The Impact of the OECD and UN Model Conventions on Bilateral Tax Treaties

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5

Brazil

LUÍS EDUARDO SCHOUERI AND NATALIE MATOS SILVA

5.1 The relevance of the OECD and UN Model Conventions and their Commentaries on the interpretation of Brazilian tax treaties

Tax treaties are not a frequent issue in Brazilian courts, particularly if one considers the judicial decisions. Specifically concerning interpretation, one could recall a recent decision about the application of Article 7 to services (instead of Article 21, as claimed by tax authorities), but even this case has not yet been concluded.

As a matter of fact, several tax cases do not even reach the judicial courts, since Brazilian law has an Administrative Review Procedure whereby taxpayers may bring their claims to the so-called Administrative Council of Administrative Appeals (*Conselho Administrativo de Recursos Fiscais* (CARF)), which replaced the Taxpayers' Council that existed until 2009. CARF is a very specialized group of experts, chosen among both tax authorities and taxpayers, which is supposed to review tax assessment in a way similar to a judicial procedure.

CARF has recently made some interesting decisions concerning tax treaties, particularly since Brazil adopted a full-transparency regime on its worldwide taxation, which is claimed to be against Article 7 of Brazilian tax treaties. In some cases, CARF understood that Article 7 would prevail before Brazilian legislation and, in others, that the treaty would not be applicable.[1]

On 1 January 2011, Brazil had treaties signed and in force with the following countries: Argentina (*1980*, 1983); Austria (*1975*, 1977); Belgium (*1972*, 1974); Canada (*1984*, 1986); Chile (*2001*, 2004); China (*1991*, 1994); the Czech Republic and Slovakia (*1986*, 1991); Denmark (*1974*, 1975); Ecuador (*1983*, 1988); Finland (*1996*, 1998); France (*1971*, 1973); Hungary (*1986*, 1991); India (*1988*, 1993); Israel (*2002*, 2006); Italy (*1978*, 1982); Japan (*1967*, 1968); Luxembourg (*1978*, 1981); Mexico (*2003*, 2006); the Netherlands (*1990*, 1992); Norway (*1980*, 1982); Peru (*2006*, 2009); the Philippines (*1983*, 1991); Portugal (*2000*, 2001); South Africa (*2003*, 2006); South Korea (*1989*, 1992); Spain (*1974*, 1976); Sweden (*1975*, 1976); and Ukraine (*2002*, 2006). The first year in italics represents the year when the treaty was signed and the second the year when the treaty entered into force.

[1] Recognizing that the treaty shall prevail over domestic legislation, see *Eagle Distribuidora de Bebidas S.A.* v. *2nd Judgment Panel of Federal Revenue Officer of Brasília*, CARF, 19 October 2006, judgment No. 101–95.802.

On transfer pricing issues, CARF has never accepted that Brazilian law would be against Article 9 of Brazil's tax treaties, despite taxpayers' claims that Brazil does not follow the OECD standards. Perhaps such cases could be mentioned as situations where CARF had to decide whether OECD standards would be applicable for the purpose of interpreting tax treaties. However, it should be noted that in such cases taxpayers did not refer to the Commentaries, but rather to the OECD Transfer Pricing Guidelines. CARF understood that such Guidelines were very open and that there is no international standard concerning the arm's length principle. It was claimed in an *obiter dictum* that Brazil was not forced to follow the OECD standards; however, this was irrelevant, since CARF understood that Brazilian law would not be against such broad standards.

If we examine the tax authorities' interpretation, we would immediately note that the provisions of the tax treaties are quite unique, often against the international standards of interpretation and even the context in which the treaties were signed.

Notwithstanding this, Brazilian scholars frequently recognize the importance of the Model Conventions and Commentaries to interpret tax treaties signed by Brazil. Brazil is not a Member country of the OECD but on many occasions has adopted the OECD Model Tax Convention on Income and on Capital (OECD Model) in its tax treaties.

It is possible to argue that the Brazilian authorities are familiar with the contents of the Model Conventions and of the existing Commentaries. As a matter of fact, at least on one occasion concerning transfer pricing, the tax authorities quoted the OECD Guidelines. It is true that one could say that this quotation was not appropriate for the case, but this shows that they are prepared to quote the OECD whenever they understand that this could be convenient to support their opinion.[2]

Since the tax authorities claim that Brazil is not a Member of the OECD (which is true), they may feel free not to follow its standards. However, by quoting the OECD's positions, we should see these positions at least as a founded opinion to support one's position.

The positions on the OECD Model and Commentaries are also an important source to scholars and practitioners to better understand the policy commonly adopted by the country in its negotiations with tax treaty partners. Once more, the positions of Brazil regarding the OECD Model are not mandatory, as it frequently chooses not to follow a certain opinion expressed therein.

[2] Making an erroneous quotation of the OECD Guidelines to support their argument, the tax authorities stated in Decision no. 21 of 2000 that the OECD recognizes that Article 9 does not forbid the domestic law to provide profit adjustment methods, even if they are contrary to the arm's length principle.

Brazilian literature usually understands that the Commentaries are not mandatory to countries which are not Members of the OECD, since there is no juridical basis regarding the obligatoriness of its observance in the interpretation of a tax treaty signed by a non-OECD Member country.[3]

Accordingly, after research of the few judgments delivered by Brazilian courts concerning tax treaties, Sergio André Rocha states that the Commentaries were not taken into account by the courts on such occasions.[4] He concludes that there is no basis for the consideration of the Commentaries in the interpretation of the tax treaties signed by Brazil. To this effect, the Commentaries could not be considered as 'context', as provided by Article 3(2) of the OECD Model.

Therefore, notwithstanding the fact that the usual policy adopted by a non-OECD Member country in its negotiations may be revealed to the interpreter through the positions that such a country has made in the Commentaries, one can hardly consider the Commentaries (as well as the positions made by the non-Members in them) as mandatory to non-OECD Member countries due, as mentioned above, to the lack of a juridical basis in this sense.

However, it is possible to argue that the fact that a country has signed a tax treaty following the provisions of the OECD Model may constitute an indication, unless the circumstances show otherwise, that the contracting states were aware of the Model and its Commentaries, which could justify their observance in the interpretation of the tax treaty.

5.2 Personal and material scope of the tax treaties

5.2.1 Personal scope: Articles 1 and 4

Article 1 (persons covered) in almost all Brazilian tax treaties is written identically to the wording of the OECD and UN Models (the Models) (Article 1 of the UN Model reproduces Article 1 of the OECD Model). The only exception is Brazil's treaty with Japan, signed in 1967, where an equivalent clause to Article 1 cannot be found: Article 1 of such a treaty already rules which taxes are covered by it (like Article 2 of the Models). This is a very old convention and Brazil had no experience with tax treaties at the time of its conclusion. Perhaps this can explain such divergence.

It must be said that regarding Article 1 (as can be read in the OECD Model Commentaries), Brazil has ascertained that its tax treaties would cover partnerships, since they are considered to be legal entities under Brazilian legislation.

[3] See D. V. Bellan, 'Interpretação dos tratados internacionais em matéria tributária', in Heleno Taveira Törres (ed.), *Direito tributário internacional aplicado*, vol. III (São Paulo: Quartier Latin, 2005), pp. 605–69 (at p. 652).

[4] See S. A. Rocha, *Interpretação dos tratados contra a bitributação da renda* (Rio de Janeiro: Lumen Juris, 2008), p. 161.

Article 4 has quite the same wording in the Models: the only difference is the criterion of 'place of incorporation' for the residence of companies mentioned by the UN Model. Only four Brazilian tax treaties provide this criterion: those with Chile, Mexico, Peru and Ukraine. However, it must be noted that the place of incorporation criterion was added in the UN Model fairly recently in 1999: since then, Brazil has signed seven tax treaties, four of them containing such a provision.

Brazil has reserved its right not to include in its conventions the second sentence of Article 4(1), as can be seen in the positions expressed by Brazil in relation to Article 4 of the OECD Model. This provision mostly deals with foreign diplomats and consular staff, and Brazil has stated that the position of its diplomatic staff is dealt with under its domestic law. However, provisions similar to the second sentence of Article 4(1) of the Models can be found in the treaties that Brazil has signed with Finland, Peru and the Philippines.

Thus, almost all Brazilian tax treaties (excluding those with Chile, Mexico, Peru and Ukraine, which include the place of incorporation criterion) follow Article 4(1) of the OECD Model, defining the resident with the domicile, residence and place of management criteria. However, the treaties never mention the second sentence of Article 4(1), with the exception, as mentioned above, of those signed with Finland, Peru and the Philippines.

All Brazilian tax treaties adopt the tie-breaker rules of Article 4(2) of the Models to resolve conflicts where, by the provisions of Article 4(1), an individual would be considered to be a resident of both contracting states. However, the place of effective management criterion to resolve the same conflicts regarding persons other than individuals (companies, for instance), provided by Article 4(3) of the Models, was not adopted by some of the Brazilian tax treaties. Those signed with Canada, Chile, Finland, Japan, Mexico, Peru, the Philippines and South Korea state that the authorities of both contracting states shall make efforts to reach a mutual agreement in the case of conflicts in the matter, as suggested by para. 24.1 of the Commentary to Article 4 of the OECD Model.

