

The history of international tax treaties from the Brazilian perspective (20th November 2023)

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Abstract

Brazilian tax policy, strongly influenced in its development by Francisco Dornelles's theories, has always used the tax treaty instrument as a tool to attract foreign investment, following an approach based on the principle of territoriality. Nevertheless, peculiar measures such as matching credit and tax sparing, long debated globally, have influenced its negotiating capacity (consider, for instance, the persistent lack of a tax treaty with the United States). Following the BEPS initiative, despite not joining the Multilateral Instrument (MLI), Brazil decided to adopt LOB (Limitation on Benefits) and PPT (Principal Purpose Test) clauses, in an attempt to align its tax treaty negotiations with OECD and UN models, in order to gain greater tax competitiveness on a global level.

Keywords: Brazilian tax policy; principle of territoriality; marching credit; tax sparing; BEPS initiative; LOB; PPT; tax competitiveness.

[Prof. Marino]

Well, I think we can start. This is the fourth lecture. My old friend, Luís Eduardo Schoueri from the University of São Paulo in Brazil. It's a great honor to have with us the guru of international tax treaties, from the perspective of South America, especially from Brazil. Why I thought it was wise to have Prof. Schoueri here with us? Because Prof. Schoueri, as you will see from the slides, from his speech he is offering us a brand new perspective in comparison with the perspectives we have been hearing from the other professors. Because, even if, at the time of 1923, Italy, and the Netherlands were developing countries, certainly then became developed countries belonging to the big powers of the OECD, which we all know, is the club of the rich countries. And certainly, if the approach is to see international taxation from the side of the OECD, we

miss something. This is the reason why it is a great pleasure and honor that we have here, Prof. Schoueri that is offering us a totally different perspective, the perspective of a big economy, a big country, but very far away from the OECD perspective. And this is the reason why he could only enrich our idea of international taxation. And thank you again, Luís, for being with us. I hope this is not the last time, I hope there are other occasions, and it's a great pleasure also that you happen to be here with the Brazilian students, very lucky Luís. Thank you very much, the floor is yours.

[Prof. Schoueri]

Thank you for the invitation, it's an honor for me to be here, it is a pleasure. Well, talking about Brazilian perspective, Brazil doesn't have a huge number of treaties, 36 treaties we have now. Italy is among the treaties we have. But this idea is on our network, it is a country which is missing, very relevant for Brazil, who can guess which country is clearly missing there? The US. I'll try to explain you the reason, it is kind of important for the US to sign a treaty with Brazil. Giuseppe, this is not a problem, because if you are American, you want to invest in Brazil, as always...Holland. Holland is by coincidence, the second biggest investor in Brazil. And you will not certainly say that Holland is such a huge economy. So, when people are talking about treaty shopping and these things, I think, let's pick seriously. I mean, of course, when Brazil signed a treaty with Holland, it was in the 90s, 1990. I'll ask you, why did Brazil sign a treaty with Holland? To have Dutch investors? Or to have multinational investors in Brazil? Why did Holland sign a treaty with Brazil? Make sure that Dutch people would invest Brazil? Or to continue to be a place where international investors could have their holding companies and invest all over the world? I'm just saying this because it's a word in fashion, people talk about the abuse of treaties. And myself, Giuseppe, I don't know about your opinion, but I have problems with this expression. I say there is no abuse but there's the use of treaties. I mean, the treaty was signed by Brazil and by Holland for the purpose of catching international investors, allowing them to have their holding companies in Holland and to invest all over the world including Brazil. Is this treaty shopping? Yes. Is this abuse? No, this is the use of treaties. I am against this opinion. The only country which is being abused is the US because the US cannot force Brazil to sign a treaty. So, the parties involved in treaty are not being abused. I don't know what your idea about treaty shopping is, but I have a different position.

Anyway, talking about Brazilian perspective on tax treaties. Let's try to think Brazilian, let's try to think Latin America. Brazil got independence in 1822, so we have almost 400 years being exploited by the metropole, Portugal in case of Brazil, Spain in case of other Latin Americans. The idea of being dependent is to say, our gold is ours, you're not any more selling our gold abroad, we are independent. We're talking about a period to which the independence was

