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Advogados Associados

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"International Taxation and Treaties to Avoid Double Taxation"

The months of July and August saw some acts being approved, as well as a decision concerning International Treaties being rendered. This Special Edition of VGL News aims to list and illustrate some of these changes:

1. VIENNA CONVENTION APPROVAL BY THE NATIONAL CONGRESS

Legislative Decree no. 496/09, dated July 20, 2009.

The Federal Official Gazette published Legislative Decree no. 496 (*Legislative Decree*) on 20.07.09, which approves the text of the Vienna Convention on the Rights of Treaties ("**Convention**"), entered into in Austria in 1969 and adopted internationally in 1987. This approval by the National Congress took place 40 years after the execution of the convention. However, although approved by the Senate, its ratification still depends on the sanction of the president in order for it to have legal effects in Brazil. Broadly speaking, the Convention aims to set clearer and more objective procedures in relation to the application and interpretation of international treaties and agreements ("**Treaties**").

From the viewpoint of the application of treaties, we point out the following procedures addressed by the Convention: (i) the moment Treaties enter into force, (ii) capacity of the States (signatory countries) to sign treaties, (iii) form of adhesion to the provisions in the Treaties, and (iv) means whereby the signatory countries endorse Treaties' rules. As to the interpretation, the Convention sets forth: (a) the definitions of certain concepts, such as "treaty", "ratification" and "full powers"; (b) that treaties are to be interpreted based on the principle of good faith, according to the regular (textual) meaning of terms, within its context and in light of its objective and purpose; and (c) which supplementary means, such as preparatory work for international agreements, may be used in the interpretation of ambiguity or obscurity.

Another essential aspect defined in the Convention in question concerns the process of accepting Treaties with reserves. Brazil used the mentioned prerogative to approve the Convention (through such Legislative Decree), except for articles 25 and 66: the first article addressed the possibility of a provisional application of the Treaty, which can be in effect regardless of the ratification in Brazil, whereas the second article dealt with Judicial, Arbitration and Conciliation Solution processes.

Furthermore, the Convention defines other several relevant parameters related to the application of Treaties, specifying elements of their legal effectiveness, nullity and termination, such as: the non-retroactive application of the Treaties and the compliance with the rules of a Treaty by the

internal laws of the signatory countries. As to tax, specifically, the prevalence of the treaties over the internal legislation is already provided for in article 98 of the National Tax Code, and a presidential approval of the Convention will certainly reinforce the prevalence of the treaties over the domestic legislation.

2. TAXATION OF CAPITAL GAIN AND THE APPLICATION OF TREATIES TO INDIVIDUALS

Administrative Response to Inquiry no. 260, of July 30, 2009.

Response to Inquiry no. 260/2009, issued by the Regional Superintendence of the Federal Revenue ("**SRRF**") of the 7th Tax Region, has analyzed the taxation of capital gain earned by an individual resident in Brazil arising from the disposal of real property located in France ("**Capital Gain**"), taking into account the Treaty entered into by Brazil and France in order to Avoid Double Taxation and Prevent Tax Evasion in relation to Income Tax ("**Treaty Brazil/France**").

According to the Brazilian tax authorities, such capital gain can be taxed in both countries – Brazil and France – through the application of articles 6 and 13 of the Brazil/France Treaty, which combined regulate the taxation on capital gain of real estate.

Moreover, the Tax Authorities viewed that the tax paid in France on capital gain generates the right of credit to the individual resident in Brazil for reducing the tax value due in Brazil, provided that the French tax is not offset/refunded abroad, in accordance with the limit of tax due in Brazil (article 22 of the Brazil/France Treaty – "**methods to avoid double taxation**"). In other words, the tax authorities deemed that the capital gain is inserted in article 22, which literally sets forth the possibility of credit in Brazil of the tax paid on *earnings* obtained in France.

3. APPROVAL OF THE BRAZIL/PERU TREATY BY THE NATIONAL CONGRESS

Legislative Decree no. 500/09, dated August 11, 2009.

Legislative Decree no. 500 was published on August 11, 2009, which approved the Treaty entered into between Brazil and Peru to Avoid Double Taxation and Prevent Tax Evasion in relation to Income Tax ("**Brazil/Peru Treaty**"). Although it was approved by the Congress, its ratification for legal effects in Brazil has not yet been sanctioned. Pursuant to article 28 of this Treaty, each country is to notify the other, through diplomatic channels, on the performance of its legislation procedures for its adoption, which must therefore enter into force as of the date of receipt of the last notification between the countries.

The rules set forth in the Brazil/Peru Treaty did not bring considerable alterations to international tax laws, which were similar to those already used in treaties signed by Brazil. We highlight below some of these rules:

- **Article 2: Aimed Taxes**

This Treaty applies to the federal tax on income, and to the taxes of similar or identical, or substantially similar nature to such, introduced after the date of execution of this Treaty. There is no express mention as to the applicability of the Social Contribution on the Net Income.

- **Article 3: Definitions**

The term 'person' includes: trusts, associations (partnerships) and any such other group of persons. Unless the Treaty's context specifies a different interpretation, terms or expressions that are not expressly defined shall be interpreted pursuant to the internal legislation of the country applying it, although the meaning attributed by the tax legislation related to the taxed aimed in the Treaty at the moment of its application (as opposed to definitions of other branches of law) shall prevail.