Regarding the other treaties, where the Models' 'place of effective management' criterion can be found, it must be noted that, as it was positioned in the OECD Model Commentaries, Brazil does not adhere to the interpretation given in para. 24 of the Commentaries, where 'place of effective management' is considered to be 'the place where key management and commercial decisions that are necessary for the conduct of the entity's business as a whole are in substance made'. The Brazilian authorities consider that such a definition is an issue to be dealt with by domestic law and the decisions of domestic courts.

It should be noted that the fact that Brazil tends to accept the place of effective management criterion is especially interesting if one considers that

domestic law does not provide for such a criterion: resident companies in Brazil are those incorporated according to Brazilian law and whose seat is in the country. This could be considered as a sign that Brazil would be prepared to follow some of the provisions of the Models even if this would diverge from Brazilian practice.

5.2.2 Material scope: Article 2

Brazilian tax treaties usually do not have equivalent clauses to Article 2(1) and (2) ('Taxes covered') of the Models (and, regarding these paragraphs, they are identical), making use of the alternative version suggested in para. 6.1 of the OECD Commentaries on Article 2. This is what happens in the treaties signed with Argentina, Austria, Belgium, Canada, China, Denmark, Ecuador, Finland, France, Hungary, India, Israel, Japan, Luxembourg, Norway, Portugal, South Korea and Sweden.

Whenever Brazilian tax treaties have similar clauses to Article 2(1) and (2) of the Models, they are written in a different way. Such clauses never make reference to taxes on capital, as Brazil stated in the Commentaries (which may be explained because Brazil has no tax on capital), and do not mention 'political subdivisions or local authorities', as was also set out in the Commentaries (which derives from the fact that Brazilian income tax is charged only at a federal level). An exception is its treaty with Italy, which mentions that the treaty covers the taxes levied by political or administrative subdivisions and local authorities. This is irrelevant for Brazil, since there is presently no such tax.

In spite of the position on Article 2(1) of the OECD Model, where Brazil reserves its right not to add the final part of the paragraph, which reads 'irrespective of the manner in which they are levied', such a provision can be found in some Brazilian tax treaties (those with Canada, the Czech Republic, Ecuador, Mexico, the Netherlands, Peru and the Philippines).

Although Brazil states a position on Article 2(2) of the OECD Model, where it reserves the right not to include such a clause in its conventions, the definition of tax on income can be found in three of its treaties (those with Peru, South Africa and Spain). While the referred clause is written according to the Brazilian understanding in its treaties with Peru and South Africa (taxes on income are deemed to be those 'imposed on the totality of income or parts of it'), apart from what is set forth in the Models, the wording of the clause in its treaty with Spain is very close to the Models, excluding only the references made to capital, since there is no Brazilian tax on capital, and not including the social security charges, in accordance with the OECD Commentaries to Article 2.

Brazil's treaties with Belgium, France, Japan and Luxembourg differ from Article 2(4) of the Models as they do not make reference to the need for notification between the competent authorities of the contracting states about significant changes made to their tax law.

Except for the case of Portugal (which will be seen below), Brazilian tax treaties cover only the federal income tax. This has raised some relevant issues in Brazil, especially for those treaties signed before 1988.

Accordingly, in 1988 Brazil adopted a new Constitution, which provided, *inter alia*, for a new tax system. The 1988 tax system retained the income tax in federal hands but determined that almost half of its revenues should be distributed by the federal government to states and municipalities. It is clear that such a provision aimed to grant the latter levels with more resources. However, the Constitution provided for an enlargement of the scope of the social contributions to be levied by the federal government: beyond the traditional contributions on payment rolls, new contributions were created, among which was a peculiar contribution on companies' profits.

Therefore, from 1988 onwards, Brazilian companies' profits are subject both to an income tax (levied by the federal government but distributed among federal, state and municipal governments) and a social contribution on profits (also levied by the federal government and not subject to any redistribution). From the companies' perspective, it is irrelevant to pay income tax or social contribution on profits, since their tax bases are equivalent. The fact that they are distributed in different ways is an issue which only affects the relations between federal subdivisions.

It is therefore natural that taxpayers could question whether tax treaties signed before 1988, which of course did not refer to the social contribution on profits (which was non-existent until then), would be extended to the new contribution.

Thus, bearing in mind the provision of Article 4(2) of the Models, there is a large dispute as to whether Brazilian tax treaties cover the social contribution on companies' profits. One could claim that for those tax treaties signed before 1988, the social contribution would be covered, as Article 2(2) of Brazil's treaties (repeating para. 4 of the same article in the Models) usually provides for the extension of the tax treaties to 'substantially similar' new taxes, which seems to be the case. However, the tax authorities would not necessarily agree with such an argument.

Accordingly, at least in the case of Brazil's treaty with Denmark, the Brazilian Revenue Service has ruled that it would not cover the social contribution, since the treaty was signed before the latter ever existed. The issue of 'substantially similar' was not even mentioned.

Concerning Brazil's treaties signed after 1988, the social contribution would only be covered if this were expressly foreseen by the treaty: taxes covered must be mentioned in the treaty. Although Brazil has signed eleven tax treaties since 1988, the only cases where social contributions have been mentioned were in its new treaty with Portugal and the amendment to its treaty with Belgium.

5.3 Business profits and other independent activities

5.3.1 Permanent establishment: Article 5

All Brazilian tax treaties follow Article 5(1) and (2) of the Models (which are identical in both Models), with the single exception that its treaties with Japan, the Philippines and Ukraine include 'warehouse' among the examples of a permanent establishment (PE) given by Article 5(2).

Concerning Article 5(3), most Brazilian tax treaties adopt the wording of the OECD Model, but with a six-month threshold period of time (the same period as the UN Model), as Brazil has positioned on Article 5. The treaties with Ecuador and Ukraine adopt a twelve-month period, exactly as provided by the OECD Model. The treaty with China is the only Brazilian tax treaty that follows the wording of Article 5(3) of the UN Model exactly. The treaties with Israel and Portugal provide a nine-month threshold. Currently, Brazilian tax treaties have no provisions regarding PE due to the performance of services (the 'service PE'). However, since services are a very important issue in Brazilian international tax policy, one might imagine that Brazil could adopt this in future. Perhaps a good explanation for this not having happened could be that the Brazilian authorities understand that payment for services would not fall under Article 7, but rather Article 21 (other income).

Fifteen Brazilian tax treaties (among a total of twenty-eight) include the UN Model provision on PEs of insurance companies (Article 5(6) of the UN Model). However, almost all of its tax treaties follow the wording of the OECD Model regarding Article 5(5), (6) and (7). The second sentence of Article 5(7) of the UN Model, which concerns the determination of an agent's status as independent or not, can only be found in the treaties with Chile, China, India and Mexico. The treaties with Argentina, Japan and Luxembourg include the provision that a company shall have a PE when, among its activities, it offers services from artistes or sportsmen as these are referred to in each treaty.

5.3.2 Business profits: Article 7

Regarding business taxation, all Brazilian tax treaties adopt Article 7(1) of the OECD Model, not mentioning the 'limited force of attraction' principle provided by the corresponding article in the UN Model. Considering Article 7 of the OECD Model as a whole, most Brazilian tax treaties adopt its wording with the exclusion of paras. 4 and 6 and, as expressed in the positions on Article 7, without the words 'whether in the State in which the permanent establishment is situated or elsewhere' found in Article 7(3) relating to the deduction of expenses in the determination of the profits of the PE. However, the treaty with China contains all the paragraphs of Article 7 of the OECD Model and is the only one to do so.

Brazil's treaties with Japan and Portugal include Article 7(6) of the OECD Model (which has an identical correspondent in the UN Model), which states the maintenance of the method for attribution of profits used and was excluded from all the other treaties. Its treaties with Mexico and Ukraine contain some provisions of Article 7(3) of the UN Model, whereby no deductions on the PE profits will be allowed in respect of the amounts that have been paid to its head office or any of its other offices, by way of royalties, fees or other similar payments in return for the use of patents or other rights.

5.3.3 Shipping, inland waterways transport and air transport: Article 8

Brazilian tax treaties partially adopt Article 8 of the OECD Model. As Brazil has set forth in the OECD Commentaries, Article 8 of its treaties does not cover profits from inland waterways transportation. Therefore, the treaties it has signed do not include a provision similar to Article 8(2) of the OECD Model. Usually, Brazilian tax treaties adopt Article 8(1), (3) and (4) of the OECD Model. However, some of its treaties (those with Chile, Finland, Japan, Peru, the Philippines, South Africa and South Korea) do not adopt the 'place of effective management' rule of para. 1, stating instead that profits from the operation of ships or aircraft in international traffic shall be taxable in the contracting state where the enterprise is resident, as suggested as an alternative rule by the Commentaries to Article 8 of the OECD Model.

Some of Brazil's treaties (those with Canada, Chile, Finland, Peru, South Africa and South Korea) do not include the provision of Article 8(3) and some do not include the provision of para. 4 (those with Belgium and France). The treaties that it has concluded with Argentina, Chile and Peru extend the scope of the article to cover land transport. Its treaty with the Philippines, unlike the OECD provision, states that the profits from shipping and air international transport shall be taxable both in the source and in the residence countries. Its treaty with Norway includes in Article 8 a provision for the circumstance where the enterprise is exploited by jointly liable partners who are resident in different contracting states and, for this reason, the authorities cannot agree on the location of the place of effective management – in this case, the profits shall be taxable in the state where the partner is resident, in the exact proportion of each partner's share.

