Independent Personal Services in the Brazilian Double Tax Conventions

Serviços profissionais independentes nos acordos de bitributação brasileiros

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Abstract
This article tries to critically define the Brazilian policies related to the income from rendering of independent professional activities, present in the Article 14 of the double tax conventions ("DTCs") signed with several countries. Based on the premises developed along the study, it was possible to structure what would be the text-basis of Article 14 used by the country to negotiate with its partners, main characteristics, possible issues and the consequences in the bilateral relationships. The paperwork was designed, firstly describing how Article 14 is delineated in the main model-conventions, as the OECD's and the UN's; subsequently, the Brazilian conventions were submitted to analysis; at the end, the article brings final considerations and a summary of the presentation of Article 14 in the various conventions signed by Brazil.
Keywords: Article 14; independent professional services; conventions; international double taxation; Brazil; Brazilian policies.

Resumo
Este artigo tenta definir criticamente as políticas brasileiras relacionadas aos rendimentos oriundos da prestação de serviços profissionais independentes, presentes no Artigo 14 das convenções para evitar a dupla tributação ("DTCs") assinadas com diversos países. Com base em premissas desenvolvidas ao longo do estudo, foi possível estruturar o que seria o texto-base utilizado pelo país para negociar com seus parceiros, as principais características, os possíveis problemas e as consequências nas relações bilaterais. O trabalho foi estruturado, primeiramente, descrevendo como o Artigo 14 se apresenta nas principais convenções-modelo, da OCDE e da ONU; em seguida, foram tratadas as convenções brasileiras; ao final, são trazidas considerações finais e um resumo da apresentação do Artigo 14 nas convenções assinadas pelo Brasil.
Palavras-chave: Artigo 14; serviços profissionais independentes; convenções; dupla tributação internacional; Brasil; políticas brasileiras.

1. Introduction

The income from the so called liberal or independent professional activities is, if not the most, one of the most difficult to be qualified under a Brazilian tax convention, and this for various reasons: (i) first, because Brazil still follows the UN Models to include an Article 14 in its conventions that specially deals with independent professional services; (ii) second, because the concept of professional activities, in particular the similar ones, is not exhaustive and far from being clear; (iii) third, because, depending on the specific activity being performed and its circumstances, the Brazilian conventions can qualify the income arising from these activities in Articles 7, 12, or 14 (if not in the 15, 16, 17 or even in the 20); (iv) and finally, because the Brazilian tax authorities adopt a very unusual and inaccurate interpretation of the conventions towards the maintenance of source taxation.

This article has the aim to clarify the Brazilian tax treaty policies regarding the independent professional services, the qualification of the income generated from these activities, the similarities and deviations from the main model tax conventions, as the OECD's and the UN's, the reasons for these similarities and deviations, the consequences and practical issues.

We will not extend deep considerations to other kinds of services, although this can be sometimes inevitable, due to the challenge to extract from controversial grey zones the independent professional services and qualify them in Article 14.

The present article was structured to give the readers an overview on how the OECD's and the UN's Models treat the income from independent professional services, in the past and currently. Further, the policies used by Brazilian negotiators to design the Brazilian conventions along the time; we used as basis the system of Article 14 of the former OECD Models up to 2000 and the UN Models, as concept, allocation of taxing rights among others.

We hope to bring more elements to the academic debate about the qualification of services in the Brazilian tax conventions, now the independent professional services, which have been a target of fiscal policies, due to the increase of transactions among countries and, therefore, of economic relevance.

2. The model tax conventions

Earnings from independent professional activities were treated, primarily, by Article 14 of both the UN and the OECD Models.

Based on the OECD Models previous to 2000, Article 14 comprised income from activities of individuals related to professional services or other activities of an independent character (paragraph 1).

