

Brazil provides guidance on characterization of service fee payments under tax treaties

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In brief

The Brazilian Federal Revenue Authorities (RFB) on June 20, 2014, issued Interpretative Declaratory Act No. 5/2014 (ADI 5/2014), which clarifies the tax treatment of payments made by Brazilian entities for technical assistance and services (with or without transfer of technology) to a company located in a country with which Brazil has signed a double tax treaty (DTT).

In accordance with ADI 5/2014, service fees may be characterized as royalties, independent personal services, business profits, or other income under Brazilian DTTs.

In detail

ADI 5/2014 specifically provides that when the relevant DTT or protocol treats technical services or assistance in the same manner as royalties, payments should be governed by the treaty article dealing with royalties (generally article 12). In this case, Brazilian DTTs generally grant taxing rights to Brazil.

ADI 5/2014 further provides that when the technical assistance or services relate to the technical qualification of a person or group of persons, payments should be governed by the treaty article dealing with independent personal services (generally article 4). As in the case of royalties, Brazilian DTTs

generally grant taxing rights in these cases to Brazil.

In other situations, payments should be governed by the treaty article dealing with business profits (generally article 7). In these cases, Brazil generally should not tax the profits unless the foreign entity carries on business in Brazil through a permanent establishment.

Previously, through Interpretative Declaratory Act COSIT No.1/2000, the RFB had applied a literal interpretation of the term 'profit' as used in the business profits article. Accordingly, the RFB viewed payments to foreign entities for the provision of technical assistance and service contracts when no technology

was transferred as outside the scope of the business profits article and therefore governed by a DTT's 'other income' article (generally article 21 or 22), which allowed taxation in Brazil.

ADI 5/2014 repeals Interpretative Declaratory Act COSIT No. 1/2000.

The takeaway

US multinational companies should examine how the new rules may potentially lower or eliminate the Brazilian income tax withholding on technical assistance and service payments emanating from Brazil.

Let's talk

For a deeper discussion of how this might affect your business, please contact:

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