

Why a Brazil/US Bilateral Tax Treaty (BTT)?

Increased Competitiveness: The absence of a BTT impairs the competitiveness of Brazilian companies based in the U.S., relative to those from other major countries, virtually all which have tax treaties with the United States. Of the 10 countries in the world with a \$1 trillion or greater GDP, Brazil is the only one without a BTT with the United States. Due to the clear benefits involved, two of the largest regional exporters to the U.S., Mexico and Venezuela, have entered into tax treaties with the United States. A treaty between Brazil and the U.S. would increase the competitiveness of the Brazilian subsidiaries of multinationals in intra-company bidding processes for global supply of goods and services. The lack of a treaty makes products manufactured, and services provided by Brazilian subsidiaries more expensive than the ones produced and provided by subsidiaries located in other countries

Shareholder Gains: Brazilian shareholders of companies with U.S. based subsidiaries are prejudiced by the absence of a tax treaty. Dividends paid by United States corporations to Brazilian shareholders are generally subject to a 30 percent United States withholding tax that is effectively imposed on the Brazilian shareholders. This withholding tax is generally reduced to between 5 percent and 15 percent under United States tax treaties, and has been eliminated completely for certain dividends under some recent United States treaties. Various Brazilian tax treaties reduce this withholding tax rate to as low as 15 percent, so a similar reduction could occur under a treaty with the United States.

Reduction of Burden on Interest Income: Without a tax treaty, interest paid by U.S. companies to Brazilian companies and individuals that own 10 percent or more of the U.S. company is generally subject to a 30 percent U.S. withholding tax, imposed on the Brazilian recipient of U.S.-sourced interest. This withholding tax is often eliminated completely or reduced significantly under U.S. BTTs. Various Brazilian tax treaties reduce this withholding tax rate to as low as 10 percent, so a similar reduction could occur under a treaty with the United States.

Reduction of Burden on Royalties: Without a tax treaty, royalties paid by U.S. companies to Brazilian companies and individuals are generally subject to a 30 percent withholding tax, imposed on the Brazilian royalty recipient. This tax is often eliminated completely or reduced significantly under United States tax treaties. Various Brazilian tax treaties reduce this withholding tax rate to as low as 10 percent, so a similar reduction could occur under a treaty with the United States.

Brazilian Branch Office Benefits: In the absence of a tax treaty, Brazilian companies that operate in the United States through a branch (i.e., operating other than through a United States subsidiary corporation) generally are subject to a 30 percent branch profits tax with respect to earnings they repatriate out of the United States. This branch profits tax is often eliminated or significantly reduced in tax treaties entered into by the United States. Thus, a tax treaty could eliminate or reduce this tax burden that is imposed on Brazilian companies.

Reduction of Income Tax: A tax treaty between the United States and Brazil could benefit Brazilian companies operating in the United States by increasing their threshold for income tax for any income somehow related to the United States. In the absence of

such a tax treaty, Brazilian companies and individuals doing business in the United States are taxed on all income connected to the conduct of U.S. trade or business.

In contrast, if Brazilian companies and individuals could rely upon a BTT with a “permanent establishment” clause, the threshold for taxation of Brazilian companies and individuals would be increased significantly because: (i) said Brazilians and their companies generally have a U.S. permanent establishment (i.e., a fixed place of business in the United States), and (ii) U.S. sourced income is generally attributable to that “permanent establishment.” Most BTTs have historically included such a “permanent establishment” clause, which would allow many Brazilian companies to export goods and services to the United States without incurring U.S. taxes.

Increasing the importance of a BTT, the U.S. Government has aggressively cracked down in recent years upon foreign companies and individuals that operate in the United States without the protection of a tax treaty, but without paying appropriate taxes on income from exports into the United States and other U.S. -based activities.

Transfer Pricing: A tax treaty could be expected to establish a framework for resolving transfer pricing disputes that may arise due to the disparate transfer pricing regimes employed by the United States and Brazil. In the absence of such a mechanism, there is a risk of the imposition of double taxation on Brazilian companies.

Reduced Double Taxation: A BTT could be expected to further the ultimate goal of tax treaties -- the elimination of double taxation -- by establishing procedures for review when tax treatment is in dispute. When the possibility of double taxation exists, competent authority procedures may be invoked under a tax treaty to harmonize tax treatment to mitigate the incidence of double taxation of income. Most double taxation avoidance is already in place as the domestic tax legislation of both countries recognizes as credit, the income tax paid overseas. The challenge of eliminating the current existing double taxation, as in the case of independent personal services, mostly due to differences in taxation doctrine, such as source and residence principles, are hard to achieve and may prove to be a major obstacles to the agreement on a BTT.