Analysis: Brazil – China Income Tax Treaty

See treaty text

Type of treaty: Income and Capital
Model treaty on which based: OECD

Signed: August 5, 1991
Entry into force: January 6, 1993
Effective date: January 1, 1994. See Article 28.

This Analysis was updated in November 2011 by Luiz Felipe Centeno Ferraz, Andrea Bazzo Lauletta, Guilherme Lautenschlaeger Novello, Matheus Bertholo Piconez, Rodrigo de Madureira Para Diniz, Tatiana Morais Penido, Lawyers at Mattos Filho, Veiga Filho, Marrey Jr. e Quiroga Advogados, Brazil.

Expert Analysis:

This Analysis was updated in November 2011 by Luiz Felipe Centeno Ferraz, Andrea Bazzo Lauletta, Guilherme Lautenschlaeger Novello, Matheus Bertholo Piconez, Rodrigo de Madureira Para Diniz, Tatiana Morais Penido, Lawyers at Mattos Filho, Veiga Filho, Marrey Jr. e Quiroga Advogados, Brazil.

Article 1 Personal Scope

Persons who are residents of one or both States.

Article 2 Taxes Covered

Brazil Federal income tax, excluding supplementary income tax and tax on activities of minor importance.

China

Individual income tax
Income tax concerning joint ventures with Chinese and foreign investment
Income tax concerning foreign enterprises
Local income tax

Expert Analysis:

Brazil does not charge income taxes at States' level.
The Convention covers federal income taxes at individual and corporate levels, and also withholding taxes.

With regard to the taxation of companies that are resident in Brazil, the Convention refers to federal corporate income tax (Imposto de Renda das Pessoas Jurídicas - "IRPJ"), which is levied at a rough 25% rate.

Income of Brazilian resident companies is, however, also subject to Social Contribution Tax on Net Profits (Contribuição Social sobre o Lucro Líquido - "CSLL") a similar tax charged at a 9% rate to companies in general, and at a 15% rate to certain companies operating in the financial market. Although paragraph 2 of article 2 extends the application of the Convention to "similar taxes", it does so only with respect to similar taxes imposed subsequently to the signature of the Convention. Considering that the Convention was signed in 1991 and that the CSLL was introduced in the Brazilian tax system in 1988, a discussion exists as to the fact that the dispositions of the Convention should apply to the CSLL.

Article 3 Definitions

"Brazil": the Federative Republic of Brazil;
"China": the People's Republic of China; when used in geographical sense, all the territory of the People's Republic of China, including its territorial sea, in which the Chinese laws relating to taxation apply, and any area beyond its territorial sea, within which the People's Republic of China has sovereignty of exploration for and exploitation of resources of the seabed and its sub-soil and superjacent water resources in accordance with international law;
"A Contracting State" and "the other Contracting State": Brazil or China as the context requires;
"Person": an individual, a company and any other body of persons;
"Company": any body corporate or any entity which is treated as a body corporate for tax purposes;
"Enterprise of a Contracting State" and "enterprise of the other Contracting State": respectively an enterprise carried on by a resident of a Contracting State and an enterprise carried on by a resident of the other Contracting State;
"Competent authority": in Brazil: the Minister of Finance, the Secretary of Federal Revenue or their authorized representative and in China, the State Tax Bureau or its authorized representative

Expert Analysis:

The Convention sets forth a specific definition of the term "national" (i.e., all individuals possessing the nationality of a Contracting State and all legal entities created or organized under the laws of that
Contracting State, as well as any organizations without legal personality treated for tax purposes as legal entities created or organized under the laws of that Contracting State”.

In addition to that, it is important to observe that, under Brazilian legal system, there is no explicit definition of the concepts of “enterprise”, “national” or “business”.

**Article 4 Resident**

See treaty text

Brazilian residents and companies liable to income tax. Imposition of taxes decided on case by case basis.

**Expert Analysis:**

All Brazilian resident individuals and companies are liable to income taxes. Whether or not tax liability will result in taxes effectively being imposed can be determined solely on a case by case basis.

In this regard, some investment funds set up in Brazil actually benefit from tax exemption regimes. Because of that there is a discussion as to whether such funds could be considered “residents” of Brazil for purposes of entitlement to the benefits of the Convention, since the Convention defines as “resident” a person who is liable to tax in the Contracting State. To this moment, there are no decisions tackling this issue.

**Article 5 Permanent Establishment**

See treaty text

For a Permanent Establishment to exist, there must be a place of business, the place of business must be fixed and business must be conducted through fixed place.