5.3.4 Associated enterprises: Article 9

Article 9(1) of the OECD Model (which has an identical equivalent in the UN Model) concerning associated enterprises is reproduced by all Brazilian tax treaties. However, as has been stated by Brazil in the OECD Commentaries, none of its treaties adopt Article 9(2) of the OECD Model, which provides for

correlating adjustment. Consequently, its treaties do not adopt Article 9(3) of the UN Model either.

Brazilian law introduced transfer pricing rules in 1996. To determine the arm's length price, Brazilian law sets forth specific methods, based on the traditional transactional methods (independent prices, cost and resale price). The Brazilian tax authorities do not accept the adoption of other methods, such as profit split or the transactional net margin method (TNMM), to determine the arm's length price of a given transaction between related parties.

The Brazilian transfer pricing system as a whole, although inspired by international practices, presents several peculiarities, in part arising from the text of the law itself and partially resulting from an erroneous interpretation of the law by the Brazilian authorities.

In spite of such differences, the Brazilian authorities claim that Brazilian transfer pricing rulings comply with Article 9. Up to the present, CARF has never accepted taxpayers' arguments concerning the incompatibility of Brazilian transfer pricing rulings with the treaties in force.

The Administrative Court recognizes the differences between the Brazilian transfer pricing rules and the system proposed by the OECD, due to the referred peculiarities of the Brazilian system: while the OECD rules are open and flexible in their way of reaching the arm's length, Brazil has adopted specific and close methods.[5] Nevertheless, CARF decided that there is no conflict between the Brazilian transfer pricing rules and those of a tax treaty inspired by the OECD Model, even taking into consideration the risk that the arm's length price might not be reached properly, since Brazil does not adopt Article 9(2) of the Model (correlating adjustment), having reserved the right of its non-inclusion in the positions on the article. Moreover, CARF stated that since Brazil is not a Member country of the OECD, its Guidelines are not binding in respect of the effectiveness and application of domestic law.[6]

One provisional decision, issued by a judicial court, has accepted such an argument, but this decision is not yet final and should not be considered as a precedent.

5.3.5 Independent personal services (Article 14), directors' fees (Article 16) and artistes and sportsmen (Article 17)

All Brazilian tax treaties deal in Article 14 with the independent personal services matter (with the exception of its treaty with Japan, which does so in Article 13). However, most of them do not adopt the 'fixed base' criterion for

[5] *Schering do Brasil Química e Farmacêutica Ltda.* v. *7th Judgment Panel of Federal Revenue Officer of São Paulo*, CARF, 17 April 2008, judgment No. 101–96.665.

[6] The Brazilian Revenue Service has pronounced with the same understanding on many occasions, as in Decisions No. 19, 20 and 21 of 2000 or Consultation No. 6 of 2001 and No. 431 of 2007.

the taxation of independent personal services in the source country, as provided by the OECD Model before the exclusion of Article 14 in 2000 and currently by the UN Model.

The criterion generally adopted is that the gains arising from independent activities or services of a resident of a contracting state shall be taxed only in that state, unless the remuneration for such activities or services is paid by a company (or merely a resident in Brazil's treaties with India, Israel, Portugal and Ukraine) or a PE of the other contracting state, when it will also be taxed in that other state. The protocols of its treaties with Canada, the Czech Republic, Denmark, Ecuador, Hungary, Italy, Luxembourg, Mexico, the Philippines, South Korea and Spain determine that the provisions of Article 14 shall apply even if the activities referred to are exercised by a partnership.

Some of Brazil's treaties (those with China, Ecuador and Japan) adopt the 'fixed base' criterion, while others (those with Argentina, Chile, Mexico, Peru and South Africa), besides the fixed base, adopt the 183-day period of stay criterion, which is similar to the provision of Article 14(1)(b) of the UN Model.

The provision of Article 16 of the OECD Model concerning taxation of directors' fees is reproduced in all Brazilian tax treaties. However, the treaties also expand the article's coverage to members of boards other than the board of directors, such as the board of auditors and the board of officers. Brazilian tax treaties do not mention the 'top-level managerial position', as provided by Article 16(2) of the UN Model.

Concerning the taxation of artistes and sportsmen (Article 17 of the Models), most Brazilian tax treaties follow the provisions of the OECD Model (which are the same as those of the UN Model). Some of its treaties, however, have a different wording in para. 2, which deals with the situations where the income resulting from artistes' and sportsmen's activities accrues to other persons – its treaties with Austria, the Czech Republic, Denmark, Ecuador, Hungary, Norway, the Philippines, Spain and Sweden mention in Article 17(2) only the circumstance of the activity being provided in a contracting state by an enterprise resident of the other contracting state when it shall be taxed in the first-mentioned contracting state (in this case, the 'other person' of the Models would be only a legal entity). Earlier Brazilian tax treaties (those with Belgium, France and Japan) and those with Argentina and Luxembourg only provide Article 17(1), perhaps because the 1963 OECD Draft Convention did not have an Article 17(2).

In 2008 the Superior Court of Justice judged an appeal by Paulo Roberto Falcão,[7] a famous former soccer player who went to Japan to be a soccer coach

[7] *Paulo Roberto Falcão* v. *National Treasury*, Superior Court of Justice, 27 May 2008, Special Appeal No. 882785.

of a local team. In this case, the remuneration received by Mr Falcão had been taxed in Japan but not in Brazil. The tax authorities claimed for the Brazilian income tax on the remuneration derived in Japan.

Among other arguments, the Court stated that a soccer coach could be considered as a 'public entertainer', given that he collaborates with the team. In this way, Article 15[8] of Brazil's treaty with Japan would be applicable. However, it is important to mention that this question was superficially analysed by the Court and the core of the decision was based on certain specific provisions of Brazilian domestic legislation.

Some Brazilian tax treaties limit the scope of Article 17. Its treaties with India, Israel, the Philippines, South Africa and South Korea exempt in a contracting state events supported by public funds of the other contracting state in a provision similar to that given by para. 14 of the OECD Commentaries to Article 17. Its treaty with Portugal extends the exemption to activities supported by funds of entities with their corporate capital composed mostly by public funds. Its treaties with China, the Czech Republic and Hungary exempt activities performed within the framework of cultural exchange agreements between the governments, while its treaty with Canada exempts income derived by a non-profit organization the status of which is certified by the competent authority of the contracting state in which it is resident.

5.4 Dividends, interest, royalties and capital gains

5.4.1 Dividends: Article 10

Brazilian tax treaties deal with the taxation of dividends in Article 10 (with the exception of its treaty with Japan, which does so in Article 9). Most of its treaties restrain the taxation of the dividends in the source country if the beneficial owner is a resident of the other contracting state at a 15 per cent maximum rate of the gross amount, as provided by Article 10(2)(b) of the OECD Model.

However, many of Brazil's treaties do not set forth a lower rate in the case of the beneficial owner being a company which directly holds a percentage of the company paying the dividends, as provided by Article 10(2)(a) of the OECD Model – this is what happens in its treaties with Austria, China, the Czech Republic, Ecuador, Denmark, France, Finland, Hungary, India, Italy, the Netherlands and Norway. The treaties that limit the taxation on dividends in the source country to a lower rate in the case of substantial participation in the capital of the paying company generally do so at a 10 per cent rate (instead

[8] Article 15: 'Notwithstanding the provisions of Articles 13 and 14, income derived by public entertainers, such as theatre, motion picture, radio or television artistes, and musicians, and by athletes, from their personal activities as such may be taxed in the Contracting State in which these activities are exercised.'

of the 5 per cent rate provided by the OECD Model); however, this is conditioned to a direct participation of 20 per cent in the treaties with Mexico and Peru, 25 per cent in the treaties with Chile, Israel, Portugal, South Africa, Spain and Ukraine, 10 per cent in the treaties with Belgium and Japan, and 15 per cent in the treaty with Luxembourg.

Brazil's treaty with Denmark provides dividend taxation at source at a 25 per cent maximum rate, as does its treaty with Sweden (if the beneficial owner is not a company, when the maximum rate shall be 15 per cent) and the Philippines (with a 15 per cent maximum rate in cases of companies, including partnerships). Its treaty with Japan provides a unique maximum tax rate of 12.5 per cent, while its treaty with Argentina does not provide any rate limitation for dividend taxation at source.

As can be noted, Brazilian tax treaties generally adopt a maximum rate of 15 per cent in the taxation of dividends at source, as provided by Article 10(2)(b) of the OECD Model. It should be noted that when Brazil negotiated its treaties, the average rate for taxation at source of dividends was 25 per cent. Thus, if treaties provided for a maximum taxation rate of 15 per cent, this could be considered a reduction of Brazilian tax (or a tax incentive) in favour of the investor. However, Brazil presently does not tax dividends. This is not a tax incentive in Brazil, but rather a tax policy which avoids economic double taxation: since companies are taxed, there is no reason for a second taxation of the same profits when distributed.

Article 10(3) of the OECD Model (reproduced in the UN Model) makes an enumeration of examples found in the majority of countries as 'dividends', since it was not possible to define them in an exhaustive and general formula due to the peculiarities of each domestic law. Thus, both Models consider as dividends income from corporate rights not mentioned in the paragraph that is subjected to the same taxation treatment as income from shares by the law of the state of residence of the company making the distribution.

