

HR & Tax Alert



Brazil: Reduction to Government Severance Indemnity Fund Rate

October 2006

Executive Summary

The contribution rate to the Government Severance Indemnity Fund for employees, known as FGTS, which is funded by an employer's monthly compulsory contribution may be reduced to 8% beginning January 2007. Currently the rate is 8.5% of gross salaries (8% to directly benefit employee and 0.5% to the government).

Background

The FGTS is a severance fund which is administered by the Federal Government. The amounts deposited, plus interest, may be withdrawn tax-free by the employee under certain conditions, including retirement, dismissal without reasonable motivation or early termination of a labor contract.

Due to the Brazilian economic situation at the beginning of this decade, the Complementary Law # 110, dated June 29, 2001, was enacted to establish an additional contribution of 0.5% as a social contribution to the FGTS for a five year period, beginning in the following year (i.e. 2002). Consequently, the month of December 2006 is the last month to collect this additional social contribution, which has not been deposited to benefit the employee, but has been used by the Brazilian Government for general social programs.

Changes to Employer's Contribution

If there are no further changes or legislative bills to extend the additional social contribution, according to this Complementary Law the employer's contribution to the Government Severance Indemnity Fund will drop back to 8%, and the 0.5% will no longer be required.

Next Steps

As the social charges due from employers upon payment of employees' remuneration in Brazil will be reduced by one-half percentage point, companies are advised to consider this possible impact on their payroll systems beginning January 2007. Companies should also watch for any further changes or legislative bills which might extend the additional social contribution.

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