A dependent agent is not a permanent establishment if activities limited to purchase of goods for the enterprise.

A building site or construction or assembly project which exists for more than six months is deemed to amount to a permanent establishment.

A fixed place of business used for a combination of otherwise exempt activities is not expressly excluded from permanent establishment status.

An agent whose work is wholly or almost wholly spent on the enterprise is deemed not independent.

**Expert Analysis:**

Under the Convention, a building site or construction or assembly project which exists for more than six months is deemed to amount to a PE, as opposed to twelve-month period established under the OECD Model for the building site, construction or assembly project to be deemed to amount to a PE.

Furthermore, pursuant to the Convention, the furnishing of services, including consultancy services, by an enterprise of a Contracting State through employees or other engaged personnel in the other Contracting State, provided that such activities continue for the same project or a connected project for a period or periods aggregating more than six months within any twelve-month period is also deemed to amount to a PE.

The Convention does not contain section (f) of paragraph 4 of the OECD Model, which provides that the combination of any of the previously described activities in a fixed place of business is not considered a permanent establishment provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.

Paragraph 6 of article 5 contains a last provision stating that in when the activities of the agent are devoted wholly or almost wholly on behalf of that enterprise, he will not be considered an agent of an independent status.

**Article 6 Income from Immovable Property**

See treaty text

The general rule is that income derived by a resident of a State from immovable property in the other State may be taxed in that other State. Unlike the OECD Model, the Convention also encompasses in this article income derived from immovable property used for the performance of professional services.

**Article 7 Business Profits**

See treaty text

Only profits actually arising from a permanent establishment may be taxed by the source State.

Profits made by a permanent enterprise will be treated as if they had been made by a distinct and separate enterprise working under the same conditions.

Apportionment of total profits permitted

No express provision for same profit attribution method to be used each year.

**Expert Analysis:**
The Convention does not have paragraphs 4 and 6 of the OECD Model. Paragraph 3 does not have the clarification provided by the wording of the provision of the OECD Model: “whether in the State in which the permanent establishment is situated or elsewhere.”

Additionally, the Brazilian Revenue Service maintains a position that article 7 should not necessarily apply to income of a Chinese controlled or affiliated company of a Brazilian company. Instead, Brazilian tax authorities tend to take the stand that the domestic legislation which provides that income realized by a controlled or affiliated company abroad should be computed in the Brazilian parent company's income every year-end regardless of distribution, applies irrespective of double tax treaties provisions. There are good grounds to challenge the tax authorities’ view in the administrative and judicial courts.

From a Brazilian outbound perspective, the Brazilian Revenue Service tends to consider that services that may not be covered by other articles of the Convention (e.g. article 12) are not covered by article 7 either, and therefore are subject to local withholding tax levy. To date, a few taxpayers have succeeded in obtaining judicial decisions allowing remittances abroad to be carried out without bearing such levy.

**Article 8 Shipping and Air Transport**

See treaty text

No express requirement for profits from inland waterways transport to be taxed in State where effective management of the enterprise is situated.

No express requirement for effective management of a boat or ship to be deemed to be situated in the home harbor of that boat or ship, or in the State in which the operator of the ship is resident.

This provision does not override the Agreement on Maritime Transport between the two States.

**Expert Analysis:**

The Convention does not contain paragraph 2 of the OECD Model, which provides that profits related to the operation of boats engaged in inland waterways transport shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated.

**Article 9 Associated Enterprises**

See treaty text

Usual OECD provisions regarding transfer pricing

Arm's length principle applies in dealings

**Expert Analysis:**

Paragraph 2 of the OECD Model is not present, meaning that there is no express requirement for a reciprocal adjustment with regard to transfer pricing. To avoid double taxation, relief would have to be sought under the Mutual Agreement procedure.

**Article 10 Dividends**

See treaty text

Treaty rate: 15%

Domestic rates:

**Brazil**

There is no tax on dividends.

**China**

Withholding tax at a rate of 10%.

Business profits other than those made by a PE expressly covered.

**Expert Analysis:**

Regardless of the differences between this article and the provisions of the OECD Model, the distribution of dividends made by Brazilian resident companies out of profits generated as of 1996 is exempt from withholding tax in Brazil. Such differences are therefore irrelevant for the purposes of this analysis.

**Article 11 Interest**

See treaty text

Withholding tax imposed at 15%.

