

THE TAX RELATIONSHIP BETWEEN BRAZIL AND THE CARIBBEAN

By Rafael Barbosa de Sousa, Municipal Tax Auditor for the City of São Paulo and international tax specialist. Appointed to serve as Administrative Tax Judge in the Municipal Board of Tax Appeals for the 2022/2024 Term.

1. OVERVIEW

The Federative Republic of Brazil is the fifth largest country in the world measured by total land area and has the world's sixth highest population, estimated to be at over 210 million people as of the time of writing.

Economically, the country is a global powerhouse, with the 8th largest GDP (PPP) in the world as of October 2022, according to an estimate by the International Monetary Fund . It is the largest economy in Latin America and the second largest in the Americas, after the United States.

However, in spite of its significant economy, large consumer market and geographic proximity to the Caribbean, Brazil has a relatively limited economic exchange with Caribbean nations, including those that form the Dutch Caribbean. Though the reasons for this somewhat circumspect joint economic activity are varied and complex, cultural differences, linguistic barriers and a strong economic presence in the Caribbean by the United States and Western European countries (thus possibly crowding out other global participants) are some of the contributing factors.

From a Brazilian standpoint, Caribbean jurisdictions are often utilized by Brazilian corporations and foreign MNEs with permanent establishments in Brazil as domiciles for holding companies, financial/insurance subsidiaries and investment vehicles. These entities are often incorporated to serve tax-planning purposes, in order to reduce the share of their total income subject to taxation in Brazil, which is considered to have high tax rates for a developing country. As a result, there is perhaps a generally cautious attitude towards strengthening cooperation with



Caribbean jurisdictions on tax matters, and in particular with signing double-tax treaties (DTTs) with such countries, as there may be concern with regards to the potential abuse of any such provisions by taxpayers resident in Brazil with the aim of unfairly and artificially reducing the share of their corporate income subject to taxation in the country.

This more conservative attitude also extends to other matters of tax cooperation as a whole. Exchange of tax information and high-level interchange between Brazilian and Caribbean authorities appears to be relatively limited. It can therefore be said that there is significant room for an intensification of the tax relationship between Brazil and the Caribbean, both in terms of implementing a robust DTT network and of creating a framework for increased cooperation between Brazilian and Caribbean authorities on tax matters.

2. CURRENT SCENARIO: LIMITED TOOLS FOR TAX COOPERATION AND THE PREVENTION OF DOUBLE TAXATION

The Brazilian DTT network is quite limited considering the size and global relevance of its economy; as of the time of writing, the official website of the Brazilian Federal Revenue Service² lists only 37 (thirty-seven) DTTs active and in force between Brazil and foreign jurisdictions. In addition, Brazilian authorities signed in December 2022 new DTTs with Norway and the United Kingdom, but these treaties must yet be ratified by the Brazilian Congress and therefore are still not in force.

From a legal standpoint, the prevalence DTTs over domestic legislation in Brazil can be inferred from the joint interpretation of Article 5, Paragraph 2, and Article 150, caput, of the Brazilian Constitution. Paragraph 2 of article 5 provides that domestic law must observe fundamental rights and guarantees assured by the international treaties to which Brazil is a party.

The caput of Article 150, which deals with limitations on the power to tax, qualifies taxpayer rights as fundamental rights. Moreover, article 98 of the National Tax Code (“Código Tributário Nacional” – CTN – Federal Law nº 5.172/1966) expressly determines that international tax treaties and conventions must prevail over domestic legislation. Decisions of the Brazilian superior courts – i.e., the Federal Supreme Court (“STF”) and the Superior Court of Justice (“STJ”) – applying article 98 of the National Tax Code acknowledge the prevalence of DTTs over domestic legislation.

Therefore, DTTs in force must be observed by Brazilian domestic legislation and supersede its application in the event of conflict.

It is of particular notice that, whilst Brazil does have an active DTT with the Netherlands³, the territorial effects of such treaty are explicitly limited to the European part of the Kingdom of the Netherlands and do not cover neither the special municipalities of Bonaire, St. Eustatius and Saba (BES Islands); nor the constituent countries of Aruba, Curaçao and St. Maarten (CAS Islands).



The treaty, however, defines “nationals” for the effects of its applications as all natural persons who are nationals of either State, according to the laws of that State. As people born in both the BES and the CAS islands are Dutch nationals according to the Dutch Nationality law, one can infer that they may benefit from the treaty, for income taxable in the European Netherlands, as long as they are considered a resident of the European Netherlands for tax purposes in accordance to the residence provisions of the treaty.