In the paragraph 2 of the Article 14, the former OECD Models brought a set of activities that should fall under the concept of "professional services" for the purposes of the article, especially including independent scientific,

literary, artistic, educational or teaching activities as well as the independent activities of physicians, lawyers, engineers, architects, dentists and accountants. This list is merely indicative, not exhaustive, what is understood from the term "especially" before "includes"[1].

However, Article 14 of the OECD Model was deleted by the Report "The 2000 Update to the Model Tax Convention", adopted by the OECD Committee on Fiscal Affairs on 29 April 2000 based on another report entitled "Issues related to Article 14 of the OECD Model Tax Convention" (adopted by the OECD Committee on Fiscal Affairs on 27 January 2000).

The OECD Committee came to the conclusion that Article 14 had the same effects of Article 7 and it there was no proper and material justification to maintain it, and was therefore superfluous[2]. Since 2000, income before governed by Article 14, has been regulated by Article 7.

The OECD Models were submitted to one single small but not less substantial modification to the Article 14 since the first OECD Model of 1963 and its deletion in the year 2000, namely in paragraph 1:

OECD Model of 1963	*Amendment – OECD Model of 1977*
1. Income derived by a resident of a Contracting State in respect of professional services *or other independent activities of a similar character* shall be taxable only in that State unless he has a fixed base regularly available to him in the other Contracting State for the purpose of performing his activities. If he has such a fixed base, the income may be taxed in the other Contracting State but only so much of it as is attributable to that fixed base.	1. Income derived by a resident of a Contracting State in respect of professional services *or other activities of an independent character* shall be taxable only in that State unless he has a fixed base regularly available to him in the other Contracting State for the purpose of performing his activities. If he has such a fixed base, the income may be taxed in the other State but only so much of it as is attributable to that fixed base.

The amendment to paragraph 1 occurred in 1977 amplified the scope of the term "other activities": from (i) only those independent activities with similar character to the professional services, described in paragraph 2; to (ii) any kind of activity with independent character. In other words, with the 1963

[1] See reference to the doctrine in BELLAN, Daniel Vitor. *Direito tributário internacional* – rendimentos de pessoas físicas nos tratados internacionais contra a dupla tributação. São Paulo: Saraiva, 2010, p. 129.

[2] Cf. BENDLINGER, Stefan; WASER, Karl; *in* AIGNER, Dietmar; KOFLER, Georg; TUMPEL, Michael (coord.). *DBA OECD-Musterabkommen mit den Besonderheiten der österreichischen DBA Kommentar*. Vienna: Linde, 2016, Article 14, p. 906, rf. 2.

OECD Model, only activities requiring specific qualification and formal education or creative-artistic skills would be covered by Article 14. From the 1977 OECD Model on, this requirement was abolished, so that, for example, an independent photo-model or an agent could fall under Article 14[3].

Despite this difference, by comparing situations involving also Article 7, some scholars understand that the activities falling under 14 should be primarily backed in a specific knowledge and skills[4], otherwise the income therefrom should be qualified in Article 7 (in case no other article is applicable, as Article 17 etc.). In our view, though, only those DTCs signed following the writing of the 1963 OECD Model should observe such requirement. This subject is a hotspot for discussions, especially in borderline cases with Article 7[5].

Difficulties in qualifying these other activities, irrespective whether in the 1963 or in the 1977 text, could be solved by the domestic laws, as allowed by Article 3 (2). However, in our opinion, this should be carried out only after analysis of the context and the first attempt to solve them based on the other articles of the convention[6].

In any case, for an accurate qualification it is necessary to compare them to the professions[7] and, either way, the doctrine indicates that two points should be definitely noted: (i) it is effectively a service, unlike to industrial or skilled manual production or manufacturing of merchandise to the business activities; and (ii) the use of capital represents a secondary role[8].