The provision of such a paragraph is reproduced in all Brazilian tax treaties, sometimes with additions, as in the treaty with Portugal, which states that the term 'dividends' shall be deemed to also include profits derived under an account or arrangement for participation in profits, or the treaties with Argentina, Canada, Ecuador, Hungary, Italy and the Philippines, which provide in their protocols that it is understood that in the case of Brazil, the term 'dividends' also includes any distribution in respect of certificates of an investment trust that is a resident of Brazil.

Article 10(4) of the OECD Model (reproduced in the UN Model), which establishes the inapplicability of paras. 1 and 2 to dividends on shares that are effectively connected with a PE of the recipient in the source country, is adopted by all Brazilian tax treaties. Nevertheless, some treaties (those with Argentina, Chile, China, the Czech Republic, Hungary, Mexico, Peru, the Philippines and South Africa) widen the scope of the article to also cover

dividends connected with a fixed base for independent activities, as provided by the 1977 OECD Model and still provided by the UN Model. The inclusion of such a provision does not seem to be as a result of Brazilian initiative, but rather an acceptance of the suggestion of the Models, since there is no particularity of Brazilian law which could require such a provision.

The provisions of Article 10(5) of the Models, which rules out the extraterritorial taxation of dividends, are adopted by most Brazilian tax treaties. However, the earliest treaties (such as those with Austria, Denmark, France, Japan, Spain and Sweden) do not include such provisions. The first treaty to adopt the provisions was with Belgium, concluded in 1972, and it adopted the paragraph as provided by the 1963 OECD Draft Convention, without mentioning the exception of effective connection with a PE. So did the treaty with Luxembourg, concluded in 1978, which also adopted Article 10(5) of the 1963 OECD Draft Convention. However, the treaty with Italy a month earlier (October 1978) had already adopted such a provision as it was provided by the 1977 OECD Model. From then on, all Brazilian tax treaties included the Model's Article 10(5), mostly with the wording of the UN Model, which (as the 1977 OECD Model did) still provides the connection with a 'fixed base' besides the PE. The treaty with Mexico is the only one that does not mention the prohibition of taxation on the company's undistributed profits, as provided by the final part of Article 10(5) of the Models.

Reflecting a position made on Article 10(5) of the OECD Model (where Brazil reserves the right to 'levy withholding tax on profits of a permanent establishment at the same rate of tax as is provided in paragraph 2, as is the traditional rule in the Brazilian income tax system'), Brazilian tax treaties include in Article 10 a provision dedicated to the tax treatment of PEs of the other contracting state situated in Brazil. Generally, the provision limits such withholding tax at source to 15 per cent (25 per cent in the treaty with Denmark, 10 per cent in the treaties with Chile, Finland, Israel, Mexico, Peru, South Africa and Ukraine, and 12.5 per cent in the treaty with Japan, while the treaty with Argentina does not provide any limit) of the gross amount of the profits of that PE determined after the payment of the corporate tax related to such profits. The treaty with Spain states that this withholding tax shall be applicable only when the profits are effectively transferred abroad.

The treaties that Brazil has concluded more recently (those with Mexico, Peru, South Africa and Ukraine) provide an anti-abuse rule regarding dividends dealing with source taxation as suggested by para. 21.4 of the Commentary to Article 1 of the OECD Model, stating the inapplicability of the provisions of Article 10 if it was the main purpose or one of the main purposes of any person concerned with the creation or assignment of the shares or other rights in respect of which the dividend is paid to take advantage of the article by means of that creation or assignment.

5.4.2 Interest: Article 11

Concerning interest, almost all Brazilian tax treaties limit taxation at source to 15 per cent of the gross amount (the exceptions are the treaty with Japan (12.5 per cent) and the treaty with Argentina, which does not provide any limitation at all), while the OECD Model provides a limit of 10 per cent – Brazil reserved its position on the rate provided by the Model.

However, many of Brazil's treaties additionally set forth a lower rate of 10 per cent for interest from loans and credits granted by a bank for a period of at least seven years (those with Luxembourg, the Netherlands and South Korea), eight years (Hungary) or ten years (the Czech Republic) in connection with the selling of industrial equipment or with the study, installation or furnishing of industrial or scientific units, as well as with public works. According to its treaties with Belgium and France, the referred bank must have participation from public bodies of specialized financing. Its treaty with Canada provides that a 10 per cent maximum rate at source will be applied to interest arising in Brazil and paid to a resident of Canada in respect of a loan guaranteed or insured by the Export Development Corporation of Canada for a minimum period of seven years. Its treaty with Sweden increases the maximum rate at source to 25 per cent if the recipient is an individual or a partnership.

In spite of the fact that the OECD Committee on Fiscal Affairs criticized the original provision of the Model Convention regarding the concept of interest and changed it in the 1977 review (the revision was intended to be exhaustive), most Brazilian tax treaties (including those signed after 1977) adopt Article 11(3) of the 1963 OECD Draft Convention.

To this effect, almost all Brazilian tax treaties (the exceptions are those with China, Finland and Ukraine) consider interest as any income assimilated to income from money lent, according to the tax law of the contracting state in which the income arises (as stated in the position on Article 11(3)). This clause was severely criticized by the Committee on Fiscal Affairs since 1977 (when it was deleted from the OECD Model) by the argument that it does not offer security from a legal point of view, as changes in domestic law would affect the treaty and therefore the Model's references to domestic law should be avoided as far as possible. In another deviation from the Model provision, Brazilian tax treaties regard penalty charges for late payment as interest for the purposes of Article 11 (as has been pointed out in the positions on the Commentary to Article 11 of the OECD Model), with the only exceptions being the treaties with China and Hungary.

Brazil's treaties with Italy, Luxembourg, the Netherlands and Norway also establish in their protocol that it is understood that the commissions paid by a resident of Brazil (or any of the contracting states, in the case of its treaty with

Chile) to a bank or financial institution in connection with services rendered by such a bank or financial institution are considered to be interest.

An issue which is very relevant to Brazil and which is reflected in almost all its treaties (except those with China, Finland and Ukraine, as mentioned above) is that the definition of interest is extended to all payments which, according to the legislation of the source state, are considered interest. The relevance of such a provision is due to a particularity of the Brazilian tax system, which, according to Law No. 9,249/95, stipulates that type of interest paid as remuneration on the company's equity ('*juros sobre o capital próprio*').

There is much discussion in Brazil as to whether such payments should be dividends or interest, since, on the one hand, they are paid only to shareholders in proportion to their equity participation and only if the company has profits to be distributed. Furthermore, the payment of such interest may be deducted from dividends due to the shareholders. For this reason, it could be claimed that Article 10 would be applicable for such payments. On the other hand, the statute referred to above explicitly declares that for tax purposes, such payments shall be deemed to be interest and shall be treated as interest, both for the purposes of deducting such payments from companies' profits as well as for taxing payments at source (it should be recalled that dividends are not taxable at source in Brazil, while interest is subject to such taxation).

Therefore, when treaties refer to the domestic tax definition of interest, it should be understood that the referred interest on a company's equity shall be included in Article 11, not in Article 10. Some of Brazil's recent treaties (those with Chile, Israel, Mexico, Peru, Portugal, South Africa and Ukraine) provide in their protocol that interest paid as remuneration on the company's equity in accordance with Brazilian tax law shall also be considered interest for the purposes of Article 11.

Article 11(4) of the OECD Model, which concerns the inapplicability of the limitation at source for interest taxation if the recipient has a PE in the source country effectively connected with the interest paid, is adopted by all Brazilian tax treaties. Most commonly, the provision is closer to its original wording in the 1963 OECD Draft Convention, which does not mention the connection with a fixed base for independent activities. None of the treaties has adopted Article 11(4) of the UN Model, which also provides for the inapplicability of the limitation in case interest is connected with business activities in the source country of the same or similar kind as those effected through the PE due to the 'limited force of attraction rule' in Article 7 of that Model.

However, concerning interest, almost all Brazilian tax treaties (the exception is that with Japan) provide for a paragraph in Article 11 which subordinates the application of the convention not only according to the residence of the creditor and debtor of the interest in the contracting states, but also considering the place of the PE (that must be in the creditor's own country

of residence). Thus, such a provision derogates the treaty relativity principle, which is only concerned with the residence of the creditor and debtor, with the place where the PE is located being irrelevant. To this effect, reflecting the Brazilian position on Article 11(4) of the OECD Model, the treaties provide a clause by which the interest taxation limitation at source is inapplicable to interest arising in a contracting state and paid to a PE of an enterprise of the other contracting state that is situated in a third state.

Due to the particularity of Brazil's treaty with Japan, this is the only case where a payment made to a PE of a Japanese company (usually a bank) not situated in the contracting state shall be protected by the treaty.

As Brazil stated in its position on Article 11(2) of the OECD Model, its treaties (with the exception of those with Peru and Chile) include a paragraph in Article 11 exempting from taxation at source interest from the public debt paid to the government of the other contracting state or to one of its political subdivisions or agencies. Sometimes the agencies that can benefit from the exemption are enumerated in the treaty (the treaties with Argentina, Austria or the Czech Republic – in the case of Austria, the protocol provides that interest from loans granted by the Bank of Brazil and the *Oesterreichische Kontrollbank Aktiengesellschaft* shall be exempted in the source country). However, more often the provision states that whenever the interest is paid by the government of a contracting state (or one of its political subdivisions or a local authority thereof or any agency, including a financial institution), it will only be taxed at source.