The only DTT in force between Brazil and a Caribbean country is that signed with Trinidad and Tobago in 2008, ratified by the Brazilian Congress in 2011 and promulgated by the Brazilian Presidency in 2014⁴. Some noteworthy highlights of this treaty include:

- The treaty explicitly applies to the following Trinidadian taxes: corporation tax, income tax, unemployment levy, petroleum profits tax and the supplemental petroleum tax;
- The only Brazilian tax which explicitly falls under the purview of the treaty is the Federal Income Tax (“Imposto Federal sobre a Renda”), which applies both to personal and corporate income;
- Notwithstanding the express indication of the taxes mentioned above, the treaty shall apply to any future taxes of a substantially similar nature, enacted after its celebration, either in addition to or in substitution of the expressly covered taxes;
- The method of choice to avoid double taxation is the Credit Method, as opposed to the Exemption Method;
- Income derived by a resident of one State from Real Estate located in the other State may be taxed by that other

State, and such tax owed shall be deductible from the tax owed to the residence State;

- Profits from the operation of ships or aircraft in international traffic are taxable only in the State in which the place of effective management of the enterprise is situated;
- Dividends paid by a company resident of one State to a company resident in the other State may be taxed by that other State, but may also be taxed by the State of residence of the paying company. However, if the company receiving such dividends is their beneficial owner, the maximum tax rate which can be levied by State of residence of the paying company is limited to 10% (ten per cent) if the beneficial owner holds directly or indirectly at least 25% (twenty-five per cent) of the capital of the paying company, and 15% (fifteen per cent) in all other cases;
- Interest and royalties arising in one State and paid to a resident of the other State may be taxed in that other State. However, such interest and royalties may also be taxed in the State in which it arises, but, if the beneficial owner of the interest and royalties is a resident of the other State, the tax so charged shall not exceed 15 per cent of the gross amount of the interest and royalties;
- Visiting professors and researchers from one State residing in the other State for a period not exceeding two years are exempt from tax levied by that other State on their income derived from such activities, provided that the payment of such remuneration is derived by him from a source outside that State; and
- A Limitation of Benefits (LOB) Clause excludes treaty benefits with regards

to income benefitting a company resident of either State when its beneficial owners are residents of other jurisdictions, and the amount of tax imposed on such income is substantially lower than what would have been levied had the beneficial owners had been residents of that State.

Brazil has a history of willingness to stray from the rigidities of both the OECD and the UN Model Conventions on Tax in order to safeguard what it sees as critical national interests and prevent treaty abuse. Such straying can be seen in the treaty signed with Trinidad, and the author believes this DTT will serve as a model for any future treaties negotiated with Caribbean jurisdictions (including the BES and CAS islands), in particular since that treaty was drafted and negotiated by Brazil under President Luis Inacio Lula da Silva, who has once again assumed the Presidency, and has brought back several members of the economic and foreign policy teams which assisted him during his first Administration.

3. NORMATIVE INSTRUCTION N° 1.037/2010 OF THE BRAZILIAN FEDERAL REVENUE SERVICE: CARIBBEAN TAX HAVENS

Caribbean-based tax professionals interacting with Brazil and the Brazilian tax authorities should be cognizant of the content of Normative Instruction n° 1.037/2010⁵, issued by the Federal Revenue Service of Brazil (“Receita Federal do Brasil”), which lists foreign jurisdictions considered by Brazil as having favorable or privileged tax regimes – tax havens.

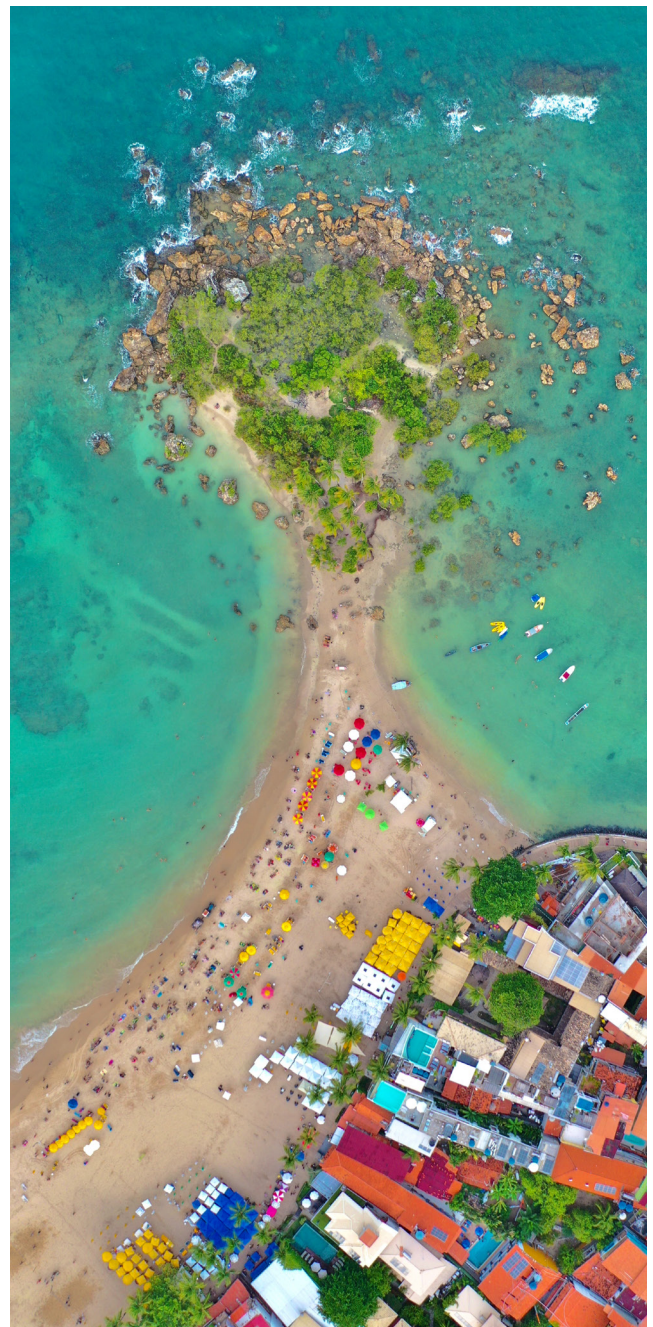
A significant number of Caribbean jurisdictions are listed. As of the time of writing, these were:

