International Bar Association Annual Conference 2022

Recent Developments in International Taxation

Brazil

Teresa Meyer
BMA Advogados, São Paulo
tenc@bmalaw.com.br
Highlights of 2021 and 2022

Brazil has been active in its international tax policy efforts during 2021 and 2022. It is negotiating and renegotiating tax treaties, implementing new transfer pricing (TP) rules and moving towards becoming an Organisation for Economic Co-operation and Development (OECD) member state.

Regarding domestic tax matters, there have been some important case law milestones and much has been discussed about reintroducing taxes over dividend distribution, a sensitive topic that resurfaces from time to time in the public debate, especially in election years. To this date, no further legislative measures have been taken regarding taxing dividends.

Treaty network

Brazil has 35 double tax treaties (DTT) in force and is working on reviewing and expanding its treaty network. Since it opted not to sign the OECD Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (MLI), Brazil has been negotiating and renegotiating its tax treaties to comply with the minimum standard of the base erosion profit shifting (BEPS) project, and introducing changes that align to its domestic legislation.

In 2021, new DTTs came into force with Singapore, Switzerland and the United Arab Emirates, in which the minimum standard was addressed in their preamble statements and by introducing a principal purpose test (PPT) combined with a limitation of benefits (LOB) clause. Moreover, those treaties have defined interest on net equity (juros sobre capital próprio or JCP) as interest and included an article for technical services fees, given that both topics have already been the subject of several controversies in domestic and international settings.

Brazil has also signed a new DTT with Uruguay, and new protocols for the existing treaties with Chile, Sweden and Denmark:

- the DTT with Uruguay presents the same elements as the aforementioned DTTs;
- the protocol with Chile introduces the PPT with LOB;
- the protocol with Sweden introduces the PPT with LOB and changes the tax sparing for exemption and tax credit provisions; and
- the protocol with Denmark only changes tax sparing for a tax credit provision.

In all these treaties, there is, by means of introduction or pre-existence, an article of exchange of information and an article of mutual agreement procedure without the arbitration clause.

According to the Ministry of Foreign Affairs, negotiation of a new DTT with Colombia has been concluded and negotiations are ongoing over DTTs/protocols with Austria, Jordan, Lithuania, the Netherlands and Qatar. Social security agreements (SSA) with Austria, the Czech Republic and Mozambique have been signed in recent years, but they are not yet in force. Brazil has also recently signed tax information exchange agreements (TIEA) with Bermuda and Guernsey, but they are not yet in force.
Brazil in the OECD

Brazil formally applied for OECD membership in 2017. However, it was only in 2022 that the possibility of being a member state became more concrete. At the beginning of 2022, the OECD provided Brazil with an individual roadmap establishing a blueprint with change requirements on several areas of Brazilian policy for the country to be a member state. Regarding tax matters, Brazil has already signalled its intentions to comply with the needed requirements by pushing a new TP regulation that aligns with OECD Guidelines and enacting a decree that provides for the phasing out of the financial transactions tax (IOF) on foreign exchange. Both measures intend to enhance inbound transactions and foreign direct investment (FDI) in Brazil.

Transfer pricing rules

The Brazilian tax authorities presented a proposal for the new system in June 2022, which will be submitted to the National Congress before the end of the year. The new rules follow the arm’s length principle advocated by the OECD; it is deemed to consider the Brazilian scenario to the extent that it provides for definitions of intangibles, commodities, cost share agreements and reorganisation of businesses. As for simplification and legal certainty measures – which are a key issue in Brazil – the rules will provide for unilateral advance pricing agreements (APAs) and specific safe harbours that have not yet been disclosed by the tax authorities. Since the United States enacted new rules for the foreign tax credit system, which restricts credit to countries that have DTTs with the US or TP rules that follow the arm’s length principle, the agenda to change the Brazilian TP rules has become more pressing for policymakers.

Domestic case law and tax rulings

Tax ruling on most favoured nation clauses in DTTs

In September 2021, the tax authorities issued a ruling regarding the taxation of capital gains derived by a Portuguese company from the sale of a direct investment in the shares of a Brazilian company. The ruling confirms that the limitation provided in the Brazil–Israel treaty applies by virtue of the most favoured nation (MFN) clause in the Brazil–Portugal treaty; therefore, the gains derived by the Portuguese company are subject to withholding tax at the rate of 15 per cent instead of the progressive rates from 15 per cent up to 22.5 per cent. It is the first time that the tax authorities have issued a position on the application of the MFN clause.

Case law on controlled foreign corporation rules and DTT provisions

The Administrative Court rendered two decisions in 2021 and 2022 – in the lower and superior Chamber – which ruled that DTT provisions prevail over Brazilian controlled foreign corporation (CFC) rules. Thus, the profits of companies controlled by a Brazilian entity shall only be taxed in the country of their residence in a case in which there is a DTT in force. The discussion brought before the Court was whether the CFC rule was taxing the deemed profit of the foreign controlled entity, or its profit accounted in the Brazilian parent’s financial accounts under the equity method.
In the latter scenario, the understanding was that the treaty provisions would not apply, whereas in the former scenario the treaty provision would apply and prevail over the domestic CFC rule. The two cases referred to entities in the Netherlands and Argentina.

Supreme Court decision on gift tax and inheritance tax of non-Brazilian residents

The Brazilian Federal Supreme Court declared that the gift and inheritance tax (tax based on causa mortis transmission and donation, or ITCMD) collected by the Brazilian states from non-Brazilian residents is unconstitutional due to the lack of adequate legal provision. The decision affects tax events occurring after 20 April 2021 – the date of publication of the decision – and for ongoing judicial lawsuits filed by taxpayers that have not paid the tax in relation to past tax events.

Moreover, the Court set forth a 12-month deadline (up to June 2023) for the National Congress to issue a complementary law with general rules for the ITCMD imposition by the states on gifts and inheritances from foreign residents.

1 As of the time of writing.
2 Brazil is expected to have a Presidential election in October 2022.
3 Regarding JCP, there are several issues on its qualification as interest for the purpose of a DTT as it is a hybrid instrument, which raises many concerns in several jurisdictions. As for the technical services fees, there is a long-lasting domestic controversy around this, which a DTT article would help to clarify (independent services, royalties, business income or even other income) – this led Brazil to negotiate a specific article on DTTs for this income and to deviate from any UN or OECD model.
4 Decree No. 10.997 of 15 March 2022.
5 According to the Decree, the IOF levied on (1) exchange transactions for inbound loans with an average term up to 180 days, will be reduced from 6.0 per cent to 0.0 per cent from 19 March 2022; (2) exchange transactions for credit or debit cards, travellers' cheques and international prepaid cards will be reduced from 6.38 per cent to 0.00 per cent from 2 January 2028; (3) exchange transactions for the acquisition of foreign currency in cash and for the transfer of funds by residents in Brazil for availability abroad will be reduced from 1.1 per cent to 0.0 per cent from 2 January 2028; and (4) other exchange transactions will be reduced from 0.38 per cent to 0.00 per cent from 2 January 2029.
6 Ruling No. 150, 22 September 2021.
7 CARF decisions no 1301-005.817; no 9101-006.102.
8 More specifically, the decision comprises ITCMD in cases of: (1) donations in case the donor of assets and rights located in Brazil has residence abroad; and (2) inheritance of assets and rights located in Brazil if the deceased person was a non-Brazilian resident or had their inventory processed abroad.