quite recent, 1960s. The mentality, we're talking about Latin America, would be territoriality, meaning, if income is produced within my borders, I'm going to tax. I don't recognize your right to tax income which is produced here. Because otherwise the money might go back to the metropole. Please try to understand, this was very strong for Latin American countries, the idea of territoriality to say income should only be taxed where it is produced. By the time we're talking about, the 60s, it was very normal that you have taxation at source at very high rates, 25% was a normal rate. Considering this, and somebody says, oh, you should sign a tax treaty. The very first question when you're asked to sign a treaty, and you're Brazilian, you say, okay, let's talk about this, why would I sign a treaty? Wow, you see, because if you sign a treaty, then you will reduce your taxation at source, and then there will be something for the residence state to tax. Authorities would say, what? Are you inviting me to not tax for you to be able to tax something? Why would I sign such a treaty? I'm not stupid, I continue saying there's no reason for you, residence state should get income, which was reducing my state, I need this taxation, I have no reason for signing a treaty. But then in the 60s, something happened in Brazil. Sorry, I am talking about Brazil, but you may also always extend to Latin America, but I was talking about Brazil. In the 60s, we had our military regime, and this military regime had a different mentality, it had a mentality for development and understood that the development would only come with foreign investments. So, they think foreign investments would be a way to develop the country. And also, of course, I am talking about military regime for several issues, not democratic and so on. Talking about economic perspective, they have the view, Brazil must develop, and it will develop if we can get investments. So now maybe we can sign a treaty, not to allow you to tax, but to get your investors. So, this was a different idea. So, the idea was to get investments and treaties would be a tool for catching investments, this was the idea. And if this is true, Brazil would be prepared to reduce its taxation, provided this is an incentive for the investor. Brazil will not sign a treaty and say, okay, I reduce my taxes for you to be able to tax. I've reduced my taxes for your investor to pay less taxes. Is it clear the difference? Because this will explain the main idea of our system. This guy here, Francisco Dornelles, is very relevant for us in Brazil, because he designed our policy. He was a member of the UN committee and so on, and he was very critical, even from the UN model. He said the UN model is said to be a model for developing countries, people say this, and he wrote a text saying this is wrong, UN model is not a model for developing countries yet. Because if they chose to start from the OECD model as a consensus measure, that means it's okay, it's better UN and then OECD, but it is not a source state model. It is merely a residence state model, moderated. He was very critical because he also has principles which should be the basis for any treaty policy. And the principles, if you are going to make a policy, to understand Brazilian policy, you must understand this guy.

He said, you must promote the flow of investments in technology from developed countries to developing countries. Second, you must ensure that the fiscal sacrifice resulting from the use of any method to eliminate double taxation is borne by the developed country. Third, you should allow the taxing power of the developing country to be exercised to its fullest extent, as much as possible due to the provisions in item B. And fourth, guarantee that the tax benefits granted by developing countries to attract foreign investments are not nullified or eliminated by the tax legislation of the investor's country of residence, and I will return to this. So, if you get these four topics, you can understand what the Brazilian policy was, because this guy designed the policy. This guy studied in Harvard, he was very intelligent guy. I mean, really, it is interesting to see that somebody in Brazil by the time was already thinking internationally, and thinking, not copying, because it's very normal that you get a Brazilian who comes abroad, who learns, suddenly begins to repeat. This guy was a guy who came abroad but said, this is not great. I mean, it means he made something further.

So, our negotiation began, and these are our very first tax treaties, Sweden, Japan, Norway, Portugal, France, all of them. This is a very important period. Italy is here as you can see. I need to just stop on this text very soon to explain about this issue, which is very important now to Italy and several other treaties. But also, although the OECD model has a very limited taxation for dividends and interests, Brazil always will have at least 15% at source. OECD model says for royalties, only residence, Brazil 15% at source. I'm going to return to technical assistance, something very specific for the Brazilian policies since the beginning.

I'm going to present this topic, so don't worry about this. What I would like you to understand is this, matching credit and tax sparing. If you get this notion, you can understand Brazilian policy. I'm talking about now what is the matching credit. As I said, If I would have normal slides, there will be some movements, which I don't have, so please help me in the movement. Try just to see here, just the first line. I have a situation, an original situation in which Brazil is taxing interests, dividends, at 25% and source. And here the state is a credit state. If you see the first line, it's clear for you that since Brazil is taxing up to 25%, the residence state will only be able to tax from 25 gross, 25 on. Is this clear? Because it's a credit state. That means up to this moment, whatever will be taxed in the residence state there will be a residence credit. So, there will be no taxation at residence. Is this clear? I mean, can you understand the first line here? Source taxation, residence taxation would be the amount which supersedes 25%. Clear or not clear? Now let's go to line number two, assuming a normal or regular treaty, assuming that Brazil would accept, I'm not taxing 25, I'm taxing 15%, who gains with this? Who gets a benefit from Brazil reducing its taxation? The residence state. And for the investor? What's the difference between line one and line two? What is the difference for the investor between

line one and line two? The amount I have not paid to Brazil, I am paying to my residence state. Is it clear or not? Yes, or no? If you understand this, you understand what a matching credit provision is. According to a matching credit provision, the source state accepts to reduce its taxation to 15% but the resident state will grant the credit as if there would have been no reduction in the treaty. So that means, in this case, the resident state is in the very same situation, there is a sacrifice by the source state. In a matching credit clause, who benefits from the reduction of taxation at source? Taxpayer, the investor, that means you taxpayer, you pay 15%, but you are granted a credit of 25%, that means you only pay taxes from 25 on. Is this clear? It is a very important notion you must have what the matching credit is. Because this is part of our policy in Brazil, several treaties of ours, including Brazil-Italy, have this matching credit provision. That means you will see that the tax at source will not be higher than 15%. There is a difference. So, this idea of Dornelles, which is any sacrifice must be to attract investments, I'm reducing my tax, I'm signing a treaty, not for you, residence state, to get your amount, I'm reducing my tax for your investor to choose my country. Clear or not clear?

