entity who received the payments; in the second, Mr. Scolari signed the agreement as an individual, but the payments were made to a legal entity in which he was a partner only during his time as coach at the club), the judges recognized the sham, and thus applied the penalty of 150% on the amount due concerning the transactions involving GOL – Consultoria.

2.2. Article 129 of Law No. 11,196/05

Due to the Scolari case, as well as some cases concerning TV artists, there was a lobby for changing Brazilian tax law, in order to permit parties to decide whether they wish to hire individuals or companies, even, if in the latter case, services are to be performed on the personal capacity of companies' partners.

Article 129 of Law No. 11,196/05 provided that the rendering of intellectual services, including scientific, artistic and cultural ones, when performed by a legal entity provider of services, in a personal nature or not, with or without the attribution of any obligations on the partners or employees of such legal entity, is subject exclusively to the legislation applicable to legal entities for tax and social security purposes.

Thus, this Law established that the constitution of a company for the rendering of intellectual services, even if by a partner in a personal way, would not be disregarded for tax purposes. Consequently, in these cases, the partner will not be taxed as an individual, as happened to Luis Felipe Scolari.

However, although the lobby intended to cover all cases, the Law itself does not mention sports activities in its ambit of application. Thus, Law No. 11,196/05 is an interesting tool for artists, but its benefits may not extend to sportsmen.

Given that, there is a chance that sportsmen who receive their earnings through legal entities constituted with the purpose of rendering services, in a personal way, to the teams may suffer a tax assessment from the Brazilian tax authorities.

3. Conclusion

One can conclude that Brazilian tax law does not provide for specific structures for athletes. Although they usually try to avoid a high tax burden by means of being hired through a company, this scheme has already been challenged by tax authorities and has not been accepted by the Courts. Article 129 of Law No. 11.196/05 could be a solution for this problem, but its scope does not seem to cover sportsmen.