

AN ALERT FROM THE BDO INTERNATIONAL TAX PRACTICE

BDO KNOWS: INTERNATIONAL TAXATION



► SUBJECT

BRAZIL: TREATY INTERPRETATION

► DETAILS

A longstanding Brazilian tax issue that has existed for more than a decade, with respect to the application of the business profits clause (“Article 7”) of Income Tax Treaties (also known as Double Taxation Treaties or “DTTs”), has evolved in a positive direction.

For more than a decade, the Brazilian tax agency (“RFB”) applied a literal interpretation of the definition of business profits under Article 7 of DTTs. The RFB took a narrow position on the application of Article 7 of DTTs relating to net profits generated by a non-Brazilian person. Applying this narrow position, the RFB determined that a non-Brazilian person’s items of gross income should not be covered by Article 7. Instead, such items of gross income would be covered by the other clauses of DTTs. This interpretation by the RFB essentially meant that Brazil would have the right to tax all outbound payments made to non-Brazilian persons for service charges to Brazilian persons. The tax would be assessed on a gross basis through withholding income tax. This interpretation of the RFB was in force for Brazilian tax purposes through the issuance of Normative Act 01/2000.

Late in 2013, through the issuance of Legal Opinion 2363/2013, the Federal Revenue Attorney General’s Office (“PGFN”) reversed its prior view on this matter. PGFN’s opinion concludes that the interpretation given in Normative Act 01/2000 was incongruent with the intent and purpose of Article 7 of DTTs. The PGFN argued that the definition of business profits under Article 7 of DTTs should be broader than the meaning legislated through Normative Act 01/2000. The PGFN’s main criticism of Normative Act 01/2000 was that it rendered Article 7 of DTTs as an essentially inapplicable empty provision. In Legal Opinion 2363/2013, the PGFN recommended the revocation of Normative Act 01/2000. Legal opinions issued by the PGFN, however, are neither law nor binding on the tax authorities.

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On June 20, 2014, the RFB issued Normative Act 5/2014, revoking Normative Act 01/2000. In general, the content of Normative Act 5/2014 focuses on the characterization of service fees under DTTs. In sum, Normative Act 5/2014 sets forth the following directives:

- In DTTs in which technical services and technical assistance services are characterized as royalties, such service fees should be subject to the royalty clause of the particular DTT. In these cases, Brazil would have the right to tax such items of income at source.
- With respect to technical services and technical assistance services related to the expertise of an individual, such payments should be subject to the independent personal services clause of DTTs. In these cases, Brazil would have the right to tax such items of income at source.
- The effect of revoking Normative Act 01/2000 is that payments for services rendered by a non-Brazilian person that would not otherwise be subject to another clause in a DTT should be subject to Article 7. In these cases, Brazil would generally not have the right to tax such profits, unless the non-Brazilian person has a Brazilian permanent establishment.

Unlike Legal Opinion 2363/2013, Normative Act 5/2014 is binding on the tax authorities. Therefore, multinational companies providing services in Brazil or for the benefit of a Brazilian customer should analyze whether the new rules could potentially eliminate or reduce Brazilian withholding income taxes.

HOW BDO CAN HELP

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