I'm going to return to discuss several times. So, this concept was very clear for you, what matching credit provision is, okay? Now just to continue, tax sparing. Tax sparing is a bit different. Line 1, the same thing. Line two, I sign a treaty, I reduce my tax, and you, residence state, may take from 15 on. So, I'm prepared for this. But now, I am allowed to tax 15%. If I do not use my 15% because I granted the tax incentive internally, so I would be allowed to tax at 15, but I use only 10. You will grant the credit of 15 anyway. So, in case of the differences due to the internal incentive, I would be allowed to tax up to 15. But I grant an incentive. So, the idea is the same. If I want to grant investors an incentive, you should not nullify. Just for you to think and to understand the tax sparing issue. If there is no tax sparing issue, if only 10% will be taxed at source, what would happen? The resident state would have more taxation. That means any sacrifice made by internal law would not be benefit of the investor, but of the residence state. That means I would make a sacrifice, I would grant a tax benefit, which will be no tax benefits for you investors. You investors say what's the reason? It's not good for me to get the tax incentive. So, normal tax treaties, regular tax treaties will nullify any measure taken by source state to attract investments. Whatever the source state does to attract investments, whatever tax benefit which is given by the source state will be nullified by the residence state.

If a source state which is allowed to tax according to the treaty on 15%, if it does not tax, grant tax incentive, what will happen in normal treaty? What will happen in a normal treaty if a source state, in regular OECD treaty, source state may tax up to 15%, residence state shall grant the credit. Source state does not tax, what happens? What happens if the source state which would be allowed to tax, does not tax? Will the residence state grant credit? Because the residence

state grants the credit if there is a taxation at source. So, if source state does not tax, the resident state will grant no credit. Clear? So, that means if source state does not tax, the residence state says, well, if you're not taxing, I don't need to grant a credit. That means for the investor, he is not paying taxes at source, but the same tax will be paid to the residence. So yes, there is way to say I want to have the right, as a source state, not to tax and you must respect my decision, you will not nullify my decision. This is a very important part of the Brazilian policy, of the South American policy, to say, if I grant an incentive, I want this to be to be respected.

There was a law in Brazil, which reduced to zero the withholding tax rate on income derived from certain investment funds. So, it means, in principle, without this reduction, there will be a taxation of 15% at source, and the residence state will tax 30%, with credit of 15%. If you don't have a treaty, if Brazil decides to grant an incentive, what happens? Residence state says okay, Brazil is not taxing, but the residence state is still granting the same credit. If you compare situation 1 to 3, you see that the residence state is in the very same situation. I said, Brazil has no treaty with the United States because Brazil did sign a treaty with US with a tax sparing revision, and the US Congress never accepted a tax sparing provision. We had at the same time treaties with the US and Pakistan. The Treaty with Pakistan was not ratified. For the United States, from a US perspective, treaties are there to avoid double taxation. If there is no taxation at source, there is no reason for credit, full stop. I'm American, I'll say well, I have treaties to avoid double taxation, if you're not taxing, I'm taxing. I'm Brazilian, I say I'm signing a treaty to attract investments, if I'm not taxing, I want investors to come. So, you see, there's a shock of perspectives. As we'll see, Brazil moved from this policy to which you will guess, I wouldn't be in favor of the Brazilian policy.

This case also should be mentioned, it was the matching credit provision. So, Brazil will not tax more than 15%, and France will grant a credit of 20%. But there was a reduction to zero. I'll ask you, from what you know, what should France do if Brazil taxes 0%?

[Student]

Give a credit of 20%?

[Prof. Schoueri]

Good. You're a good student but you're not a member of the Conseil d'État of France. Just look at what they did with our obvious matching credit provision. It's unbelievable what they did. Here's the provision: interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State but shall not exceed 15%. So, interest should not be taxed more than 15%. Then you continue, talking about avoiding double

taxation: as regards income referred to in Articles X, XI, XII, XIII, XIV, XVI and XVII which has borne Brazilian tax in accordance with the provisions of those Articles, France shall grant to its residents receiving such income deriving in Brazil a tax credit corresponding to the tax paid in Brazil, within the limits which the French tax establishes in such income. As regards of income in Article 11, the Brazilian tax shall be considered as being levied at a minimum rate of 20%.

If there were any tax paid in Brazil, it would have been deemed to be 20%, but zero is no tax. That means they made a huge difference. They said that since there was no taxation, there would be no credit. If there was 1%, okay, there will be 20% of credit. It's simply a stupid mistake. So, the whole idea was if there was 1% that would be a credit. It makes no sense. But just to know how things work. Credit of 20% because there was a tax paid. Since there was no tax paid, there will be no credit. They did not understand what that matching credit provision is. Now, nevertheless, we do have several treaties with tax sparing or matching credit provisions in force today.

[Prof. Marino]

I want to be back on the abuse of treaties versus the use of treaties. Now, let's imagine that you have a treaty between Brazil and the Netherlands that is used by a US investor. The US investor made the investment directly in Brazil, there is no credit, correct? Through the Netherlands it would get the credit and would get amount of dividends back to the US. Now, who's being abused? Brazil?