- **Article 10: Dividends**

Dividends paid by a company resident in Brazil/Peru to a resident of another country may be taxed in both countries. Nevertheless, there is a limitation as to the taxation by the country wherein the paying company resides (source), when the dividends are paid to the resident of the other country that is the beneficial owner of such dividends. This tax may not exceed the limit of: (i) 10% of the dividends' gross amount, if the beneficial owner is a company, directly or indirectly controlling at least 20% of the voting shares of the company paying the dividends; and (ii) 15% of the gross amount of dividends in all the other cases.

- **Article 11: Interest**

Interest arising from a signatory country paid to a company resident of the other country may be taxed in both countries. As in the article on dividends, the country from which the interest arises is limited to the collection of the tax levied on such earning at a 15% rate, provided the resident of the country receiving the interest is the beneficial owner. There is no special rule in regard to the interest paid to governments, interest deriving from governments, neither in regard to reduced tax rate at source in long-term equipment financing.

Item 3 of the Protocol expressly provides that the amounts paid as Interest on Net Worth will be dealt as interest in this Treaty.

- **Article 12: Royalties**

Royalties arising from a country and paid to a resident in the other country will be taxed in both countries. There is a taxation limit for the country from which such royalty (source) payments arises, at a 15% tax rate, provided the resident of the other country receiving them is the beneficial owner.

The following, among others, is subject to the article on Royalties of this Treaty: (a) rental proceeds, as inferred from the expression: "*for the use or concession of use of industrial, commercial or scientific equipment (...)*"; and (b) any kind of payment for the rendering of technical or technical assistance services, including digital, corporate and consulting services, pursuant to item 4 of the Protocol.

- **Articles 10, 11 and 12: Specific Rules of Special Relations and Anti-Abuse for Dividends, Interest and Royalties**

With regard to Articles 10, 11 and 12, there are some rules limiting the benefits granted by the Treaty in cases in which the main purpose of any person involved with the creation or attribution of (i) shares or other rights (related to dividends); (ii) credit (related to interest); and (iii) rights (related to royalties), is to take advantage of the benefits granted by such articles, through the mentioned creation or attribution.

As to interest and royalties, in case there is a special relation between the creditor and the beneficial owner; and on account of such special relation, the amount previously agreed upon by the parties for interest or royalties is *superior* to the one that would have been agreed on in case such special relation did not exist: the tax benefit granted by the Treaty will not be applied on the total amount paid; and the "exceeding" amount will be subject to the internal laws of each country.

- **Article 13: Capital Gain**

Except for gains arising from the disposal of ships, boats, aircrafts or transportation vehicles explored in the international traffic, or of assets related to such transportation means, the domestic legislation of each signatory country must be applied in relation to the taxation of capital gains earned from the disposal of assets.

- **Article 22: Methods to Avoid Double Taxation**

Both in Brazil and in Peru, there is the possibility for the credit to be deducted from the income tax to be paid in the resident country, as well as the income tax in the other country.

As to Peru, exclusively, when a company resident in Brazil pays dividends to a company resident in Peru, directly or indirectly controlling at least 10% of the voting capital of the Brazilian company, the company in Peru may credit the tax paid in Brazil by the Brazilian company in relation to the profit on which such dividends are paid. However, this credit is only allowed when the Peruvian tax exceeds the credit amount without taking such benefit into account.

- **Article 25: Exchange of Information**

This article sets forth the circumstances and procedures for the exchange of information between the competent authorities from both countries, clarifying that the authority from the requested country must, *taking into account constitutional/legal limitations and reciprocal treatment*: obtain/furnish information from financial institution, agents, representatives or trusts, in the form of statements and certified copies of documents (books, announcements, statements, accounting records, notes) having the same broadness that such statements/documents are obtained by the laws and practices of the other country, including, with regard to the equity ownership, on bearer shares.

- **Article 27: Miscellaneous Provisions – Inclusion of Anti-abuse Rule (*Limitation of Benefits*)**

When a country, after the signature of the Treaty, adopts legislation in which the earnings arising from abroad obtained by a company having certain activities –among them activities related to the financial market and investments in general– and on account of providing administrative or other kinds of service to a group of companies performing corporate activities particularly in other States, suffer any kind of exemption or taxation at a much lower rate than the one applied to the earnings obtained from similar activities performed in its own territory, the other country can opt for not applying the limitations imposed by the Brazil/Peru Treaty on its right to subject to taxation those earnings obtained by the companies of such activities performed abroad or the dividends paid by the companies.

In case a company resident of a country earns profits or earnings from sources resident of other countries, it will not be entitled to the benefits granted by the Brazil/Peru Treaty in the country originating the earnings/profits, in the following events: when the company which earns such earnings/profits holds more than 50% equity ownership in the company generating such earnings/profits (or 50% of the shares of a company), directly or indirectly, from any combination of one or more persons that are not resident in the country where the entity (or company) is located. This limitation, however, does not apply if the company receiving earnings/profits is engaged in substantial corporate activities that are not the mere holding of titles or any such other activities in relation to other associated companies.

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