

Global Tax Alert

News from EY Americas Tax

Brazilian Superior Court of Justice rules service income received by French companies for technical services rendered in Brazil is not subject to withholding

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EY Americas Tax

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On 28 May 2020, the first chamber of the Brazilian Superior Court of Justice (STJ) ruled that service income received by French companies rendering technical services in Brazil, without a permanent establishment, is not subject to withholding tax (WHT) in Brazil.

Taxpayers have long debated this topic with the tax authorities, who tend to deny the applicability of the business profits article in tax treaties. According to the tax authorities, cross-border payments for technical services made by Brazilian parties should be considered royalties or other income that is subject to taxation at source. This decision confirms the taxpayers' view that tax treaties should be uniformly interpreted and should prevail over domestic provisions if the latter imposes a higher burden to a transaction covered by the treaty.

Facts

A French-resident company with no permanent establishment in Brazil was hired to construct and maintain submarine cables for a Brazilian resident. Upon payment of the service fee, the French company did not withhold tax. The tax authorities challenged the transaction and asserted that the company should have withheld tax because Article 7 of the Brazil-France double tax treaty (DTT) did not apply.

The regional court in Brazil ruled in favor of the tax authorities, finding that Brazil's legislation separates income and profit, and service fees qualify as income. Additionally, the lower court found that the DTT does not specifically list technical services in its provisions on specific types of income (e.g., royalties, capital gains). Therefore, the judges ruled that the payments are subject to domestic legislation, which imposes a 15% WHT.

Decision

The STJ reversed the decision of the lower court, finding that Article 7 of the DTT applies to the income from the technical services and, therefore, the income is not subject to WHT.

The STJ's decision recognizes that Brazil largely adopted the Organisation for Economic Co-operation and Development (OECD) model treaty convention and, thus, the DTTs entered into by Brazil should be interpreted in accordance with the OECD's guidelines.

Although the decision is not binding, the STJ is the highest court in which this matter may be decided and, therefore, groups resident in countries with a DTT with Brazil (and not only French residents) who do business in the country may rely on this decision. Companies rendering services to Brazilian residents (or intercompany services to Brazilian entities) should evaluate their situations to determine whether this decision applies to them and evaluate the impact on their businesses and service income.

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