[Prof. Schoueri]

No, Brazil signed a treaty for this. I mean, assuming there was an investment, why did Brazil sign a treaty? It doesn't happen.

[Prof. Marino]

Okay, this is clear. So, he said, I don't care whether the investor is coming from the Netherlands, from Japan or from the United States, I will always get the tax sparing clause. End of the story. So, you want to use the treaty with the Netherlands? Okay, fine.

[Prof. Schoueri]

Brazil was not aware that Holland was a place where international investors would have their holding companies to invest all over the world. Brazil wanted to compete to get a part of these investments, and Brazil is competing. I don't accept the word "abuse", let's say it's "use".

[Student]

So, referring to the structure where you are the investor in the US, holding company in the Netherlands and he is a resident in Brazil. So, I understand this is not an abuse of law. So, I'm asking, can we qualify it as a sort of aggressive tax planning?

[Prof. Schoueri]

I believe that you abuse when you find a loophole, which was not intended by the states, whether it is a mismatch or whatsoever. I'd say at least from a Brazilian perspective, it's happening exactly what should happen, from a Dutch perspective also. But somebody is being abused. It is because the only country which is really being abused is the US. The US should have the correct measure within the US saying okay, Holland, if my investor is in Holland as an investor in Brazil, I shall not grant the benefits from the treaty US-Holland. This may be correct. What I'm saying is that this has nothing to do with Brazil. I cannot accept because Brazil, due to the BEPS measures and so on, also accepted inclusive framework, Action number six, abuse of treaties. I'm saying we are playing the wrong music; this is not our problem. But the OECD hates tax sparing. They even wrote a paper report called "Tax Sparing: a Reconsideration", talking about the potential abuse offered by tax sparing, whether or not tax sparing would be an effective instrument for foreign aid, and in terms of tax incentives. I read this report, and I wrote an Article, which you can find afterwards, just look for my name, Schoueri.com.br, that's my site. And you can find all Articles published, including this one.

"Tax sparing: a reconsideration of the reconsideration". I tried to respond to all the arguments by saying, for instance, according to the OECD, tax sparing would be something in disuse. And I quote in my Article the research by Thuronyi saying that 1/3 of the treaties between 2000 and 2003 had some tax sparing clauses. So, it's not very true to say this is in disuse between. Half of them are OECD members. Let's speak seriously about this issue. Ah, there is no evidence that tax sparing would affect the level of foreign direct investments. This is true. But there is no evidence that treaties affect the level of foreign direct investments. I mean, this is a typical argument which logically is wrong. Because also, there's no such evidence. I even give an example. It happened. Brazil had a treaty with Germany. Germany denounced the treaty, so we don't have a treaty with Germany anymore. Since then, the volume of German investments in Brazil increased. So that means there must be several other explanations for foreign direct investments, but it is not a serious argument again. For you to get a tax sparing, you will have to reduce your taxation at source. So, you're paying a high price, source state, for getting this benefit. Come on OECD, you should be happy for this first, because that's what you want me to do. I mean, if I negotiate this, prepare to get to offer this, I will allow him or

her to do it. Ah, developing countries today are not what they were in their past, they have the standards of living in developing countries increased a lot today. So, they don't need this aid anymore.

Again, typical OECD, which data they are based on? Have they looked at data for this or the opposite? There's clearly a need for developing countries. So, this again, the OECD reporting, who dared to write it? There will be abuse of tax sparing clauses. That may be a sign of abuse. But then if the problem is abuse, not use, abuse, then you can write a LOB provision and PPT or whatsoever. But you should not consider the abuse of tax treaty because of this argument. It is very good to encourage an excessive repatriation of profits tax, real profits, and tax sparing will encourage excessive repatriation of profits here. It is not true. Once you have tax sparing, there is no reason for you to repatriate because you can use the tax sparing today or tomorrow, after one year or two years. There is no relationship between the speediness of repatriation and the fact of whether you have or not tax sparing because you always use it in the future. Tax sparing would be a subsidy for developing countries: I hope to have shown you that there is no subsidy because the developed countries knew that there is no subsidy of tax sparing. It continues on the very same situation. So, we cannot talk about subsidy, the one which is making sacrifices are the developing countries, not the developed countries.

Okay, you're saying if I, source state, don't tax, you may tax, I agree. But let's make it the opposite. If you grant an exemption for your resident, I'm going to tax with no limit at source. For instance, you grant participation exemption on dividends. Are you prepared to allow me to tax dividend at source with no limits since you're not taxing? Just make the other way around. If the residence state grants benefit, the source state may not increase its taxation, which should be at least both sides. I hope you're curious enough to read my "reconsideration on the reconsideration" to think about this, because I think we should reconsider the tax sparing, but not in the sense of the OECD's reconsideration.

Going into the second period after the 80s, we continue to have with developed countries more or less the same policy but then we begin to have treaties with equals, Argentina, India and then we had a different policy. I call this a Janus, the Roman God of the Gates who had two faces. I said Brazil in the 80s was a Janus, depending on who he was negotiated with, he had a different face.

