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Brazil’s absence from the Multilateral BEPS Convention and the new amending protocol signed between Brazil and Argentina

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As widely reported, the signing ceremony of the Multilateral Convention to implement tax treaty related measures to prevent Base Erosion and Profit Shifting (“MLI”) took place on 7 June 2017, in Paris, with the participation of Ministers and other high-level political representatives from various countries around the world.

Besides the United States, which from the outset chose not to sign the MLI and expressed that the BEPS project unfairly focused on US multinationals, another notable absence at the signing ceremony was that of Brazil, which had participated in the Ad Hoc Group of the BEPS Project and manifested its interest in signing the MLI.

Brazil’s justification for its absence

The absence of Brazil at the signing ceremony was justified on the basis of the complexity of the MLI, which intends to amend several bilateral tax treaties through a single instrument. According to the Brazilian Tax Administration, this innovative procedure could generate lengthy discussions in the Brazil’s National Congress, thereby delaying the approval of the MLI for years, a result that would be undesirable.

Thus, as its tax treaty network is small in comparison to international standards, Brazil decided that it would be better to amend and update its tax treaties through bilateral negotiations, in order to submit each of them individually to the National Congress.

From a Brazilian Constitutional standpoint, the modification of international treaties through a multilateral instrument would be perfectly possible. For instance, Brazil signed the International Convention for the Suppression of the Financing of Terrorism, promulgated by Decree No. 5,640/2005, which changed other international treaties listed in its annex, such as Convention for the Suppression of Unlawful Seizure of Aircraft, promulgated in Brazil by Decree No. 70,201/1972. This previous experience suggests that the difficulty foreseen by the Brazilian Tax Administration in the approval of the MLI by the National Congress is eminently political, given that, from a legal perspective, this amendment of bilateral tax treaties by the MLI would be valid and desirable.

However, from a practical perspective, this political concern seems to be justifiable, since the tax

treaty signed between Brazil and Russia recently promulgated by Decree No. 9,115/2014 took 13 years to be approved by the Brazil's National Congress.

Interestingly, the first bilateral renegotiation has just occurred with Argentina. On 24 July 2017, Brazil and Argentina signed an amending protocol in the city of Mendoza, which modified the original tax treaty entered into by the two countries, thereby incorporating, among other changes, the recommendations articulated by the OECD in the MLI.

As the MLI makes the interpretation of the modified tax treaties more complex, especially for the purpose of determining the current wording and the scope of amended provisions, it should be acknowledged that such traditional path followed by Brazil, if adopted in a timely manner, may have its merits, either because certain proposals suggested by the OECD are not interesting from a Brazil's tax treaty police perspective, or because bilateral renegotiations avoid the complications brought by the MLI.

The new protocol of Brazil-Argentina Tax Treaty

The amending protocol introduced several modifications in the Brazil-Argentina tax treaty, which can be segregated into three basic types:

- tax treaty measures to prevent BEPS;
- updating of tax treaty provisions to incorporate changes in the OECD MC and UN MC;
- amendments that reflect country-specific tax treaty policies.

A brief summary is provided below for each type of modification.

Tax treaty related measures to prevent BEPS

Initially, the amending protocol modified the title of the Brazil-Argentina tax treaty, in order to include the objective of preventing tax avoidance, as well as its preamble, which now states that both countries intend to eliminate double taxation without creating opportunities for non-taxation or reduced taxation[1].

The preamble also asserts that Brazil and Argentina desire to further develop their economic relationship and to enhance their co-operation in tax matters[2].

Strictly speaking, the assertion that Brazil and Argentina do not intend to create opportunities for double non-taxation has limited effects, since it does not automatically exclude the results that may emerge in the application of a tax treaty. If the application of a treaty provision, in interaction with domestic laws, results in double non-taxation, it is not possible to exclude such effect solely based on the interpretation of the preamble, with the consequent collection of the income tax in violation of the tax treaty.

In this sense, it is worth remembering the decision rendered by the Federal Court of Australia in the *Commissioner of Taxation v. Lamesa Holdings BV*, judged on 20 August 1997, which stated that the purpose of a tax treaty may in certain circumstances shed light on the interpretation of a specific clause, but that the text of treaty provisions must always have primacy, being the starting point for the interpretation, regardless of the original intention of the Contracting States.

> *"There will be cases, and Thiel was one, where resort to the purpose of the double tax treaty to be found in the words "for the avoidance of double taxation with respect to taxes on income" may throw light on the interpretation to be adopted with respect to a particular Article. But it is difficult to see that that is the case here. The text of the treaty, being the starting point in any investigation as to the meaning of the text, necessarily has primacy in the interpretation process (…). The starting point of interpretation is the elucidation of the meaning of the text, not an investigation ab initio into the intentions of the parties".*

The second set of changes reaches the concept of permanent establishment ("PE"). The amending protocol updated the PE concept, modifying the list of specific activity exemptions[3] and the definition of dependent agent PE[4]. However, it did not include in the Brazil-Argentina tax treaty the MLI provision concerning the splitting up of contracts[5].