The rule that the source state of the interest is the residence state of the payer (with the exception of interest-bearing loans economically linked with a PE, when the source of the interest is the contracting state where the PE is situated) is adopted by all Brazilian tax treaties. Most of the treaties provide such a provision with the 1963 OECD Draft Convention wording (even the treaties signed recently, such as those with Israel and Ukraine) – they mention the circumstance when the payer is the state itself, a political subdivision or local authority of the state. A few treaties (such as those with China, Ecuador and Hungary) adopted the 1977 OECD Model wording, which excluded mention to the circumstance referred to above and added the exception of the connection with a fixed base for independent activities along with the PE connection. However, the latest treaties signed by Brazil (those with Mexico, Peru and South Africa) adopt Article 11(5) of the UN Model, which provides the connection with the fixed base to establish the source of the interest, as the 1977 OECD Model did. The treaty with Argentina adds a rule in its protocol by which interest is deemed to arise in Argentina when the capital on which the interest is paid is placed or economically used in its territory.

Article 11(6) of the OECD Model (which is identical in the UN Model), which restricts the application of Article 11 in cases where the amount of

interest paid is not stipulated at an arm's length basis, was adopted in all tax treaties that Brazil has signed. It should be noted that Brazilian transfer pricing rules provide for a limitation of interest paid to related parties, which may not exceed the Libor rate (for six-month loans, irrespective of the actual duration of the loan) plus 3 per cent. Several scholars in Brazil claim that such a predetermined margin is not at arm's length, but the tax authorities will respond that there is no international standard for arm's length.

Recent Brazilian tax treaties (those with Chile, Peru, South Africa and Ukraine) also set forth an anti-abuse rule to interest, as suggested by para. 21.4 of the Commentary to Article 1 of the OECD Model.[9]

5.4.3 Royalties: Article 12

Regarding royalties, Brazil – in clear contrast to the OECD position but in accordance with Brazilian tradition in its treaties – has rejected the exclusive taxing right of the residence state, as positioned on Article 12. To this effect, Brazil follows the policy of the UN Model, which allows royalties taxation at source. Generally, Brazil has agreed in its treaties upon a maximum withholding tax of 15 per cent on royalties (with the exception of the 12.5 per cent rate in its treaty with Japan, which represents half of the usual 25 per cent rate applicable at the time of the conclusion of the treaty).

Brazilian treaties signed recently (those with Israel and South Africa) reduce the withholding tax on royalties to a 10 per cent rate – such a reduction also provoked a rate decrease to 10 per cent in the treaties with Spain, Mexico and South Korea, which have a form of most favoured nation clause in their protocols. Many treaties, however, provide for an exception to this 10 per cent or 15 per cent rate for cases where the royalties arise from the use or the right to use trade marks, when the maximum rate at source is 25 per cent (those with Austria, Belgium, China, the Czech Republic, Denmark, Ecuador, France, Finland, Hungary, India, Japan, the Netherlands, the Philippines, South Korea and Sweden).

Some Brazilian treaties also provide a lower rate of 10 per cent (those with Austria, Belgium, Finland and France) on royalties arising from the use or the right to use any copyright of literary, artistic or scientific work or for the use of, or the right to use, any films or video tapes for television or radio broadcasting produced by a resident of one of the contracting states. The treaty with Argentina does not provide any limitation for the taxation of royalties at source. Most Brazilian tax treaties, especially those

[9] 'The provisions of this Article shall not apply if it was the main purpose or one of the main purposes of any person concerned with the creation or assignment of the debt-claim in respect of which the interest is paid to take advantage of this Article by means of that creation or assignment.'

signed after the 1977 OECD Model, require the recipient of the royalties to be the beneficial owner.

Brazil adopts an extended concept of royalties. Thus, it has decided to maintain the traditional definition of royalties (which includes *inter alia* leasing, as provided by the 1977 OECD Model). The definition also includes payments from films and tapes for television broadcasting, as provided by the UN Model.

Since the royalties provision has always been a focus of Brazilian treaty negotiators, in several agreements they obtained a statement in the protocol with the view to including technical assistance and technical services within the scope of Article 12. This occurred for the first time in the treaties with Denmark and Spain (both signed in 1974). This provision did not appear in the treaties with Austria and Sweden (both signed in 1975), but from then on, it was a constant feature in all subsequent treaties in force in Brazil, except for that with Finland, which contains no such provision. Evidence that Brazil wishes this to be a basic characteristic of its treaties is the provision of its treaty with Israel, which contains something similar to a most favoured nation clause. Accordingly, the protocol to this treaty provides for an extension of Article 12 to technical assistance, but it declares that if in future Brazil shall accept to sign a tax treaty with a non-Latin American country which does not provide for the extension of Article 12 to technical services, then the same regime shall also be applied to Israel.

Brazilian authorities, however, understand that income from services which would not be included in Article 12 (in the case of Brazilian treaties, very few services would not be included therein due to the broad interpretation of royalties and technical services) would automatically fall within the scope of Article 21, not Article 7 – but, deviating from Article 21 of the OECD Model, Brazil also claims that the source state is entitled to unlimitedly tax such 'other income', provided that it derives from the source state.[10]

In order to justify their position, the Brazilian tax authorities argue that the scope of Article 7 is restricted to the taxation of profits, meaning that Article 7 would only be applicable in the circumstances where taxation would reach companies' profits. They claim that profits of non-residents are not taxable in Brazil; only some items of income are taxable. Since Article 7 would protect non-residents from taxation of their profits, it would not be a protection against taxation of mere items of income.

Of course, this has been heavily criticized by treaty partners and also by the majority of Brazilian scholars. As pointed out by Alberto Xavier, since it provides the exclusive taxation right to the residence state in the absence of a PE, Article 7 is precisely applicable to the circumstance when the company

[10] See the Brazilian Revenue Service's Normative Declaratory Act No. 01/00.

of a contracting state does not have a PE in the other contracting state, which generally happens to be the case for services.[11]

The wording of Article 7(7) itself assumes that it is applicable to items of income, not only to profits as a whole, since it recognizes that the profit is compounded by several items of income, which may or may not be disciplined in a specific article of the Model Convention. Thus, the profit taxable under Article 7 is not just that which matches with the definition of profit given by Brazilian domestic law (the result from the receipts and expenditures accounting), as intended by the tax authorities.

As noted by Rothmann, Article 7 covers all the income derived from business activities which are not disciplined in a specific article of the Model Convention (as interest, dividends and royalties): the general concept of business profit covers a plurality of income attributable to an enterprise.[12]

Moreover, according to Alberto Xavier, the 'other income' provided by Article 21 is income that is unusual, atypical or of little expression, which would not justify a proper discipline in the Model Convention, and therefore services could not be taxed under such an article.[13]

Nevertheless, as a matter of practice, services rendered to Brazilian parties are subject at least to the risk of such taxation. What makes this a dramatic situation is that usually Brazilian treaty partners would not recognize Brazil's right to tax services rendered in Brazil without a PE, due to Article 7. Consequently, there is the risk that tax paid in Brazil would not be offset against the tax due in the residence state. Recently, this issue has been successfully resolved between Brazil and Spain, whereby the latter recognized a broad interpretation to Article 12 but, on the other hand, Brazil agreed not to apply Article 21 to the remaining services.[14] Unfortunately, the same understanding was not found with Germany and this seems to be one of the reasons why Germany revoked its treaty with Brazil.

In a case judged recently dealing with technical assistance services rendered by a Finnish company (which did not have a PE in the country) to a Brazilian company, the tax authorities, claiming the fact that Brazil's treaty with Finland does not include technical services in Article 12, understood that such income should be taxed as 'other income' under Article 21 instead of being taxed under Article 7.[15] Nevertheless, the Federal Court, adopting the argument that a tax treaty must be interpreted according to its own

[11] See A. Xavier, *Direito Tributário Internacional do Brasil* (Rio de Janeiro: Forense, 2004), p. 695.

[12] See G. W. Rothmann, 'Problemas de qualificação na aplicação das convenções contra a bitributação internacional', 76 *Revista Dialética de Direito Tributário* 76 (2002), 33–43.

[13] See Xavier, *Direito Tributário Internacional*, p. 698.

[14] See the Brazilian Revenue Service's Interpretative Declaratory Act No. 27/04.

[15] *Veracel Celulose S.A.* v. *National Treasury*, 2nd Region Federal Court, 16 March 2010, judgment No. 2004.50.01.001354–5.

circumstances and context, always regarding the differences between the languages and the understandings and not according to the technical meanings of the domestic law, concluded that the income was clearly a profit and therefore should be taxed according to Article 7 of the tax treaty.

The exception for residence-state taxation of royalties provided by Article 12(3) of the OECD Model (when the beneficial owner of the royalties, being resident of a contracting state, carries on business in the other contracting state in which the royalties arise through a PE effectively connected with the payment of the royalties) is adopted by all Brazilian tax treaties. However, most treaties adopt the wording of the 1963 OECD Draft Convention, which does not mention the application of Article 14 in the case of independent activities through a fixed base connected to the royalties, which would have been the case in the 1977 OECD Model and is still provided by the UN Model.