- Anguilla;
- Antigua and Barbuda;
- The CAS islands (Curaçao, Aruba and St. Maarten);
- The Bahamas;
- Barbados;
- Belize;
- Bermudas;
- The Cayman Islands;
- Dominica;
- Granada;
- Saint Lucia;
- Saint Christopher and Nevis;
- Saint-Pierre and Michelon;
- Saint Vincent and the Grenadines;
- The Turks and Caicos Islands;
- The US Virgin Islands; and
- The British Virgin Islands.

According to Brazilian law, tax havens are defined as jurisdictions which meet at least one of the following requirements:

- a) Does not tax income or does so at a maximum rate of less than 20% (twenty per cent);
- b) Grants tax benefits to non-resident natural and/or legal persons without requiring such persons to carry out substantive economic activity in that jurisdiction; and
- c) Refuses access by foreign tax authorities to information relating to corporate structuring and ownership; the persons holding the underlying rights to goods, services and other economically significant assets; and the parties to transactions of an economic nature.

The consequences for a foreign jurisdiction of being listed as a tax haven by Brazilian Authorities is the increase in Corporate Income Tax (CIT) rates on remittances of capital gains and yields from 15% (fifteen percent) to 25% (twenty-five percent), additionally to the enforcement of special and more rigorous Transfer Pricing rules.



4. PROSPECTS FOR THE FUTURE

Though the current scenario leaves room for improvement in terms of effective tax cooperation between Brazil and Caribbean nations – and the prevention of double taxation or double non-taxation – there is cause for optimism.

As previously mentioned, President Luis Inacio Lula da Silva was inaugurated on 1 January 2023 to serve his third non-consecutive term as President of Brazil, following his victory in presidential elections held in late 2022. In his two previous presidential terms, Lula developed a strong record of accomplishments in deepening the political and economic relations between Brazil and nations of the so-called “Global South”, with a particular emphasis on Latin America.

Furthermore, economic exchange between Brazil and the Caribbean though still far below its potential, has been growing rapidly, spurred by Brazilian investment in Caribbean enterprises, strong and growing financial services and logistics sectors in the Caribbean region, and an

increasing flow of Brazilian tourists to destinations such as Aruba, Curaçao and the Dominican Republic.

As a result, one can anticipate economic and financial flows to increase over the upcoming years, which, when combined with an expected greater attention by the Brazilian government to its developing neighbors in the Americas, bodes well for a strengthening of the tax relationship between Brazil and the Caribbean, with opportunities for new DTTs and a deepened cooperation between tax authorities.



Rafael Barbosa de Sousa

¹World Economic Outlook database: October 2022. Available at <https://www.imf.org/en/Publications/WEO/weo-database/2022/October/weo-report> accessed in December 2022.

² <https://www.gov.br/receitafederal/pt-br/acao-informacao/legislacao/acordos-internacionais/acordos-para-evitar-a-dupla-tributacao/acordos-para-evitar-a-dupla-tributacao#trinidadetobago> accessed in January 2023.

³“Convention between the Kingdom of the Netherlands and the Federative Republic of Brazil for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income.”, promulgated in Brazil by Federal Decree n° 355/1991. Article 3, Section 1, Item c: “the term ‘the Netherlands’ means the part of the Kingdom of the Netherlands that is situated in Europe including the part of the seabed and its subsoil under the North Sea, to the extent that that area in accordance with international law has been or may hereafter be designated under Netherlands

laws as an area within which the Netherlands may exercise certain rights with respect to the exploration and exploitation of the natural resources of the seabed or its subsoil.” English version authentic.

⁴ Convention Between the Government of the Republic of Trinidad and Tobago and the Government Of the Federative Republic of Brazil for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion With Respect to Taxes on Income and for the Encouragement of Bilateral Trade and Investment”, promulgated in Brazil by Federal Decree n° 8.335/2014. English and Portuguese versions equally authentic.

⁵Instrução Normativa RFB n° 1037, de 04 de Junho de 2010. Full text available at <http://normas.receita.fazenda.gov.br/sijut2consulta/link.action?naoPublicado=&idAto=16002&visao=anotado> accessed in January 2023.