Tax Treaty Case Law around the Globe 2024

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Preface

Both the OECD Model Tax Convention on Income and Capital (OECD Model) and the United Nations Model Double Taxation Convention (UN Model) are designed as tools for legislative harmonization and, therefore, often serve as a basis for tax treaty negotiations between different jurisdictions worldwide. However, the interpretation of a specific tax treaty provision may still vary between countries for several reasons. The risk of double/multiple (non) taxation is, therefore, not entirely removed, and this will adversely affect the international exchange of goods and services and the movement of capital, technology and persons. To facilitate a uniform interpretation of tax treaties worldwide and, hence, reduce the risk of double/multiple (non) taxation, basic knowledge is needed of how various tax treaty issues are resolved by different jurisdictions.

It is widely known that a unified approach to the interpretation and application of international tax treaty rules may benefit not only the countries/parties to a certain tax treaty but also their taxpayers, as well as international trade and investments in general. This topic is, therefore, an ongoing concern for many tax practitioners, representatives of international organizations, public officers and tax scholars.

The Tax Treaty Case Law Around the Globe 2024 Conference was held by Tilburg University on 13-15 May 2024 in a hybrid way. This international event took place for the thirteenth time and was jointly organized by the European Tax College of Tilburg University and the Institute for Austrian and International Tax Law of WU. The conference was dedicated to the analysis of the most important cases on international tax treaty law decided in 2023 in different tax jurisdictions worldwide. Thirty-six cases were presented by tax experts from more than 20 different countries. Each presentation was followed by an intensive and fruitful discussion. Participants in the conference compared the interpretation approaches existing in both OECD and non-OECD member countries and produced comprehensive conclusions and suggestions. This book contains the key scientific outcomes of the conference.

Each report in this book is dedicated to a court case or a number of cases relating to a particular article of the tax treaty at issue (often based on the OECD or UN Model) that was decided in a certain jurisdiction in 2023. Each report is structured in a similar way, presenting the facts of the case, the decision and reasoning of the court, and the observations and conclusions of

Chapter 22

Brazil: The *Engecorps* Case: The Wording of Protocols on Technical Services

Luís Eduardo Schoueri and Jonathan Malaquias

22.1. Introduction

This chapter examines the *Engecorps* case as ruled by the Federal Court of the Third Region.[1] The case centred on the application of article 12 ("Royalties") of the Treaty between Brazil and Spain (DTC-BRA-SPA) to technical services that did not involve transfer of technology. Brazil generally treats technical services under the scope of article 12 through protocols. This case is significant for two reasons.

First, the case raises a fundamental question regarding the scope of article 12: does it encompass all technical and assistance services, or is it limited to those services that closely resemble the concept of royalties? According to the latter interpretation, only technical services that result in the transfer of technology would be covered by article 12. In essence, this chapter explores whether the protocol's wording leads to a broad or narrow interpretation of the concept of royalties.

Second, the case highlights the role of article 31 of the VCLT, to which Brazil is signatory.[2] Article 31 emphasizes that the context and ordinary meaning of treaty terms must be taken into account when interpreting a treaty. Considering the context and ordinary meaning can lead to a completely different interpretation from that reached by the Courts, especially given the absence of a mutual agreement procedure (MAP) between Brazil and Spain to address the issue of technical services until 2004.

The applicable Brazilian legislation is article 685 (II) (a) of decree n. 3000/1999, which imposes a 25% withholding income tax on remittances resulting from the provision of technical services. Relevant to this case are the Normative Declaratory Act (NDA) n. 01/2000, which established that technical services should be taxed under articles 7 ("Business Profits") or

1. BR: Federal Court of the 3rd Region, 10 October 2023, Appeal n. 0003473-92.2012.4.03.6130.
2. BR: Decree n. 7.030/2009.

22 ("Other Income"), respectively; the Interpretative Declaratory Act (IDA) n. 27/2004, which adopted the approach outlined in the MAP between Brazil and Spain, subjecting all technical services to taxation under articles 12 or 14 ("Independent Personal Services") irrespective of transfer of technology and concurrently restricting the application of article 7; IDA n. 4/2006, which revoked IDA n. 27/2004 but maintained the same tax treatment for technical services; and finally, IDA n. 5/2014, which revoked NDA n. 01/2000 and established that articles 12, 14, and 7 should be applied to technical services, respectively.

22.2. Facts of the case

Engecorps S.A. (hereinafter referred to as "taxpayer"), a Brazilian entity, provides technical consulting services, encompassing study and project development, management, supervision, and construction in the engineering field. In 2011 and 2012, the taxpayer contracted Técnica Y Projectos S.A., a Spanish resident company, to coordinate, manage, and conduct engineering project studies.

The tax authorities considered that the amounts remitted to Técnica Y Projectos S.A. fell under article 685 (II) (a) of decree n. 3000/1999. This provision states that payments remitted abroad for the provision of services are subject to a 25% withholding income tax. The tax authorities further argued that technical services should be taxed according to article 3 of IDA No. 4/2006, equating them with royalties and thereby applying article 12 of the DTC of Brazil-Spain.