The 'permanent establishment limited force of attraction' rule provided by the UN Model, which excludes from the scope of Article 12 royalties received in connection with business activities of the same or similar kind as those of a PE in the source country, was not adopted in any of the tax treaties that Brazil has signed.

The provisions of Article 12(4) of the OECD Model (reproduced in the UN Model), which deal with cases where the amount of royalties paid was not stipulated at arm's length due to special relations between the payer and the beneficial owner of the royalties, are adopted in all Brazilian tax treaties. It should be noted that Brazilian tax treaties will usually include in the protocol a provision stating that the present limitation imposed by Brazilian legislation on the deduction of royalties will not be affected by the treaty. Accordingly, Brazilian transfer pricing rules do not apply for royalties paid from Brazil; there is an older provision concerning royalties that limits payments from 1 to 5 per cent of the revenues, irrespective of the peculiarities of the concrete case. If the protocol provides for such limitation, the arm's length issues cannot be discussed by the taxpayer.

As Brazilian tax treaties provide for the taxation of royalties at source, they also add a paragraph in Article 12 determining the place which is their source (as positioned in the OECD Commentaries). To this effect, most treaties make an analogy to Article 11(5), with the wording of the 1963 OECD Draft Convention, which defines the source for interest. Thus, for most of the treaties, royalties are deemed to arise in a contracting state when the payer is that state itself, a political subdivision, a local authority or a resident of that state (source of payment). Where, however, the person paying the royalties, whether a resident of a contracting state or not, has in a contracting state a PE in connection with which the obligation to pay the royalties was incurred and such royalties are borne by the PE, such royalties are deemed to arise in the contracting state in which the PE is situated. Some treaties (those with Argentina, China, Ecuador and

Hungary) also add the connection with a fixed base for independent activities for establishing the source. The treaties with Chile and South Africa adopt Article 12(5) of the UN Model, while the treaties with Mexico and Peru adopt it partially, excluding the requirement of the royalties to be borne by the PE or fixed base.

As they do in the case of interest, Brazil's treaties with Chile, Peru, South Africa and Ukraine (among the most recent signed) provide an anti-abuse rule for royalties, with the wording suggested by para. 21.4 of the Commentary to Article 1 of the OECD Model.[16]

5.4.4 Capital gains: Article 13

Regarding Article 13 of the Models, Brazil's treaties generally adopt the provision of Article 13(1), by which gains derived from the alienation of immovable property may be taxed in the contracting state where such immovable property is situated.

The provision of Article 13(2) of the Models, which deals with the alienation of movable property forming part of the business property of a PE of an enterprise, is adopted by Brazilian tax treaties (with the exception of those with Argentina, Canada and Ecuador). Thus, such alienation is taxed in the contracting state where the PE is located. Most Brazilian tax treaties also include the fixed base for independent personal activities, as provided by the 1963 and 1977 OECD Models and still provided by the UN Model (the exceptions are those signed with Finland, France, India, Israel, Portugal, South Korea and Ukraine).

The rule by which gains from the alienation of ships and aircraft (and the movable property pertaining to their operation) operated in international traffic shall be taxable only in the contracting state in which the place of effective management of the enterprise is located, provided by both the OECD and UN Models, is adopted by most of the tax treaties that Brazil has signed. However, the treaties do not cover in their Article 13 inland waterways transport (as they also did not regarding Article 8), while the treaties with Peru and Chile also cover in Article 13 land transport vehicles. There are exceptions to the provisions of the Models, as the treaties with Chile, Finland, Japan, Peru, the Philippines, South Africa and South Korea state that such gains shall be taxable only in the contracting state where the selling enterprise is a resident (note that these treaties also provide in Article 8 the taxation at the state of residence and not at the place of effective management).

[16] 'The provisions of this Article shall not apply if it was the main purpose or one of the main purposes of any person concerned with the creation or assignment of the rights in respect of which the royalties are paid to take advantage of this Article by means of that creation or assignment.'

Brazil's tax treaties do not adopt Article 13(4) of the OECD Model, nor do they adopt the same paragraph of the UN Model. Its treaties with Finland, Israel and South Africa are the only ones that provide a paragraph in Article 13 dealing with gains from alienation of shares. In its treaties with Israel and South Africa, gains from the alienation of shares of a company the assets of which consist 'more than one half' (Israel) or 'principally' (South Africa) of immovable property may be taxed in the contracting state where such property is situated. Its treaty with Finland provides that gains from the alienation of shares which entitle the owner to the enjoyment of immovable property held by the company, the income from the direct use, letting or use in any other form of such right to enjoyment may be taxed in the contracting state in which the immovable property is situated.

In contrast to the Models, Brazilian tax treaties provide that gains from the alienation of any property different from those referred to previously (immovable property, movable property of PE, ships and aircraft) may be taxed in both contracting states. To this effect, Brazil has taken a position on Article 13 of the OECD Model reserving the right to tax at source gains from the alienation of property situated in a contracting state other than property mentioned in Article 13(1), (2) and (3). The only exception is its treaty with Japan, which adopts the Model Convention rule by which such gains are taxable only in the contracting state of which the alienator is a resident.

It is worth mentioning that in cases where both the seller and buyer are not resident in Brazil, domestic law also provides for taxation in Brazil of capital gains deriving from the sale of Brazilian assets.

5.5 Employment and other dependent activities

5.5.1 Income from employment: Article 15

Regarding income from employment taxation, Brazilian tax treaties adopt the place of work principle of Article 15(1) of the Models: such income is taxable in the state where the employment is actually exercised.

The exceptions to the general rule provided by Article 15(2), by which income from employment shall be exempted in the country where the activity is exercised, were also adopted by Brazilian tax treaties. In those treaties signed after 1992, the condition of the 183-day period limitation (the treaty with South Korea is the only one to provide a different period of 182 days) may not be exceeded 'in any twelve-month period commencing or ending in the fiscal year concerned', as defined in the 1992 OECD Model.

In previous treaties, the provision is that the 183-day period shall not be exceeded in 'the fiscal year concerned', as provided by the 1963 OECD Draft Convention and the 1977 OECD Model – this formulation was changed by the Models, as it created difficulties whenever the fiscal years of the

contracting states did not coincide and opened the way for tax avoidance opportunities. Some treaties (those with Finland, India, Israel, the Netherlands, Portugal, South Korea and Ukraine) do not provide the exception of the remuneration not being borne by a fixed base of the employer in the source country (as provided by the 1963 and 1977 OECD Models and still provided by the UN Model), but merely make reference to the PE.

The provision of Article 15(3) of the Models, which deals with taxation of the remuneration of the crews of ships or aircraft operated in international traffic, is generally adopted by Brazilian tax treaties. However, Article 15(3) of the treaties does not mention remuneration derived from employment exercised aboard boats engaged in inland waterways transport. The treaties with Chile and Peru also cover income from employment exercised on land transportation vehicles.

Nevertheless, certain Brazilian treaties contain different solutions to the circumstance of Article 15(3). The treaties with Chile, Finland, Peru and the Philippines provide that remuneration from employment exercised aboard boats and aircraft shall be taxed in the contracting state where the employee is resident. By contrast, the treaties with Japan, South Africa and South Korea provide that such remuneration may be taxed in the contracting state where the enterprise is resident, as suggested as an alternative rule by the Commentaries to Article 15 of the OECD Model.

5.5.2 Pensions: Article 18

Regarding pensions, Brazilian tax treaties generally do not adopt the rule of Article 18 of the OECD Model by which the residence state of the recipient has the exclusive right of taxation – only the earliest treaties (those with Belgium, France and Japan) adopt such a provision.

Some Brazilian treaties (those with China, Mexico, Portugal and Ukraine) adopt Article 18 of the UN Model, i.e. they assign to the residence state the exclusive right to tax pensions and other similar remuneration, but set forth that pensions payments made under a public scheme of the social security system of a contracting state shall be exclusively taxed in the source state (or cumulatively by the source state in the treaty with Finland). The treaties with China, Mexico and Ukraine also add the exception when the pension may be taxed in the source state if the payment is made by a resident of such a contracting state or by a PE situated therein, as is provided by Article 18B of the UN Model.

Some Brazilian treaties assign the exclusive right to tax pensions to the residence state of the recipient until a determined amount of payment and the value exceeding such a limit may be taxed in both contracting states. The treaties with the Czech Republic, Hungary, Luxembourg, South Korea and Spain provide a limit of USD 3,000 per year, while the treaty with Sweden

provides a limit of USD 4,000 per year, the treaty with Canada a limit of CAD 4,000 per year and the treaties with Italy and the Netherlands a limit of USD 5,000 per year.

According to Brazil's treaties with India, Israel, Peru and South Africa, both contracting states may tax pensions, with the exception of payments related to public social security programmes, when the right is exclusive of the source state. Its treaties with Norway and the Philippines give an unlimited taxation right to both contracting states in relation to pensions. Its treaties with Argentina, Austria, Chile, Denmark and Ecuador foresee an exclusive right to tax pensions to the source state. Thus, it can be seen that Brazilian tax treaties adopt many solutions to the taxation of pensions, most of them different from provisions of the OECD and UN Models.