The OECD Report "Issues Related to Article 14 of the OECD Model Tax Convention from 2000" indicated that, in practice, various OECD countries didn't apply the Article 14 to these other activities of an independent character, but only to the listed professional services, described in paragraph 2[9]. As per the Report, the new coverage by Article 7 of the activities formerly falling

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3 Cf. PROKISCH, Rainer G.; *in* VOGEL, Klaus; LEHNER, Moris. *DBA* – DoppelbesteuerungsabkommenKommentar. 4. ed. Munich: C.H. Beck, 2003, p. 1268, m.n. 13. Depending on the kind of performance and the DTC involved, the activities of a model could fall under Article 17 and of the agent in Article 7.

4 BENDLINGER, Stefan; WASER, Karl; AIGNER, Dietmar; KOFLER, Georg; TUMPEL, Michael. *Article 14*, op. cit., p. 907, rf. 7.

5 S. VAN DER BRUGGEN, Edwin. Developing countries and the removal of Article 14 from the OECD Model. *Bulletin* – Tax Treaty Monitor. Amsterdam: IBFD, 2001, p. 602; and further: PROKISCH, Rainer G.; *in* VOGEL, Klaus; LEHNER, Moris. *DBA* (2003), op. cit., p. 1.268, m.n. 13.

6 Contrary to the remittance to domestic laws: PROKISCH, Rainer G., *in* VOGEL, Klaus; LEHNER, Moris. *DBA* (2003), op. cit., p. 1.267, m.n. 12. In favour to the remittance to domestic laws: BENDLINGER, Stefan; WASER, Karl; AIGNER, Dietmar; KOFLER, Georg; TUMPEL, Michael. *Article 14*, op. cit., p. 907, rf. 6.

7 Cf. LANG, Michael. *Einführung in das Recht der Doppelbesteuerungsabkommen*.2. ed. Vienna: Linde Verlag, 2002, p. 118, m.n. 349.

8 See PROKISCH, Rainer G.; *in* VOGEL, Klaus; LEHNER, Moris. *DBA* (2003), op. cit., p. 1.267, m.n. 13.

9 In Paragraph 9. Further in VAN DER BRUGGEN, Edwin. Developing countries, op. cit., p. 602.

under Article 14 could avoid misinterpretations and difficulties in applying the article.

For those countries which adopt the OECD Model entirely, in particular to the general rule about allocation of taxing power in the residence country, the merger of Article 14 into Article 7 seems to be appropriate.

The allocation of the taxing power in the OECD Models was determined as exclusive competence by the residence country of the income beneficiary, unless the service provider had a fixed base in the source country, for performing its activities. In this case, the source country could also tax the income, letting the residence country apply one of the methods to avoid double taxation.

The concept of fixed base was not described in the Article 14, as the concept of permanent establishment was in the Article 5. Despite the absence of a formal concept, the fixed base as such, as a platform for rendering of services of a professional, has many similar aspects to the permanent establishment. At the end, they have same origin and meaning. In accordance with the OECD Report that excluded Article 14 from the Model, even if differences exist, these should be irrelevant[10].

However, also due to its essence, being a platform for rendering of services of intellectual character, aspects such as physical presence or timing of this presence are not that decisive for qualifying a fixed base, as with permanent establishments[11]: for Article 14, it suffices the mere existence of a fixed facility not necessarily equipped, once this is available for the performance of a given activity; for Article 5, the activities must be totally or partially carried out through this facility[12]. These are relevant differences, in our opinion[13].

During the development of the 1980 UN Model, the Group of Experts made two substantive changes to the text of the OECD Model that served as basis for its preparation (OECD Model of 1977). Besides the reserve of "fixed base", the UN Model included new exceptions to the general rule that the taxation of such income should be taxed only in the country of residence: (i) one, in relation to the individual's length of stay in the source country; (ii) another, if the remuneration is paid by a company resident in the source country or that belongs to a fixed base or permanent establishment and the amounts paid exceed certain limits[14].

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[10] In Paragraph 28. See HUSTON, John. The case against "fixed base". *Intertax* 1988/10, Kluwer Law International, p. 286.