Third period. In this period here we really believed Brazil was going to be a huge economy, and we had signed some treaties as a capital exporting country. This was mentality by the time and we had these treaties here. And there was no issue about tax sparing anymore, because now we're talking about, we are a big economy. I'm not supporting this policy. Once again, I believe that tax sparing should be in every treaty, I believe it is a matter of consistency. But as a reality, it is changing. And we began to adopt LOB provisions, we began to adopt LOB

provisions in our treaties, several treaties have already had this LOB provisions. As you have already noticed, I hate LOB provisions.

And after BEPS period, Brazil is not a part of MLI, we did not sign the multilateral instrument. We preferred to renegotiate treaty by treaty, as we are negotiating, renegotiating or we have new treaties following the BEPS minimum standards, but on a bilateral basis. So, all problems you have with this multilateral instrument and how to interpret it and so on, we say, we have a treaty. I think that this was correctly business side. Well, this being said, in this new treaty, we have the LOB, the PPT, we do not have matching credit, except Emirates. Emirates is a recent treaty after BEPS and still has a matching credit.

Now we're coming to the second part of the presentation, specific topics of the Brazilian policy. These are the topics which I want to cover now.

[Prof. Marino]

Before starting the second part, I'm curious to understand what is your relationship with the OECD? Because after the 2000, Brazil became an economic power basically.

[Prof. Schoueri]

Brazil is unfortunately applying for being a member of the OECD. Made the application and is going to be exposed with the acceptance. I am using the word unfortunately. I mean, I prefer to be the head of an ant, not the tail of an elephant. But Brazil is going to be a member of OECD. And it's interesting, because in the 2000, the OECD wanted Brazil to be a member. And Brazil, by that time, doesn't want. It's a pity because if Brazil would have become a member in 2000, I would dare to say by the time that we had a very strong negotiating power into 2000s. Because the OECD wanted to have one of the BRICS as a member. And I would dare to say that Brazil is one of the 10 biggest economies in the world, that Brazil being admitted in the OECD by the time, it would have been even a change in the OECD itself. But as time goes by, when Brazil applies, Brazil is not as strong as it was earlier. And now it's accepting several of the demands from the OECD. No economy with the size of Brazil has ever accepted them. I mean, if we get the big economies in the OECD, they are members of the OECD, but they follow their own policies. The US couldn't care less about the OECD, the OECD does whatever it wishes, and the OECD will say, well, this is what we believe. I can see also Europe. Brazil now is trying to follow the OECD line by line, which is a pity.

May I continue to the second part, is the first part clear? This was the more historic. Now I'm getting this topic with several provisions. The first one is one of the most relevant. The issue of Article 12, technical assistance. Usually, historically, Brazil would not have an Article dedicated to technical services. I'm generalizing, it is wrong. If you're studying international tax law, it is a huge

mistake to generalize, to believe once you saw one treaty, you saw of all of them, each treaty has one wording, even if they follow the same model. I always tell my students, international tax law, I would compare the role of a treaty to when you want to buy a new dress, you have three options. First, you go to a shop nearby and see a nice dress, you buy it or suit, for a very reasonable price. Most probably if you go to a party, you'll find your best friend, I'm talking to ladies now, with a dress which is just like yours. Because you bought in the same shop and it was like this because the dress was not for you. But it was quite cheap so you are using the dress as you could, or your suit. You have a second option, a good tax lawyer gets paid a lot, so you go to have your tailor-made suit or dress, perfect, very expensive. The third option, you go to shop, you see this dress is nice, this suit is nice. When you went there, the dress is not ready, it is almost ready. But there will be a tailor who will come, will see your measures, and will make sure it is for you. You don't pay as a tailor-made suit, but it is still a dress tailor-made. If you find your friend at the party, you will look alike, but each suit will have a different measure. When you think about a model, think about this kind of thing, of an almost-ready suit. That means all suits look alike, but each one has different measures. You have models, but each treaty derives from one negotiation. Every single word may have a small change and can be relevant. Don't ever get a conclusion from one treaty to another treaty, what you call parallel treaties, because you will very likely run into mistakes. So, generally a tax treaty will have a Protocol, which will stay in the Article addressing the royalties, also encompasses fees for technical services. There is no meaning of what technical services would be. When you go now to the treaties, there are situations in which there was no protocol. So technical services will not be considered in a treaty as something separate, which are Japan, Sweden, France, Austria, Ecuador and Finland. In some treaties, you have in the protocol, saying that technical assistance is comprehended in the concept of industrial, commercial, and scientific experience. Others will see differently, will extend the application of Article 12. This will be the type of royalty or type of technical services. And we continue this, let me try to explain to you this.