Reflecting the Brazilian position on Article 18 of the OECD Model, most of its treaties include in the pensions article an explicit reference to annuities, along with their definition.[17] Expanding the original scope of the article (as can be seen in the Commentaries, the article only applies to payments that are in consideration of past employment), some treaties (those with Canada, the Czech Republic, India, the Netherlands and Norway) also include alimony in Article 18.

5.5.3 Government service: Article 19

Concerning taxation of remuneration in respect of government service (Article 19 of the Models), the earliest treaties concluded by Brazil (those with Belgium, Denmark, France and Japan) did not adopt the rule of Article 19 of the 1963 OECD Draft Convention. Such treaties assign the exclusive right on the taxation of government services' remuneration to the country which pays it, unless such remuneration is granted to a national of the other country, when it shall be taxed by both states.

From 1977 onwards, Brazilian tax treaties generally adopted the provisions of Article 19 of the 1977 OECD Model. Some treaties (those with Argentina, the Czech Republic, Ecuador, Hungary, Italy, the Philippines and South Korea) add an explicit provision stating that pensions paid with resources deriving from the social security system of a contracting state shall be taxable only in that state.

Brazil's treaties with Argentina, Ecuador, India and Peru do not adopt the rule of Article 19(2)(b) of the Models, which provides an exception to the exclusive right of the source state to tax pensions derived from services rendered to its government if the recipient is a resident and national of the

[17] 'Stated sum payable periodically at stated times during life or during a specified or ascertainable period of time, under an obligation to make the payments in return for adequate and full consideration in money or money's worth.'

other contracting state. Its treaties with Canada and Chile do not adopt Article 19(2) at all.

Brazil's treaty with Portugal assigns the right to tax remuneration from services rendered to the government to both contracting states. All Brazilian tax treaties nevertheless adopt the rule of Article 19(3) of the Models, which provides for the application of Articles 15, 16 and 18 (those with Mexico, Peru and South Africa also refer to Article 17, following the amendment of the Models) to remuneration in respect of services connected with a business carried on by a contracting state.

Brazil's most recent tax treaties (those with Israel, Mexico, Peru and South Africa) adopt the wording 'salaries, wages and other similar remuneration' in Article 19(1), as put by an amendment in 1994 as a substitution to the previous 'remuneration' to clarify the scope of the article.

5.5.4 Students: Article 20

Brazilian tax treaties adopt the rule of Article 20 of the Models by which payments received by students for the purpose of their maintenance, education or training are exempt in the state that the student is visiting, whenever such payments are received from sources outside that state. Reflecting the Brazilian position to Article 20 of the OECD Model, the treaties with Chile, China, India, Israel, Mexico, Peru and South Africa contain a paragraph which provides that if a student has income not exempted in the visited country in the terms of the rule referred to above, he or she shall be entitled to the same exemptions, reliefs and reductions granted to residents of the visited state, as provided by Article 20(2) of the 1980 UN Model (in spite of its exclusion from the Model in 1999, subsequent Brazilian tax treaties still include this rule).

Expanding the scope of Article 20 (according to the Commentaries, the article only covers payments received for the purposes of the recipient's maintenance, education or training), most Brazilian tax treaties contain a provision exempting in the visited state the student's remuneration from employment in that state that is necessary for his or her maintenance, education or practical training. This benefit is limited to a period of time, which is sometimes combined with a maximum amount of remuneration per year (as in the treaties with Belgium, Denmark, Japan, the Philippines, Portugal and Sweden).[18]

[18] This limit can be of two consecutive years (in the treaties with Ecuador, France, Hungary, Italy, Luxembourg, the Philippines, South Korea and Sweden), three consecutive years (those with Argentina, Belgium, Denmark and Japan), four consecutive years (that with Spain) or even five consecutive years (those with India and Norway). The treaties with Austria and Finland provide an aggregate of 183 days in the year concerned.

As consequence to the Brazilian position relating to Article 20 of the OECD Model, almost all Brazilian tax treaties (the exceptions are those with Austria, Canada, Chile, Finland and Peru) contain an article dealing with professors and researchers. Most of them exempt in the visited state the remuneration from their activities, under some conditions: generally, an invitation by the state, a university or other cultural institution, or an official programme of cultural exchange, as well as a maximum staying period of two years. The treaties with India, the Philippines and the Netherlands require the research to be undertaken in the public interest. In the treaties with China, Denmark, Norway and Sweden the exemption shall only be given if its beneficiary is subject to taxation in the other country. The treaty with Portugal provides the exemption in both states (while the Commentary to Article 20 of the UN Model establishes that double exemption of teachers is not desirable).

5.5.5 Other income: Article 21

A relevant issue which appears in Brazilian tax policy is that Brazil's treaties deviate from the OECD Model in Article 21. Accordingly, the OECD's understanding is that 'other income' should be taxed only in the residence state, while Brazil claims that the source state should also be entitled to unlimitedly tax such 'other income', provided that it derives from the source state (Brazil has reserved its position on Article 21 of the OECD Model Convention in the sense of maintaining the right to tax income arising from sources in its own country). It should be recalled that the Brazilian tax authorities claim that services not included in Article 12 should be included in Article 21 rather than Article 7. Since Article 21 provides for the right of the source state to tax 'other income', the practical effect of such a position is that Brazil will claim its right to tax all income deriving from services paid by Brazilian residents.

However, some treaties, among them the earliest ones Brazil has concluded (those with Belgium, Denmark, Italy, Luxembourg, Spain and Sweden), do not even require the income to derive from the source state to assign to such a country the right to tax the 'other income'. The only exception to these rules is the case of France, which does not even include an Article 21.

Brazil's treaty signed with Israel, in spite of not adopting the Model's rule for taxation of 'other income', adopts the exception of Article 21(2) of the OECD Model (income effectively connected with a PE), when Article 7 shall be applied.

By contrast, in the provision in respect of the 'other income' taxation, Brazil's treaties signed with Portugal, South Africa and Ukraine adopt the wording of the UN Model in the provision in respect of 'other income', i.e. Article 21(1) addresses the exclusive right of taxation to the residence country, while Article 21(3) assigns the right also to the source state whenever the income arises there and Article 21(2) provides the exception of income

effectively connected with a PE (its treaty with South Africa is the only one that refers to the fixed base).

5.6 Methods to avoid double taxation: Article 23

Brazil traditionally adopts the credit method in its tax treaties. In some (those with Austria, Belgium, the Czech Republic, France, Hungary, Luxembourg, the Netherlands and Norway) the exemption method was adopted in the circumstance where Brazil is the source country of the income, generally excluding so-called passive income (dividends, interest and royalties) – for such income, the credit method is provided.

In Brazil's treaty with Argentina, any income (including passive income) derived by a resident of Argentina which may be taxed in Brazil shall be exempted in the residence country, unless it is deemed to arise in Argentina. In its treaty with Spain, Brazil accepted to exempt its residents in respect of dividends which may be taxed in Spain, as well as Spain exempting dividends which may be taxed in Brazil. The treaties with Austria and Ecuador also exempted Brazil's residents in respect of dividends which may be taxed in the other contracting state; however, such an exemption is conditioned to a share (25 per cent and 10 per cent, respectively) of the capital of the paying company that must be owned by the resident.

The main focus of Brazilian policy when it comes to methods to avoid double taxation and tax treaties is the consistent adoption of tax sparing and matching credit clauses.

As in several other Latin American countries, Brazilian income tax has traditionally adopted a territorial approach. In fact, it was only in 1995 that Brazil decided to tax its companies on a worldwide basis. Tax treaties were therefore not seen as an agreement whereby both countries accept to reduce their own tax base in order to avoid double taxation, since from the Brazilian (territorial) perspective, Brazil would be the one to lose its tax base (as, from the territorial perspective, the residence country would not be entitled to such tax). Tax treaties were regarded as a tool for achieving development.

Due to the clear difference between capital inflow and outflow in the late 1960s and 1970s, Brazilian treaty negotiators understood that Brazil would usually be the source state in its treaties. To this effect, the main feature of Brazilian treaty policy in its first stage was that Brazil would not sign a treaty with a developed country if it did not contain tax sparing or matching credit provisions – it would not be acceptable that the only result of the tax treaty would be reducing Brazilian taxes and simultaneously increasing taxes in the residence state (due to lower credits), with no benefit to the investor. In fact, tax sparing and matching provisions may be considered as a good explanation for the first Brazilian tax treaties to have been signed with Sweden and Japan, since both countries had already agreed upon similar provisions with other

countries, thus sharing the Brazilian understanding as to the use of tax treaties as a tax incentive.

While in the first stage during the late 1960s and 1970s Brazil's treaty policy focused on developed countries, in the 1980s Brazil began to negotiate tax treaties with some developing countries, especially in Latin America, despite not leaving aside its negotiations with developed countries. It is interesting to note from this period that Brazil did not follow the same policy with both groups: while tax treaties with developed countries consistently focused on tax sparing and matching credits, this was not necessarily true in the case of developing countries. In some cases reciprocal matching credit clauses were negotiated. This can be seen, for instance, in the treaties with India, the Philippines and South Korea.

