

Brazilian tax authorities update tax haven list and issue guidance on foreign tax credits and income tax on software payments

January 29, 2018

In brief

The Federal Revenue of Brazil (RFB) on December 26, 2017, issued two Normative Instructions and an Interpretive Declaratory Act that, among other changes, modify the Brazilian tax haven and privileged tax regime list and provide guidance on claiming foreign tax credits and applying income tax withholding on payments to nonresidents for the right to distribute or commercialize software in Brazil.

In detail

Updates to the Brazilian tax haven and privileged tax regime list

Normative Instruction 1,773/2017 (NI 1,773/2017) updates the Brazilian list of tax havens (the 'black list') and privileged tax regimes (the 'grey list').

NI 1,773/2017 removes Singapore, Costa Rica, and the Madeira Islands from the black list. But it adds the following to the grey list: Costa Rica's 'Zona Franca' free-trade zone regime; Portugal's Centro Internacional de Negocios da Madeira (Centre of International Business) regime; and various special regimes in Singapore that provide preferential tax rates,

including regimes related to leasing, finance and treasury, insurance, and shipping.

NI 1,773/2017 also made a minor change to the holding company definition for purposes of the Danish and Dutch privileged tax regimes.

Tax havens and privileged tax regimes are subject to more restrictive thin capitalization and transfer pricing rules, regardless of whether the foreign party is related to the Brazilian entity, and to various adverse consequences and restrictions under the Brazilian controlled foreign corporation (CFC) rules. In addition, payments to tax havens generally trigger higher rates of income tax withholding.

NI 1,773/2017 is effective as of January 1, 2018.

Observation: Although NI 1,773/2017 is not law for Brazilian tax purposes, it clarifies how the RFB will treat listed jurisdictions and regimes. Taxpayers engaging in transactions with these jurisdictions should revisit these transactions to determine the impact of the changes.

Guidance regarding requirements for claiming foreign tax credits

Normative Instruction 1,772/2017 (NI 1,772/2017) amends regulations on the requirements for claiming tax credits in Brazil for foreign taxes paid.

Normative Instruction 213/2002 (NI 213/2002) and Normative Instruction 1,520/2014 (NI 1,520/2014) are the key regulations that provide the requirements and conditions for claiming tax credits for Brazilian corporate income tax purposes (including both corporate income tax (IRPJ) and Social Contribution on Net Profits (CSLL)).

NI 1,772/2017 amends NI SRF 213/2002 to allow alternatives to the requirement that tax collection vouchers that substantiate foreign taxes paid must be legalized by the Brazilian embassy in the foreign jurisdiction. However, Brazilian tax law does not explain what these alternatives would be.

NI 1,772/2017 fills that gap by providing the following:

For jurisdictions that are signatories to the *Convenção sobre a Eliminação da Exigência de Legalização de Documentos Públicos Estrangeiros* (Convention on the Elimination of the Requirement of Legalization of Foreign Public Documents), also referred to as the Apostille Convention, the official tax collection document must be certified/stamped by the appropriate designated authority and the stamped document, along with a sworn translation into Portuguese, must be kept on file. This alternative also was included in NI 1,520/2014 along with another minor reporting clarification.

According to the new NI, this requirement may be waived if the taxpayer provides the entity's statutory financial statements, along with proof that the applicable foreign legislation provides that the income tax must be paid by way of the official collection document.

NI 1,772/2017 is effective as of December 26, 2017.

Observation: Taxpayers currently taking foreign tax credits should determine whether they are able to simplify their administrative processes in accordance with the RFB's guidance.

Income tax withholding on payments to nonresidents for the right to distribute or commercialize software

Interpretative Declaratory Act 7/2017 discusses application of the income tax withholding on payments to nonresidents for the right to distribute or commercialize software (ADI 7/2017) in Brazil.

ADI 7/2017 provides that payments, credits, and remittances to nonresidents for the right to distribute or commercialize software should be classified as royalties and therefore subject to income tax withholding at a 15% tax rate. When the beneficiary of the payment is resident or domiciled in a tax haven, a 25% tax rate should apply.

This guidance follows recent decisions, including *Solução de Divergência 18/2017* and *Solução de Consulta 154/2016*, that modified the RFB's previous position in relation to this issue.

Observation: Although not law, ADI 7/2017 provides clarity on how the RFB will treat such payments going forward. Taxpayers engaging in transactions related to the acquisition with nonresidents rights to distribute or commercialize software in Brazil therefore should consider revisiting these transactions to determine how the decision may affect them, including deductibility.

The takeaway

Multinational enterprises with a Brazilian presence and nonresidents that transact with Brazilian entities should take this new guidance into account. In particular, companies operating in the software sector should carefully analyze the potential effect of the new guidance on their transactions.

Let's talk

For a deeper discussion of how this may affect your business, please contact:

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