Well, group one is easy. So technical services, not comprehend, no reference, it is easy. So, there's not a problem. Get to the second one. I'm here in 1974, and this is something, if you like this idea of a military interpretation versus a static interpretation, how should we interpret the treaty, looking or not at the history of the treaty, when it was signed. I'd like to see how it was signed. I like to ask Brazil and Denmark negotiators, go back to 1974 and ask, why did you say that expression "for information concerning industry, commercial or scientific experience includes income derived from the rendering of technical assistance and technical services"? Is this an explanation? Or is the extension? Are you saying that Article 12 should be applied to royalties and to technical services? Or should it be applied to royalties? And technical services are a kind

of royalties? I'm going to 1974 and I would have said why, because this happened to several Brazilian treaties. So, this was clearly not a Swedish position but the Brazilian one. But in case a company would pay dividends, which would be more than 12% of the capital invested in the country, so that will be super dividends, dividends which will be more than 12% a year, you may distribute, but there will be an extra income tax. So, there will be a normal income tax for dividends, but for extraordinary dividends, there will be an extraordinary taxation. So, if you want to pay more dividends than 12%, okay, but there is higher taxation. Now, you're a Brazilian company wanting to pay dividends. And you know, there's a taxation and you have a shift idea. I mean, we are in the 70s, please remember. I think well, I am not paying the dividends, I'm going to pay royalties. Because technology is so difficult for you to know, and I'll pay royalties. This is a deductible expense for me and there will be no supplementary taxation on royalties. For instance, there would be a limitation for the deductibility. Royalties would not be deductible if they would supersede 5% of the revenues of the company. And royalties, this was the biggest barrier. So, it's not deductible because Brazil has our central bank which was very strong. If you need to buy foreign currency, you need authorization by the Central Bank. Central bank would not authorize a payment of royalties which would supersede these 5% of the revenues. So, you will not be able to pay royalties. So, you have the problem of dividends, you could not pay royalties. But I have an idea, I'm going to sign with you a technical assistance agreement, the service agreement. And through the service agreement, I'll pay you what I want to pay. Then this came to Brazil government authorities, royalty authorities, who understood that in case of technical services, there would be embedded in a technical service a royalty. They created a theory which was called the parrot of the pirate. They said if somebody is rendering a service, there will always be, Brazil will be there watching and he will be learning this.

So Brazilian authorities, since there was a limitation on payment of royalties, would see in any technical assistance agreement a disguise payment of royalties. Is this clear? So, this explanation why Brazil would say to their partners, hey, pay attention. These expression for information concerning industrial, commercial, or scientific experience includes income derived from the rendering of technical assistance and technical services, that means they will not try to get a regular service of a lawyer who is hired abroad. This was not the idea. The idea was to get industrial commercial scientific experience transferred through technical assistance. So, I would say here the idea was interpretation.

Amazingly, Brazil signed a mutual agreement procedure with Spain, and both countries agreed in an exchange of letters that all technical services are included in the concept of royalties, regardless of whether in themselves they involve the transfer of technology or not. This is a very interesting case from a scientific perspective because they are changing the treaty. But they agreed on this.

Because by the time they already had clear policy to see the protocol, not an interpretation, but rather an extension, which clearly appears in several treaties of Brazil, such as: the provision of paragraph 3 shall apply to payments of any kind received as a consideration for the rendering of technical assistance and technical services. This is the change in the Brazilian perspective because Brazil saw an opportunity to catch any service, because technical service is any service. Please, if you can nominate one service, which is not a technical service, we might get a count. But the idea certainly what should be an interpretation meant to get the strength of know-how. You see this kind of wording is completely different. Again, here with Hungary: the provisions shall apply to payments of any kind received as a consideration for the rendering of technical services. As you can see, from the treaty itself, I can see that there are two different policies, one extension, the other, interpretation, and I should say that each treaty should be different. However, from what you're seeing, Brazil began to change its wordings again, extension.

Here Singapore. Singapore is a bit different, because it has an Article for technical services, Article 13, which will be Article 12 of the UN Model. But suddenly, it says that Article 12 shall apply for technical assistance. I don't know really how to apply this treaty. Thank goodness, they have the same result. Because what's the difference between technical assistance and technical services? Because fees for technical services are in Article 13, technical assistance is Article 12. I also don't know the difference, I'm glad they have the same result.

[Prof. Marino]

I was thinking since during the course we have been also talking about the digital economy that is letting these kinds of services disappearing basically. How do you catch the technical services if you don't see the service, because everything is just a swipe of a credit card? Now, my question is, do you believe that all these policies are overridden by the new economies?

[Prof. Schoueri]

It's just the opposite. I believe that due to this new approach of Brazil, this extension approach, Brazil says, well, you may discuss this pillar, this issue, and so on, I don't need it. Now, everything is a technical service, full stop. Just explain to you, if Brazil becomes a member of the OECD, it will be a problem. Because presently, since we are not the member of the OECD, you may not, in Brazil, get any foreign currency without the central bank being informed. Every bank in Brazil is obliged to follow the central bank, every single exchange transaction. And to make this clear, Brazil has adopted some years ago a tax on credit cards. And the rate was 6.8%. I will say that Brazil doesn't need to tax the operations. It's a sort of digital service whatever you pay. But due to the OECD,

Brazil has committed to reduce its taxes on this, and it is reducing. So, Brazil will face this problem. This is going to be a happy member of the OECD.