[11] Cf. MICHAUX, Eric. An analysis of the notion "fixed base" and its relation to the notion 'permanent establishment' in the OECD model. *Intertax* 1987/3, Kluwer Law International, p. 70.

[12] Cf. MICHAUX, Eric. An analysis of the notion "fixed base", op. cit., p. 73.

[13] Critically: HUSTON, John. The case against "fixed base", op. cit., p. 286.

[14] In United Nations, Department of Economic and Social Affairs Division for Public Administration and Development Management. *Manual for the negotiation of bilateral tax treaties between developed and developing countries*. New York, 2003, p. 110.

As reported in the "UN Manual for Negotiation of Bilateral Tax Treaties between Developed and Developing Countries"[15], during the discussions preceding the adoption of Article 14, some members of developing countries expressed the view that it would not be justifiable to limit the withholding tax, either by criterion of "fixed base" or "stay period", so that the criterion "source of income" should be the only one to govern the taxation.

Article 14 (1) of the UN Model of 1980 reads as follows:

> "(1) Income derived by a resident of a Contracting State in respect of Professional character shall be taxable only in that State except in the following circumstances, when such income may also be taxed in the other Contracting State:
> (a) if he has a fixed base regularly available to him in the other Contracting State for the purpose of performing his activities; in that case, only so much of the income as is attributable to that fixed base may be taxed in that other Contracting State; or
> (b) if his stay in the other Contracting State is for a period or periods amounting to or exceeding in the aggregate 183 days in the fiscal year concerned; in that case, only so much of the income as is derived from his activities performed in that State may be taxed in that other State; or
> (c) if the remuneration for his activities in the other Contracting State or is borne by a permanent establishment or a fixed base situated in that Contracting State and exceeds in the fiscal year... (the amount is to be established through bilateral negotiations)."

However, in 1999 the Group of Experts excluded the ultimate criterion of the UN Model version, published in 2001, *i.e.* the country of source could tax the income if such income exceeded certain limits. The main justification for eliminating monetary limits was that these would lose the meaning along the time, mainly because of inflation[16].

In the following chapter, all these aspects are discussed taking the Brazilian tax treaty policies into consideration.

3. The Brazilian tax conventions

3.1. Independent professional services and the Article 14 of the Brazilian tax conventions

Brazil did not adopt the new practice of the OECD countries and continued to include in its conventions exclusive article to treat income derived from activities performed by independent professionals. And it did it expressly

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[15] Referred to UN. *Manual*, op. cit., p. 110.

[16] Cf. UN. *Manual*, op. cit., p. 110.

through a formal position as OECD non-member country[17], together with Albania, Argentina, Chile, China, Croatia, Gabon, India, Ivory Coast, Malaysia, Morocco, Russia, Serbia, Tunisia and Vietnam.

All Brazilian conventions – with exception of only two (Japan 1967 and Turkey 2010) – adopt as criterion of exception to the exclusive taxation by country of residence the first part of last criteria of the 1980 UN Model (1, c): "if the remuneration for his activities in the other Contracting State is paid by a company resident of that Contracting State or is borne by a permanent establishment situated in that Contracting State".

This follows exactly from the fact that Brazil does not give up on the power to tax as source country. With this wording, any payment derived from Brazilian sources, being a company or a permanent establishment, will be taxed in Brazil.

Curious is the fact that the wording of this clause in many Brazilian conventions[18], limits the payment only by entities, not mentioning individuals. Although we believe Brazilian negotiators were extremely successful during the times, this seems an error in the negotiations conducted, leading to a mistaken writing.

A quarter of the Brazilian conventions (seven), five of them with Latin American countries (Argentina 1980, Chile 2001, Mexico 2003, Peru 2006 and Venezuela 2005) and the others with Russia 2004 and South Africa 2003, has an almost identical wording to Article 14 (1) of the 1980 UN Model, except for the last sentence of subparagraph "c" of the model, which provides for the right of the source country to tax the payments if these exceed certain quantitative limits.