Still in relation to the PE concept, the amending protocol included the concept of a "*person closely related to an enterprise*" within the definitions of the Brazil-Argentina tax treaty[6]. This new concept is important for the application of the modified PE provisions, which deal with commissionaire arrangements and specific activity exemptions.

The modifications in the PE concept will probably have no significant effects in Brazil, since its domestic law does not use the concept of PE as a parameter to trigger source taxation. On the contrary, Brazil generally opts for the collection of withholding income tax ("WHT") on payments made to non-residents, sometimes even when this mechanism is not fully compatible with tax treaty obligations.

Turning to the concept of dividend, the amending protocol introduced a minimum shareholding period of 365 days for the application of the reduced rate on dividends, in order to avoid dividend stripping tax avoidance schemes.

Another significant change is found in the method for elimination of double taxation. The amending protocol replaced the method article of the Brazil-Argentina tax treaty, adopting the credit method for the elimination of double taxation[7]. Thus, this new provision repealed the tax exemption previously granted by Brazil to intercompany dividends, as well as the exemption method adopted by Argentina to all types of income.

With regard to the mutual agreement procedure (MAP), the amending protocol replaced the old provision, in order to follow the new wording found in Article 16 of the MLI. In this respect, Brazil and Argentina did not include in their tax treaty the mandatory binding arbitration[8] and the corresponding transfer pricing adjustments[9].

These outcomes were already expected, as the mandatory binding arbitration is a highly controversial topic in Brazil. In brief, the National Treasury argues that tax treaty arbitration is incompatible with the Brazilian tax system, given the fact that the tax authorities may not dispose of the tax credit properly constituted in accordance with domestic tax laws. For this reason, Brazil has no arbitration clause in its tax treaties.

With regard to the inclusion of Article 9(2) of the OECD MC in existing tax treaties, this measure is only a best practice under BEPS Action 14. As a result, Brazil is authorized to maintain its current practice against corresponding transfer pricing adjustments. Despite this, Brazil will have

to provide access to MAP in transfer pricing cases, even in the absence of such treaty provision in its tax treaty with Argentina.

Finally, the amending protocol included a Principal Purpose Test (PPT) in the Brazil-Argentina tax treaty[10], combined with (i) an ownership clause worded negatively, along with a type of activity clause[11], which was inspired by the Limitation on Benefits clause; and (ii) an anti-abuse rule for permanent establishments situated in third countries[12].

The adoption of a PPT by Brazil as a result of BEPS Action 6 was an expected outcome, due to its apparently straightforward application and the past experience of the Brazilian administrative courts with the "business purpose doctrine".

Updating of tax treaty provisions to incorporate changes in the OECD MC and UN MC

The Brazil-Argentina tax treaty was signed on 17 May 1980, for which reason some of its provisions were not updated with the most recent versions of the OECD and UN MC.

In this context, the amending protocol updated the wording of Article 2 of the Brazil-Argentina tax treaty, adapting it to the current wording of the OECD MC.

The amending protocol also changed the wording of the PE provision for insurance companies, which are deemed to have a PE in the other Contracting State if they collect premiums or insure risks in that territory through a person who is not an agent of an independent status. This provision is patterned on Article 5(6) of the UN MC.

The concepts of dividends, interest and royalties were updated by the inclusion of the beneficial owner requirement. The amending protocol also included maximum tax rates of WHT to be charged by the source State on dividends, interest and royalties paid to a beneficial owner resident in the other contracting State.

Finally, the amending protocol made other less significant modifications, namely:

- Article 10 of the amending protocol modified the wording of the carve-out provision contained in Article 15 of the Brazil-Argentina tax treaty (income from employment), excluding the payments made to students and apprentices.
- Article 11 of the amending protocol unified in one single provision the distributive rule concerning visiting professors and researches and the distributive rule dealing with students and apprentices.
- Article 12 of the amending protocol included a new distributive rule for taxes on capital, whose wording is similar to Article 22 of the OECD MC and UN MC, with a few additions.
- Article 15 of the amending protocol updated the provision on exchange of information, following the wording of Article 26 of the OECD MC.
- Article 19 the amending protocol renumbered Articles 27, 28 and 29 of the Brazil-Argentina tax treaty, due to the inclusion of the so-called "Limitation on Benefits provision" as Article 27 of this tax treaty.

Amendments that reflect country-specific tax treaty policies

The most relevant modification made by the amending protocol involves the inclusion of the concept of technical services within the Brazil-Argentina tax treaty.