Well, Uruguay, again, you have these technical services here. And Peru, because I mentioned, Peru was interesting, because Peru, they have some kind of tax on digital services. I don't know about these types of Peru. All I know is that Peru says that the provision of Article 12, which is royalties, applies to any kind of payment received for the provision of technical services and technical assistance. So, we do have in one treaty a clear reference to digital services because of Peru.

[Student]

What are the different effects of a clause being an interpretation, or an explanation?

[Prof. Schoueri]

Thank for your question. Imagine I'm going to hire a lawyer, is he a technical? Is this a technical service? Yes. So, if our protocol is extended, if Article 12 applies then Article 7 does not apply. So, if now I am hiring a lawyer, if I'm at an Article 12 I may tax at source. If I'm not at Article 12, I come to Article 7, and unless the lawyer has a PE in Brazil, which is not the case, decision is all in the residence. Is it clear? So, if the protocol is extending, Brazil always says I can tax, if it's only interpreting, then I'll say well depends on whether or not there's a transfer of technology. And I was saying you should not generalize because as I've tried to show you, in some treaties, there is a good argument to say you're extending. In other arguments, it's clear you're interpreting. The generalization should not be done. Just to say for technical services, we still have in Brazil a second issue, which is now in tax policies, we still have Article 14. Article 14 does not exist for the OECD anymore, but we still have this independent personal services. So, all our treaties have these independent personal services, which allow for taxation at source. If it is paid by a resident in Brazil, Brazil will tax at source. So, if you're not in Article 12, the protocol still has Article 14 to consider. I just want to say this, Brazil had a stupid position. Brazil wanted to tax technical services, but instead of trying to apply the protocols, the very first tentative was even worse, it is just an argument so stupid. Oh, first, you know what other income Article means? Article 21, if an item of income is not comprehended in any of the Articles, it is under Article 21. Article 21 of the Brazilian treaties provide for a limited taxation at source. The OECD says in Article 21, the income is only taxed with the residence. Brazilian treaties, all of them say items of income which are not described in the treaty, may be taxed at source. So, Brazil said if I pay for technical service, I'm under Article 12, protocol. But now, if I'm not in Article 12, you come to Article 7. Brazil had a stupid interpretation, saying if you're not in Article 12, you come

to the Article 21 and Brazil may tax. Then somebody says, hey, come on, before going into Article 21, there's Article 7, business profits. Then Brazil says, come on, Article 7 is for profits, not for revenues, profits are net, and when you're paying a service, you're not paying profits, you're paying revenues. So, Article 7 is not applicable for any payment. Article 7 provides only for a taxation of the profit in the company, but none of the items of income, this is wrong. This was declared wrong by the courts. But Brazil had this position for several years. It was difficult to convince that come on you are wrong. But at the end they learned. Once again, they are generalizing what should never be generalized. They're talking about all treaties as if they were the same wording, we saw we are not the same wording. Brazilian official position is that the tax treatment to be given to income paid, credited, delivered, employed or remitted by a source located in Brazil to an individual or legal entity resident abroad for the provision of technical services and technical assistance, with or without the transfer of technology, based on an agreement or convention to avoid double taxation of income... by Brazil shall be as provided in the respective Agreement or Convention. In Article dealing with royalties, when the respective protocol contains a provision that technical services and technical assistance receive equal treatment, in case where the Agreement or Convention authorizes taxation in Brazil. If there is no such protocol, in the Article dealing with independent professions, Article 14, in case of the provision of the technical services and technical assistance related to the technical qualification of an individual. Or in Article dealing with business profits, which relates to the third solution. So, Article 21, not anymore. But they generalized the idea of the protocol, you see that each protocol is different. For Brazil, any service, technical service will be Article 12, except the case where you can apply Article 14. Well, just finish the idea of services, we have this case interesting with China. Maybe you have the concept of service PE. That means, this was an idea created by the OECD. The OECD itself created it in commentary, it was never introduced in the model, but China got it and we have this, that the furnishing of service, including consultancy services, by an enterprise of a Contracting State through employees or other engaged personnel in the other Contracting State, shall be a PE, provides that such activities continue for the same project or a connected project for a period or periods aggregating more than six months within any 12 months. So, any product, service which you have in the country for more than six months, will be deemed to be a PE. This is not a Brazilian traditional approach, but I just mentioned we do have this clause with China. And also, Brazil does follow the OECD model, for example, we have sales outlet, as a PE. Just continuing here, I already mentioned that Brazil has Article 21. This is all of our treaties, the same, we do not have the exclusive taxation at source. So, any item of income which is not dealt with in the previous Articles is taxable in Brazil at source with no limitation, it is a part of our policy. For the service issue, any questions? I

am going to another part of Brazil's policy, which is the LOB, Entitlement of Benefits which, as you may have already saw, I don't like it, but we do have it. So, it was mentioned what we have, Brazil has before BEPS already, it began to adopt these ideas of entitlement of benefits. Here's an example, here's a typical LOB clause. The beneficiary of the convention has some business here, which are banking, shipping, and so on, and it is taxed at a very low rate, and it will not be entitled to the benefit. It is a typical LOB, because it will limit the benefit of the treaties to some companies which, according to the to both parties, should not benefit from the treaty.