In recent years, changes in the global economy – and especially changes in the importance of Brazilian companies in the international scenario, where many of them are now global players – are reflected in a new Brazilian treaty policy. Thus, since 2002, a series of new treaties have been signed, always with countries which are neither traditional investors in Brazil nor have a regional relationship (Israel, Mexico, Peru, South Africa and Ukraine – treaties were also signed with Russia and Venezuela but are not yet in force). It is interesting to note that in this series of treaties, there are no tax sparing or matching credit clauses. This can most probably be explained by the fact that the treaty negotiators had no reason to believe that investments would be on a 'one-way' basis, as would be the case in a treaty between developed and developing countries. However, this may also be an interesting sign for the prospects of new treaties to be signed by Brazil, provided Brazilian companies increase their participation in the international economy.

It should be noted that while Brazil adopted territorial taxation until 1995 – which was the basis for the Brazilian position not to recognize the residence state's claim to tax its own residents for income deriving from Brazil – the adoption of worldwide taxation in Brazil may be a good argument for Brazilian treaty partners to not enforce the matching credit or tax sparing.

In fact, in the case of countries where one can imagine a balance between inbound and outbound investments, Brazil has not forced a tax sparing or matching credit. However, the relative success Brazil has already obtained in its treaty network shows that there does not seem to be a good reason for not requiring tax sparing and matching credits – although Brazil officially does not have its own model convention, the clauses mentioned above are already part of Brazilian tradition in its treaties. It is very unlikely that Brazil would accept to negotiate them in a different way, since this might imply reviewing all of the treaties presently in force. There remains the Brazilian position to Article 23 of the OECD Model reserving its right to add matching credit and tax sparing clauses.

In regard to matching credits, the issue is now much more complicated. In fact, when Brazil entered into its treaties in the 1970s, the Brazilian regular rate at source was 25 per cent. Thus, a limitation to 15 per cent would actually represent a reduction in government revenues: to this effect, the matching credit was the tool by which Brazil would obtain benefits from a tax treaty, and not only reduce its taxes to the exclusive benefit of the taxation in the state of residence. Therefore, the matching credit allowed that the maximum taxation of 15 per cent at source provided by tax treaties could be considered a reduction of Brazilian tax (or a tax incentive) in favour of the investor.

However, Brazil presently does not tax dividends. In such a case, it could be claimed that there would be no reason for a matching credit provision, since the treaty does not provide for any reduction of Brazilian tax. For interest and royalties, similar arguments could be presented by Brazilian partners, since both items of income are presently taxed on a 15 per cent rate in Brazil and, since tax treaties already provide for such taxation at source, it could be said that tax treaties bring no incentive for taxpayers and therefore no matching credit should be considered.

Notwithstanding the fact that the above arguments seem to be sufficient for enforcing the pressure on Brazil to no longer require a matching credit, tax sparing must not be condemned by the same arguments.

Accordingly, in the authors' view, tax sparing should not be considered as a subsidy granted by the developed country to the developing country, but rather as a respect the former has to the tax sovereignty of the latter. If two countries decide upon sharing their tax jurisdictions, each of them may exercise – or not – its taxing power; the mere fact that the source country decides not to tax an item of income which has been reserved to its jurisdiction should not be enough for its partner to tax the same item of income. The power to tax includes the power not to tax. If the source country grants a tax incentive, the residence country should respect such a decision – up to the limit of the jurisdiction of the former – thus not extending its own taxing power to the circumstance exempted by the source country.

5.7 Non-discrimination: Article 24

As regards non-discrimination, the earliest of Brazil's tax treaties (those with Austria, France, Japan, Spain and Sweden) adopted the provisions of Article 24 of the 1963 OECD Draft Convention, with the exclusion of Article 24(3), which extends the equality of treatment with nationals of a contracting state to stateless persons who are residents of one of the contracting states (as a matter of fact, none of the Brazilian tax treaties includes this provision).

Brazil's subsequent treaties, even those concluded under the 1977 OECD Model, did not adopt the second sentence added to Article 24(1), which

applies the provision to persons who are not residents of one or both of the contracting states (only its treaties with Israel, Mexico and Ukraine, all signed recently, adopt such a provision in spite of the Brazilian position on Article 24(1)). They also did not include in the non-discrimination article the definition of 'national' (Article 24(2) of the 1977 OECD Model), nor did they adopt Article 24(5) (this provision, related to the conditions of deductibility of royalties, interest and dividends to non-residents, would only be adopted in treaties signed from the end of the 1980s onwards, starting with that with South Korea).

Brazil's treaties also do not contain the provision of Article 24(7) (now para. 6) of the OECD Model: the non-discrimination provisions are limited to taxes which are subject to the convention. Actually, reflecting the Brazilian position on Article 24(6), restricting the scope of the article to taxes covered by the convention, besides those treaties that followed the 1963 OECD Draft Convention in its Article 24, only the treaties with Denmark, Luxembourg and Portugal apply the non-discrimination rules to taxes of every kind and description, and, in the treaty with Mexico, to federal taxes of any kind.

The latest tax treaties Brazil has signed (those with Israel, Mexico, Peru and South Africa, all concluded after 2001) adopt the expression 'in particular with respect to residence' in Article 24(1), as provided by an amendment in 1992 to the OECD Model.

5.8 Mutual agreement, exchange of information and mutual assistance in the collection of taxes

5.8.1 Mutual agreement procedure: Article 25

Concerning the mutual agreement procedure (MAP) (Article 25 of the OECD Model), Brazilian tax treaties generally adopt the provisions of the 1963 OECD Draft Convention, with the exclusion of the second sentence of Article 25(3) (which provides for consultation between the contracting states' authorities for the elimination of double taxation in cases not provided for in the convention) and of the second sentence of Article 25(4) (which addresses the oral exchange of opinions through a commission of representatives). This is the case for the treaties Brazil has signed with the Czech Republic, Hungary, Israel, Italy, Norway, Peru, the Philippines and South Africa. However, some treaties (those with Austria, France, Denmark, Luxembourg, Spain and Sweden, all of them signed before 1979) adopt the provisions of Article 25 of the 1963 OECD Draft Convention entirely.

A few Brazilian treaties provide in Article 25(1) a time limit for the presentation of the case, as did the 1977 OECD Model. The treaties with Argentina, Belgium, Ecuador and Portugal provide a two-year limit, while the treaties with Finland and China provide the Model's three-year limit, and the treaties with the Netherlands and India provide a five-year limit.

In spite of the Brazilian position on the second sentence of Article 25(2) of the OECD Model, as it considers that the implementation of reliefs and refunds following a mutual agreement ought to remain linked to time limits prescribed by its domestic laws, such a provision can be found in the treaties with Portugal and India.

None of the treaties adopt the provisions related to arbitration, added into Article 25(5) of the OECD Model, nor do they adopt the last two sentences of Article 25(4) of the UN Model, which proposes the development of methodologies to implement the MAP.

5.8.2 Exchange of information: Article 26

Concerning the article in respect of exchange of information (Article 26 of the Models), until 1977, Brazilian tax treaties adopted the provisions of Article 26 of the 1963 OECD Draft Convention. Nevertheless, the treaty with Japan does not mention the 'domestic laws of the contracting state' in Article 26(1) and also adds a paragraph regarding the exchange of information for the prevention of fiscal evasion in the contracting states. The treaties with Denmark and Sweden also make reference to 'courts' besides 'persons and authorities' in Article 26(1), which would only be done in the 1977 OECD Model.

After 1977, notwithstanding the fact that some Brazilian treaties (those with Canada and Luxembourg) still adopted Article 26 of the 1963 OECD Draft Convention entirely, Brazil's tax treaties (such as those with Italy, Norway and the Philippines) continued to adopt the provisions of the 1963 OECD Draft Convention with the exclusion of the reference to domestic laws of the contracting states in para. 1 and the addition in the same paragraph of authorities concerned with 'the prosecution of offences or the determination of appeals in relation thereto' (those with the Czech Republic, Hungary, Korea and the Netherlands also mentioned 'courts').

Brazil's treaties with China and Finland adopted the provisions of Article 26 of the 1977 OECD Model (its treaty with China added a reference in para. 1 to prevention of tax evasion). However, its treaty with Israel also adopted the provisions of Article 26 of the 1977 OECD Model, without mentioning the possibility of disclosing the information in public court proceedings or in judicial decisions. Its treaties with Portugal and Ukraine are the only ones which adopt the wording of the UN Model regarding the exchange of information.

In Brazil's treaty with Mexico, the exchange of information is applicable to federal taxes of any class or denomination. In its treaties signed with Peru and South Africa, it is applicable to taxes of any kind and description, as is currently provided by the OECD Model. In these three treaties, the exchange of information is – besides Article 1 – also not limited by Article 2, as is also currently provided by the OECD Model.

Brazil's treaties with Chile and Peru add a provision by which where the information is requested by a contracting state pursuant to the article, the other contracting state shall obtain the information requested in the same way as if it was its own taxation, regardless of the fact that the other state may not need such information at that moment, which is close to what it states in Article 26(4) of the OECD Model. These two treaties also add a paragraph in respect of information owned by the financial institutions, legal representatives or persons that act as representatives, agents or trustees, in a similar fashion to the current Article 26(5) of the OECD Model.

5.8.3 Assistance in the collection of taxes: Article 27

The provision regarding assistance in the collection of taxes, introduced into the OECD Model in 2003, was not adopted by the tax treaties signed by Brazil, probably due to the practical difficulties that may arise in its application, as well as to potential constitutional issues concerning the possibility of the Brazilian state to collect a foreign tax credit.