As known, Article 12 of the OECD MC allocates exclusive taxing rights over royalties to the recipient's residence state. However, Brazilian tax treaties deviate from this provision, attributing taxing rights to both contracting State.

Another common deviation found in Brazilian tax treaties lies in the scope of article 12. In the protocol of a significant number of tax treaties signed by Brazil, there are provisions stating that Article 12 also applies to remuneration derived from technical assistance and technical services. This practice has been claimed as a tax treaty policy adopted by Brazil to counterbalance its characteristic of a capital importer country.

Nevertheless, due to the lack of an express definition for such terms, this provision has generated several disputes between taxpayers and tax authorities in Brazil.

First, the distinction between "technical services" and "ordinary services" is far from clear, which gives rise to conflicts, since the income derived from the former is classified as "royalties", while the income arising from the latter is classified as "business profits" or as "income from independent personal services", depending on the circumstances.

Second, taxpayers argue that the extended concept of royalties only reaches "technical services" auxiliary, complementary or instrumental to a know-how or technology transfer agreement, based on the grounds that the protocol should be interpreted in the context of the royalty provision, which encompasses income received as remuneration for the use of, or right to use, any copyright of literary, artistic or scientific work, including cinematograph films, any patent, trademark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience.

The prevailing judicial case-law on the matter is favorable to taxpayers[13]. Nevertheless, the topic is still under dispute and the scope of the extended concept of royalties found in Brazilian tax treaties is not entirely clear so far.

That seems to be the reason why the amending protocol included in the Brazil-Argentina tax treaty an express definition for "technical services", thus considered those whose execution depends on specialized technical knowledge, as well as administrative assistance or consultancy activities carried out by independent professionals, employees or automated structures with clear-cut technological content.

The inclusion of a broad concept of "technical services" within the tax treaty can change the direction of the current case-law for the benefit of the Brazilian Tax Administration.

Furthermore, the amending protocol also establishes that the concept of dividend includes payments made by investment funds in Brazil.

Lastly, as Brazil and Argentina are closely related economies, the amending protocol included a "Most-Favoured-Nation" clause in the Brazil-Argentina tax treaty. This MFN clause provides that if Argentina enters into a new tax treaty after 21 July 2017, which restricts the taxation on capital in the source State in relation to the ownership of shares and participations, such limitation will be applicable to the Brazil-Argentina tax treaty as from the entry into force of the new tax treaty.

Final comments

As can be seen, the new amending protocol signed between Brazil and Argentina made several changes in the existing tax treaty between both countries, in order to adapt its provisions to the current international tax regime.

From a Brazilian perspective, it remains to be seen how the National Congress will react to the new BEPS measures, particularly in regard to the PPT clause, whose wording is vague and carries great ambiguity, thereby possibly infringing the principle of legal certainty.

More importantly, it is to be hoped that the Brazil's National Congress analyzes the new amending protocol within a reasonable time frame, as there is no justification for the long years spent waiting the approval of the Brazil-Russia tax treaty.

[1] Article 6(1) of the MLI

[2] Article 6(3) of the MLI

[3] Article 13, Option A, of the MLI

[4] Article 12 of the MLI

[5] Article 14 of the MLI

[6] Article 15 of the MLI

[7] Article 5, option C, of the MLI

[8] Article 16 of the MLI

[9] Article 17 of the MLI

[10] Article 6 of the MLI

[11] In accordance with the ownership clause, a company will not be entitled to treaty benefits if more than 50% of its capital stock is directly or indirectly owned by non-qualified residents. However, this provision will not apply when the company engages in substantial economic activities in the Residence State.

[12] Article 10 of the MLI

[13] 3rd Federal Court of Appeals, Appeal No. 0016356-64.2012.4.03.6100/SP, CIA DE BEBIDAS DAS AMERICAS – AMBEV, Rapporteur Judge Mônica Nobre, 24 April 2017; Superior Court of Justice, Special Appeal No. 1.272.897, IBERDROLA ENERGIA S?A, Rapporteur Judge Minister Napoleão Nunes Maia Filho, 9 December 2015.

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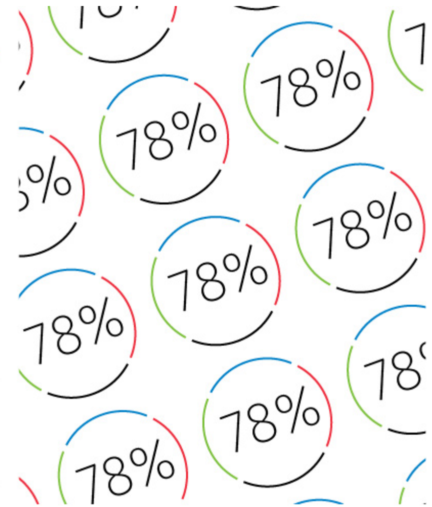

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