But usually what we do have is LOB MPPT. LOB is the first part here, Brazil-Israel here, this is before BEPS. We have this, if the controlling company has more than 50% of foreign companies, so it's a typical company, it will not benefit from the treaty. It is a typical LOB, limitation of benefit. But then we have this here, which is much more than a PPT. I'd like to read this, and imagine, Giuseppe, if I had to really enforce these before court: A competent authority of a Contracting State may deny the benefits of this Convention to any person, or with respect to any transaction. Believe me or not, this is written and signed in its opinion. So, a couple of top authorities may deny if, in its opinion, the granting of those benefits would constitute an abuse of the Convention according to its purpose. This is what you call legal certainty zero. I always say I didn't sign it, I'm just showing you.

Here's the treaty with China, again, you have the LOB, the qualified person but then you have here, a clear PPT clause. So that's showing Brazil is now following. Although Brazil has no MLI, Brazil adopted a clear PPT: obtaining that benefit was one of the principal purposes of any arrangement or transaction, and the benefits shall be denied. So that means, unfortunately, Brazil is part of this inclusive framework. Brazil is actually an active part of the inclusive framework, and now we are paying the price, this is part of our policy to have PPT and LOB combined. Giuseppe, do you want me to make a summary of the Brazilian policy? I hope I've been clear enough for you, but then of course, open to any questions you may have.

[Prof. Marino]

Thank you, I was fascinated by the Brazilian approach because actually it's an approach which makes a lot of sense with reference to the territoriality principle, because we have been facing with the other income case of Vodafone. If you remember, the case between the Indian and the Mauritian treaty, behind there was always the Netherlands. When the Indian tax administration challenged the treaty saying I want to tax as a state of source, but they lost the case. Meanwhile, Brazil has solved the problem at source by saying, no way, other income means that the state of source may tax, full stop. That is a very interesting approach actually and I can certainly make a comment, and I wish you may give

a word on the new era that we are facing with. Because maybe the OECD with the Global Minimum Tax, Pillar 1, Pillar 2, arrived at the top of the tax world supremacy, and is now starting maybe to decline, because the United Nations are starting again to take in all the beliefs. So, I wonder whether all this Brazilian policy could help the United Nations to, maybe, face a better world.

[Prof. Schoueri]

I was trying to show that Brazil is following the UN model. I mean, we are introducing Article 12.A with technical services. Well, Brazil and India, the two countries were forced to avoid the 12.B, this idea of having services whatsoever. Because, reading the PE Article, Permanent Establishment Article, and thinking whether those people in the 1920s or whoever were thinking about services. The PE was done for an industrial economy, it was not done for the reality, when the OECD creates this service PE, it's very artificial also to know what the service PE is. Sorry I was saying the solution is let's stop, the PE has nothing to do with what we want here. But the taxation at source works much better. It's the only way of doing, I don't believe in Pillar 1, I don't think it is a good solution, not a workable solution. And taxation at source is much more realistic. Article 12.A requests for no limitation of taxation at source, there should be some limitation here.

[Prof. Marino]

Very interesting approach from the state of source and we really needed it because the OECD is getting how the world works. Not only the western countries, but it's much bigger than that. So, thank you very much. Any questions, desires? I think it will be very helpful from the Brazilian colleagues.

[Student]

OECD has a report on international taxation in developing countries, right? What do you think about that?

[Prof. Schoueri]

I could not say this is a response. I think that the OECD is still behind. I don't think the OECD has the legitimacy to discuss about this issue again.

[Prof. Marino]

Maybe I can make the final words because we will be facing with the Global Minimum Tax. What is your opinion? And now Brazil is facing the Global Minimum Tax.

[Prof. Schoueri]

If you ask my opinion, I don't like tax incentives. But my opinion is also that every country should be independent to decide whether or not to grant tax incentives. And when you talk about minimum taxation, you're saying you may not grant tax incentives.

Again, I think if I was deputy in my country, I would not vote for tax incentives. I am against them. But I don't think that this is the role of tax treaties.

Then it comes to legal issues, because this whole OECD plan was not made by lawyers, it was made by economists. I am going to judge it; I am going to see this. I mean, it is very difficult for me, from legal perspective, to say that my tax would be higher or lower due to the fact that in another country of my group, in a third country, it is not being taxed. I have problems with this, question of justifying. From an equality perspective, if you have two taxpayers in the same situation making the same payment, but depending on the fact that one taxpayer belongs to a group, when another company has a lower taxation, this company should be taxed. It is difficult to understand this because this will require revolution which we are not talking about. The revolution to say okay, let's assume that now taxpayer is not a company anymore, it is a group, I am taxing the group, but then the question is why some taxpayers have to pay me tax on individual basis, and some of them pay from the group perspective. What I am trying to say is that Pillar 1 and Pillar 2 have not been thought from a legal perspective. The legal system must be renewed before it can be adopted.

[Prof. Marino]

I agree. Okay, thank you very much, Luís, and we keep in touch.

[Prof. Schoueri]

Thank you very much.