Despite the DTC with Argentina, which dates from 1980, all the others were signed in the last decade, showing a tendency to follow this model with developing countries, especially Latin American ones (other recent ones, albeit outside Latin America, are the DTCs with Israel 2002 and Ukraine 2002, whose wording follows the Brazilian general rule. Exception is the source of payment).

The DTC with China 1991 adopted two of the criteria to attribute concurrent competence to tax to the source country, contained in the 1980 UN Model: the criterion of a fixed base and of the source of payment, if made by

[17] "[...] reserve the right to maintain in their conventions a specific article dealing with the taxation of Independent personal services. Accordingly, reservation is also made with respect to all the corresponding modifications in the Articles and the Commentaries, which have been modified as a result of the elimination of Art. 14." OECD NMC Position on Article 7 (2008), n. 2.1.

[18] With the exception of the DTC with China 1991, and of the most recent ones concluded from 2000 on, as Chile 2001, Israel 2002, South Africa 2003, Paraguay 2000, Peru 2006, Portugal 2000, Russia 2004, Trinidad and Tobago 2008, Ukraine 2002 and Venezuela 2005.

a person resident in the source country or supported by a permanent establishment or fixed base situated therein.

However, the most recent DTC signed by Brazil (Turkey 2010), as noted above, adopts the last two models of the UN, which do not include the last criterion. In our opinion, this position cannot be considered a reversal of the Brazilian DTC policy, especially in view of the still strong attachment to the principle of source. It turns out, however, that Brazil admits giving up on certain principles in cases of conventions with countries similar to it in economic terms and position in the global context of development. In such cases there is not a unilateral flow of payments, as occurs in relations to developed countries[19].

The income taxation on professional services rendered by non-residents to Brazilian service takers is 15%, which is charged over the gross value of the services. The source of payment is responsible for withholding the tax and the collection to the federal tax authorities[20]. Besides the income tax, Brazil also charges other indirect taxes: 10% CIDE, 9.25% PIS/COFINS, 2-5% ISS and 0.38% IOF[21].

In an analysis carried out by the *International Chamber of Commerce – ICC*, depending on the kind of services, the profitability may range between 5% and 15% before taxes[22]. Based on a study with German enterprises, in 2013 the profit margin was ca. 13% for knowledge-based services, ca. 7% for construction services and ca. 5% for other kinds.

Considering a tax rate of 15% and disregarding all the indirect taxes, once a service provider invoices 100 and has a profitability of 13%, it will end up at an after-tax loss [100 - (87 + 15) = - 2][23]. A possible credit of the tax paid abroad is a "souvenir", which will not have practical use.

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[19] Turkey places the 66th position among the biggest investors in Brazil; source CENTRAL BANK OF BRAZIL. *Census of Foreign Capital in Brazil (2010-2012)*. Available in <http://www.bcb.gov.br/Rex/CensoCE/port/resultados_censos.asp?idpai=>. Last access on 29 September 2014. On the contrary, there are only three Brazilian companies with direct investment in Turkey: CENTRAL BANK OF BRAZIL. *CBE – Brazilian Capital Abroad (2007-2013)*. Available in <http://www4.bcb.gov.br/rex/cbe/port/ResultadoCBE2013.asp?idpai=CBE>. Last access on 29 September 2014.

[20] Law n. 10.168/2000, Article 2-A; Income Tax Regulations, Article 685 II; Normative Instruction RFB n. 1.455/2014, Article 17.

[21] More details in our DUARTE FILHO, Paulo César Teixeira. Os *royalties* nos acordos brasileiros para evitar a dupla tributação, *in* SCHOUERI, Luís Eduardo; BIANCO, João Francisco (coord.); CASTRO, Leonardo Freitas de Moraes e; DUARTE FILHO, Paulo César Teixeira (org.). *Estudos de direito tributário em homenagem ao Professor Gerd Willi Rothmann*. São Paulo: Quartier Latin, 2016, p. 321 et seq.