In response, the taxpayer filed a writ of mandamus, arguing that the payments should not be subject to tax due to the application of article 7 of the DTC-BRA-SPA, which states that profits of an enterprise of a Contracting State shall be taxable in that State. Since Técnica Y Projectos S.A. had no PE in Brazil, the remitted amounts represented its business profits and were not taxable in Brazil. Additionally, the taxpayer also challenged the application of article 3 of IDA n. 4/2006, arguing that the taxation of technical services under article 12 of the DTC-BRA-SPA should only occur when there is a transfer of technology. Applying IDA n. 4/2006 would unlawfully reduce the scope of article 7, as technical services with no transfer of technology would not be qualified as royalties.

In the preliminary ruling, the judge established that the concept of profits, based on the difference between gross revenue and expenses, was

inapplicable to the case's remittances. Instead, invoking article 3 (2) of the DTC-BRA-SPA, which allows for domestic law definitions unless the treaty context requires otherwise, the judge adopted a broader interpretation of profit. It was reasoned that the DTC-BRA-SPA intended "profit" to encompass any income capable of contributing to a company's profitability, thus article 7 should be applied.

The tax authorities, however, argued that the application of article 685 (II) (a) of Decree n. 3000/1999 did not mention the transfer of technology as a requirement for taxation. Therefore, any remittances abroad should be taxed at a 25% rate. Furthermore, they contended that the inability to classify income from service provision without technology transfer as profit under article 7 would lead to the application of article 22. This interpretation is based on NDA n. 01/2000, which states that, in Brazilian DTCs, such income should be covered by article 22, ensuring Brazil's right to tax it.

The taxpayer challenged the application of NDA No. 01/2000, highlighting the contradictory positions tax authorities have taken over the years regarding payments for technical services. In 1997, the Federal Revenue Service declared that income tax would should not be withheld on payments to a French company without a permanent establishment in Brazil for the provision of technical services that do not qualify as know-how.[3] This implied that, absent the transfer of technology, article 7 should prevail over article 12. The taxpayer contended that NDA No. 01/2000 unlawfully altered this interpretation by subjecting all technical services, regardless of whether a transfer of technology was involved, to article 22.

At the trial level, the Court upheld the preliminary ruling. According to the Court, the application of article 3 (2) of the DTC-BRA-SPA would result in a broad definition of profit, encompassing income from the payment of technical services. Consequently, article 7 was applied.

The tax authorities appealed, highlighting the specific wording of the DTC-BRA-SPA protocol. This protocol defined "information corresponding to the experience acquired in the industrial, commercial, or scientific sector" as referred to in article 12 (3), to include income from technical services and assistance. The existence of a protocol would result in an extensive interpretation, implying the taxation of any technical service or technical assistance. Although terms like "technical assistance" and "technical services"

3. Fábio Lima da Cunha, "Os Serviços sem Transferência de Tecnologia no Contexto dos Tratados para evitar a Dupla Tributação da Renda", *Revista Dialética de Direito Tributário*, 190 (2011), 19-28.

lack a precise definition, the tax authorities argued that these terms refer to services requiring expertise in a specific area of industrial, commercial, or scientific knowledge. Concerning article 22, its application would arise from the absence of explicit mention of the term "technical services" in the DTC-BRA-SPA. Finally, they also maintained that NDA n. 01/2000, as an administrative act, merely complemented the law rather than altering or contradicting its content, thus precluding any illegality.

The Appellate Court rejected the appeal, finding that the DTC-BRA-SPA prevented Brazil from taxing the profits of Técnica Y Projectos S.A., as outlined in article 7, and therefore no tax should be levied. The tax authorities subsequently filed a motion for clarification, emphasizing the protocol's role in classifying technical services payments as royalties. The Court, however, ruled that the issue had been clarified and thus denied the motion. The tax authorities then pursued the matter through a special appeal to the Superior Court of Justice (SCJ).

In the special appeal,[4] the SCJ held that the protocol expanded the concept of royalties, covering all payments made for technical assistance and technical services. The SCJ took into account article 31 (3) (a) of the VCLT, which states that, along with the context, any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions shall be considered. It concluded that Article 12 should prevail over Article 7, as it constitutes a more specific provision.

The SCJ also noted that the lower court had failed to considered the application of article 12 and also instructed the Court to rule on the application of article 14, due to IDA n. 5/2014, which gives precedence to Articles 12 and 14 over Article 7. Furthermore, the SCJ considered that DTCs may include protocols broadening the concept of royalties to "any type of payment received for technical assistance and technical services". The SCJ also requested the Court to address the presence of a mismatch in the qualification of the mentioned income (erroneously referred to as "hybridism"), which would allow different qualifications between the jurisdictions of Spain and Brazil. Additionally, the SCJ urged the Appellate Court to comment on whether the payment included embedded royalties.