All other cases: 10%

Domestic rates:

**Brazil**

In the case of interest, the withholding tax rate is 15% when paid to nonresidents and 25% if the recipient is domiciled in a tax haven.

**China**

In the case of interest, the withholding tax rate is 10% when paid to nonresidents.
Expert Analysis:
The Convention provides for different limitations of withholding tax, compared to the OECD Model, including a special limitation in case of interest payments made to a Government of a Contracting State.
Alternatively to dividend distributions, Brazilian companies may remunerate shareholders by paying so-called interest on equity ("INE"), calculated upon the application of the long term interest rate ("TJLP") on the company’s adjusted net equity. Deductibility is limited to some tax tests, and the corresponding payment is subject to a 15% withholding tax rate. Because INE is a hybrid instrument - bearing both equity and debt characteristics -, the Contracting State in which the recipient is domiciled may discuss the application of article 10 or 11 in allowing a tax credit, as the case may be. Finally it is important to note that the Convention provides for "beneficial owner" requirements on paragraphs 2 and 5.

Article 12 Royalties
See treaty text
Royalties are taxed at 25% of the gross amount from the use or right to use trade marks and 15% in all other cases.
Domestic rates:
Brazil
15% unless reduced by an applicable tax treaty. WHT of 25% or 15% for technical services that do not include transfer of technology.
China
Royalties subject to 15% withholding tax.

Expert Analysis:
The Convention provides for tax sharing powers between source and resident State, meaning that not only the country of residence of the recipient of the royalties may tax such royalties (treatment also provided by the OECD Model), but also the source State may withhold tax upon remittance of royalties (treatment not provided by the OECD Model). In this scenario, the Convention provides for different withholding income tax limitations.
Under the Protocol to the Convention, it is agreed that the provisions of paragraph 3 of Article 12 apply to payments of any kind received as a consideration for the rendering of technical assistance and technical services.

Article 13 Capital Gains
See treaty text
Gains on immovable property and property that is part of the assets of a PE may be taxed by the Situs State
No express provision for gains from the alienation of boats engaged in inland waterways transport.
Gains from the alienation of shares deriving 50% or more of their value from immovable property in the other contracting State may be taxed in that other State.
All capital gains not expressly covered may be taxed by either State.

Expert Analysis:
Unlike the OECD Model, under the Convention the term “capital gains” also encompasses the gains derived from “movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of independent personal services”.
The Convention does not contain a provision similar to paragraph 4 of the OECD Model, according to which gains arising from the alienation of shares deriving more than 50 per cent of their value directly or indirectly from immovable property situated in the other Contracting State may be taxed in that other State.
Another important difference is that the capital gains not referred to in paragraph 1 and 2 of the Convention may be taxable in both Contracting States, whereas under the OECD Model capital gains not referred to in preceding paragraphs shall be taxable only in the State where the alienator is a resident.

Article 14 Independent Personal Services
See treaty text
The income is taxed on the basis that the profits attributable to that fixed base are assessed in the country in which it is located, unless the remuneration is paid by a company or PE resident in the other State, in which case the profit may be taxed in the other State.

Expert Analysis:
The Convention is based on former OECD Model, in which independent personal services were not included under Article 7.

**Article 15 Dependent Personal Services**

*See treaty text*

Follows OECD Model, although the Model refers to the 183 day-limit as being in any twelve month period beginning or ending in the fiscal year concerned, whereas the Treaty refers simply to the “aggregate 183 days in the calendar year concerned”.

**Article 16 Directors' Fees**

*See treaty text*

General rule applies. Directors’ fees paid by a company in one State and paid to a resident of the other State may be taxed in that other State.

**Article 17 Artists and Athletes**

*See treaty text*

General rule applies, but exemption when performing activities under a cultural exchange plan.

**Expert Analysis:**
The Convention added a third paragraph (which does not exist in the OECD Model), which sets forth notwithstanding the provisions of paragraphs 1 and 2, income derived by entertainers or athletes who are residents of a Contracting State from the activities exercised in the other Contracting State under a plan of cultural exchange between the Governments of both Contracting States shall be exempt from tax in that other Contracting State.

**Article 18 Pensions**

*See treaty text*

Taxable only in State where recipient is resident apart from social security pensions

Taxable in State where recipient is resident if paid by resident of that State.

**Expert Analysis:**
The Convention provides for paragraphs 2 and 3 - which do not exist in the OECD Model - pursuant to which pensions and other similar payments made under a public welfare scheme of the social security system of a given Contracting State shall be taxable only in that Contracting State, except if such pensions are paid by a resident of the other Contracting State.