[22] ICC. *Letter to Mr. Michael Lennard, UN Dept of Economic and Social Affairs, about ICC's perspectives on the taxation of technical services*; dated 5 August 2015, Document n. 180-554. Last access on 29 September 2017. Available in <https://cdn.iccwbo.org/content/uploads/sites/3/2015/09/ICC-s-further-perspectives-on-the-taxation-of-technical-services-2015.pdf>.

[23] See ICC. *Letter to Mr. Michael Lennard*, op. cit.

This is not only a problem involving services, but to all kinds of income taxable at the source on a gross basis, especially interest and royalties, which involve considerable costs in the values invoiced.

In fact, foreign services providers generally contract with their clients the invoice value net of taxes, shifting the tax burden to the service taker. As a result, there is an increase of the service costs to include the taxes.

Further with regard to the subjective qualification of who performs the activities, the wording of Article 14 (1) of the various Brazilian DTCs refers only to "resident" of a contracting country, not specifying whether individual or company.

In our opinion, however, by the very nature of the income, this follows automatically as a result of the exercise of an individual, professional who uses his scientific expertise, technical, literary, artistic, educational, pedagogical or analogous expertise to develop, independently, his/her activities. This is the case, for example quoted in Article 14 (2), of the doctor, lawyer, engineer, architect, dentist and accountant.

About the heading "professional services", this covers the independent professionals and other independent activities of a similar nature. The first is expressly defined: it includes, in particular, the independent activities of scientific, technical, literary, artistic, educational or teaching activities as well as the independent activities of physicians, lawyers, engineers, architects, dentists and accountants. Brazilian conventions do not differ at this point from the OECD and UN Models[24], except for including among scientific, literary, artistic, educational or teaching activities, also activities of technical character:

Scope of activities	*Brazilian Convention*
"[…] scientific, *technical*, literary, artistic, educational or teaching activities […]"	Argentina 1980, Belgium 1972, Canada 1984, Czech Republic 1986, Denmark 1974, Ecuador 1983, Finland 1996, Hungary 1986, India 1988, Italy 1978, Japan 1967, Luxembourg 1978, Mexico 2003, Netherlands 1990, Norway 1980, Peru 2006, Philippines 1983, Russia 2004, Slovakia 1986, South Africa 2003, South Korea 1989, Spain 1974, Sweden 1975, Trinidad Tobago 2008, Ukraine 2002 and Venezuela 2005.
"[…] scientific, literary, artistic, educational or teaching activities […]"	Austria 1975, Chile 2001, China 1991, Finland 1996, France 1971, Israel 2002, Paraguay 2000, Portugal 2000, Turkey 2010.

[24] The DTCs with Ecuador 1983 and Peru 2006 include the profession of an "auditor" and other professionals. This has origin in the domestic legislation of these two contracting countries, which identify the auditor as a profession of independent character.

In our opinion, the inclusion of "technical" within the text of paragraph 2 does not constitute for itself an enlargement of the concept of professional services. Paragraph 2 is merely indicative and shall be interpret in a broader sense. Besides, the concept of technical services for Brazilian authorities is very close to what it is understood in the global doctrine as professional services. Normative Instruction SRF n. 252/2002 was the first normative act in Brazil to describe technical services as: "the job, work or enterprise, which depend on specialized technical knowledge to be executed, rendered by independent professionals or of arts and crafts"[25]. This concept was recently amended by the Normative Instruction RFB n. 1.455/2014, which revoked the former to establish that as *technical services* are understood "the execution of a service that depends on specialized technical knowledge or that involve administrative assistance or consultancy, rendered by independent professionals or with employment relationship or originated from automatic structures with the clear technological content"[26].

Hence, the express inclusion of the word "technical" in paragraph 2 is per se not a condition for considering technical services, when these are performed independently, in the concept of independent professional activities of Article 14.