4. BR: Superior Court of Justice, 17 October 2023, Special Appeal n. 1.759.081/SP.

22.3. The Court's decision

The Federal Court of the Third Region ruled that the services rendered did not fall within the scope of article 14, as they involved "numerous activities" rather than isolated activities such as those performed by doctors, lawyers, engineers, architects, and dentists. Regarding hybridism, the Court held that the decision would require the analysis of Spanish legislation, which was not feasible at that stage of the trial.

Citing the SCJ's ruling, the Federal Court of the Third Region determined that the DTC-BRA-SPA does not distinguish between technical assistance services provided with or without transfer of technology. Consequently, the Court concluded that the protocols broaden the definition of royalties to encompass all payments for technical services.

22.4. Comments on the Court's reasoning

Article 14 (2) of the DTC-BRA-SPA clarifies that examples of independent activities include "technical, scientific, literary, artistic, educational, and pedagogical activities, as well as independent activities of doctors, lawyers, engineers, architects, dentists, and accountants". However, it does not encompass services rendered by companies, making it inapplicable to this case. It is important to note that the SCJ did not consider the nature of the instrument (equity or debt, for example) to determine if a case of hybridism was present; apparently, the SCJ interpreted the scenario of different qualifications between jurisdictions as hybridism, a topic addressed by BEPS Action 2. The case centred on the interaction between article 12 and the protocol to the DTC-BRA-SPA.

Protocols are components of the treaty[5] and, for this reason, they are legally binding. But what interpretation should be given to the protocol regarding the application of article 12 to the services rendered? Article 31 of the VCLT was frequently referenced throughout the case; it provides that a treaty must be interpreted in good faith according to the ordinary meaning given to its terms in their context and in light of its object and purpose. The relevant context includes any agreement relating to the treaty or any instrument established by one or more parties in connection with the conclusion

5. Werner Haslehner, in Reimer & Rust (ed.), *Klaus Vogel on Double Taxation Conventions*, 5th ed. (2021), Introduction at m.no. 100, 54.

of the treaty, such as the protocol. The ordinary meaning refers to the commonly accepted understanding of legal terms.[6]

The terms "technical assistance" and "technical service" were originally used in the context of technology transfer programs during the negotiation of Brazil's treaties.[7] Brazilian policy itself was linked to industrial development and used the terms "technical assistance" and "technical service" to refer to technology transfer contracts[8]. Evidence of this includes the establishment of the INPI in 1971 and the issuance of Normative Act (AN) n. 15/1975. The INPI was created to regulate technology contracts, among which were those concerning technical services and technical assistance.[9] AN n. 15/1975 allowed the contracting of technical services from foreign companies only if there was a technical team capable of absorbing the technology implicit in the service;[10] in other words, under Brazilian law, technical services were legally inseparable from the notion of transfer of technology. The ordinary meaning of "technical services" at the time therefore referred to services involving such a transfer. This interpretation can be directly extracted from the text of the protocol since its wording indicates that technical services subject to taxation refer to those that fall within the definition of "information relating to industrial, commercial, or scientific experience". That is, only technical services or assistance that result in the acquisition and internalization of such experience in the industrial sector would qualify for taxation under article 12.

The establishment of an MAP between Brazil and Spain represented a significant shift in this approach. The MAP explicitly stated that all technical services and technical assistance are to be treated as royalties for the purposes of the DTC – regardless of whether they themselves involve transfer of technology or not. In effect, through a mutual agreement, the parties resolved the issue by defining that the protocol's purpose is indeed to extend the application of article 12 to all technical and technical assistance services, not only those involving technology transfer.

6. Werner Haslehner, in Reimer & Rust (ed.), *Klaus Vogel on Double Taxation Conventions*, 5th ed. (2021), Introduction at m.no. 100, 74.
7. World Intellectual Property Organization, Records of the Washington Diplomatic Conference on the Patent Cooperation Treaty, (Geneva, WIPO, 1972), 571-574.
8. BR: Law n. 5.648/1970, art. 2.
9. BR: Normative Act n. 15/1975, 1.1.
10. BR: Normative Act n. 15/1975, 6.1.3.

22.5. Conclusion

In the *Engecorps* case, the central question arising from article 12 was whether payments for technical and assistance services not involving transfer of technology were subject to the royalty provision. The wording of the protocol in the DTC-BRA-SPA seemed to indicate that only technical and technical assistance services resulting in acquired experiences in the industrial sector would be taxed under article 12, leading to a restrictive interpretation. This position can be confirmed by the context and ordinary meaning of the term "technical services" according to article 31 of the VCLT.

However, the MAP between Brazil and Spain provided a definitive interpretative shift, extending the scope of royalties to encompass all technical services and assistance, irrespective of the transfer of technology.

Following the SCJ's understanding, the Federal Court of the Third Region considered that the existence of a protocol would automatically extend the concept of royalties to any payment for the provision of technical services.

Nonetheless, it should be noted that the mere existence of a protocol does not justify an extensive interpretation. The context and ordinary meaning of the terms must be observed. Given the regulatory framework in place at the time of treaty negotiations, it is plausible that in other cases, article 12 would apply only to technical services that involve a transfer of technology.