**Article 19 Governmental Service**

*See treaty text*

General rule applies. Remuneration other than pensions paid by a State and paid for services rendered to that State shall be taxed in that State, unless paid to a national of the other State who did not become a resident of that other State solely for the purpose of rendering the services.

Pensions paid by a State shall be taxed in that State unless paid to a resident AND national of the other State, in which case, it will be taxed only in the other State.

**Article 20 Teachers**

*See treaty text*

Remuneration earned by an academic from one State exempt from tax for two years when teaching, lecturing or researching in the other State, provided it is taxable in the first State.

**Article 21 Students**

*See treaty text*

Income derived by a student who is temporarily present solely for the purpose of her or his education is exempt from taxation.

Grants, scholarships and remuneration from employment expressly covered.

**Expert Analysis:**
Unlike the OECD Model, the Convention contains a second paragraph concerning grants, scholarships and remuneration from employment not covered by paragraph 1 of the Convention (which is similar to Paragraph 1 of the equivalent article of the OECD MC).

**Article 22 Other income**

*See treaty text*

Right to tax shared between the two States. No exemptions from this Article.

**Expert Analysis:**
When it comes to “other income”, unlike the OECD Model, the Convention provides for tax sharing powers between source and residence State, meaning that not only the country of residence of the recipient of the other income may tax such income, but also the source State may withhold tax upon remittances of categories of income not dealt with under specific distributive rules.
Furthermore, the Convention does not provide for an exception similar to that of paragraph 2 of the OECD model.

**Article 23 Methods for the Elimination of Double Taxation**

*See treaty text*

**Brazil:**
Credit method

**China:**
Credit method

**Expert Analysis:**
Article 23 of the OECD Model presents the two leading principles for elimination of double taxation by the State of which the taxpayer is a resident: the principle of exemption and the principle of credit. When negotiating their particular double taxation conventions, Contracting States may adopt one or the other principle, or even a hybrid system.
In this sense, in the context of the Convention, Brazil eliminates double taxation by granting an ordinary tax credit for taxes paid in China.
China also eliminates double taxation by granting an ordinary tax credit for taxes paid in Brazil.
In addition to that, China also grants additional credit for the underlying corporate taxation of the Brazilian company from which dividends are paid, provided the dividend is paid by a Brazilian company to a Chinese company which owns at least 10% of the shares of the company paying the dividend.

**Article 24 Non-discrimination**

*See treaty text*

Non-discrimination provision not extended to persons who are not residents of either State.
No express provision for stateless persons.
No provision for deductibility for debts incurred by enterprise in other State.
Non-discrimination provision expressly covers income taxes only.

**Expert Analysis:**
Unlike as provided under the OECD Model, application of the non-discrimination provision of the Convention is not extended to persons who are not residents of one or both of the Contracting States.
The Convention does not contain a provision similar to paragraph 2 of the OECD Model, which deals with stateless persons.
Under the Convention, the non-discrimination provision applies solely with regard to taxes covered by the Convention, whereas under the OECD Model, the non-discrimination provision applies to taxes of every kind and description.
Finally, the Protocol clarifies that the provisions of paragraph 5 of Article 10 are not in conflict with the provisions of paragraph 2 of Article 24.

**Article 25 Mutual Agreement Procedure**

*See treaty text*

General rule applies
Time limit for bringing claims is three years
Tax authorities SHALL consult together

**Expert Analysis:**
Unlike as provided under the OECD Model, the mutual agreement procedure is not expressly available for issues between the Contracting States that may arise from the application of the non-discrimination provision.

**Article 26 Exchange of Information**

*See treaty text*

As necessary for this treaty and domestic laws
Usual limitations apply. The exchange of information article is not consistent with the current Article 26 of the OECD Model, covering only income taxes.

**Expert Analysis:**
The Convention is more restrictive than the OECD Model in the exchange of information provision since it is only applicable to the exchange of information "concerning taxes covered by the Convention", rather than "concerning taxes of every kind and description imposed on behalf of the Contracting States", as provided in the OECD Model.

**Article 27 Diplomatic Agents and Consular Officials**

*See treaty text*

General rule applies.
Article 28 Entry into Force
See treaty text
This Article contains the rules for bringing the Convention into force and giving effect to its provisions.

Article 29 Termination
See treaty text
This Convention shall remain in force so long as it is not terminated by one of the two States.