In relation to the "other activities", the Brazilian conventions vary two ways, those signed adopting the 1963 OECD Model approach, which restrict the coverage of Article 14 to professional services and independent activities similar to professional services; and those conventions following the 1977 OECD Model and UN Models, which apply to any other activity of independent character:

Scope of Activities	*Brazilian Convention*
"[…] in respect of professional services or other activities of an independent character […]"	Chile 2001, China 1991, Finland 1996, India 1988, Israel 2002, Netherlands 1990, Paraguay 2000, Portugal 2000, South Africa 2003, South Korea 1989, Trinidad Tobago 2008, Turkey 2010 and Ukraine 2002
"[…] in respect of professional services or other independent activities of a similar nature […]" – 1963 OECD Model	Argentina 1980, Austria 1975, Belgium 1972/2002, Canada 1984, Czech Republic 1986, Denmark 1974, Ecuador 1983, France 1971, Hungary 1986, Italy 1978, Japan 1967, Luxembourg 1978, Mexico 2003, Norway 1980, Peru 2006, Philippines 1983, Russia 2004, Slovakia 1986, Spain 1974, Sweden 1978 and Venezuela 2005.

[25] Article 17 (1) II a.

[26] Article 17 (1) II a.

If the activity, for example engineering, is performed by a company, we are no longer dealing with an independent personal income, but with a business income, which is covered by Article 7 of the Convention. This is our understanding even reading the Commentaries on both the OECD[27] and the UN[28] Models.

The matter is controversial among scholars worldwide[29]. Some authors claim that both the term "resident" and "person", if interpreted in accordance with Article 4 or Article 3, respectively, lead to the conclusion that can be either individuals or companies. Others take a relative position stating that, under the same conditions described above for similar activities, although the companies can be qualified as providing independent personal services, it is required to make a difference between the income covered by Article 7 and the income covered by Article 14: Article 14 covers only primary services; in addition, capital employed generally plays a small role in the context[30].

Because of this divergence, Brazil included within the Protocols of 16 of its 34 signed DTCs that the provisions of Article 14 will also apply where the activity is exercised, or better, the service is provided by a "company", in different corporate forms. In all other cases, in our opinion, Article 7 should be applicable.

This attitude reaffirms Brazilian policy of adopting the principle of source as a criterion for bilateral relations concluded through conventions to avoid double taxation. As per the structure commonly used by Brazil in their conventions, once the income is qualified under Article 14, the source country will have concurrent right to tax such income.

Although Brazil could impose its policy on their partners in almost half of the signed DTCs, only three of the latest DTCs also qualify the independent professional income under Article 14, when the services are rendered by entities (Mexico 2003, Russia 2004 and Turkey 2010).

Some of the conventions refer only to the term "entity" being fairly comprehensive, or even broader as "any other body of persons". Others specify

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27 See OECD Commentary on Article 14 (1997), n. 1.

28 See UN Commentary on Article 14 (2001), n. 9.

29 *For the coverage of entities*: PROKISCH, Rainer G.; *in* VOGEL, Klaus; LEHNER, Moris. *DBA* (2003), op. cit., p. 1.266, m.n. 11; XAVIER, Alberto. *Direito tributário internacional do Brasil*. 7. ed. Rio de Janeiro: Forense, 2010, p. 575; MORÁN,José María Tovillas. *Estudio del modelo de convenio sobre renta y patrimonio de la OCDE de 1992*. Madrid: Marcial Pons, 1996, p. 161; KORT, Jean-Willem de. Why Article 14 (independent personal services) was deleted from the OESO Model Tax Convention. *Intertax*, v. 29, n. 3, Kluwer Law International, 2001, p. 74 (72-76); *For the limitation to the individuals, besides the author of this dissertation*: PIRES, Manuel. *Da dupla tributação jurídica internacional sobre o rendimento*. Lisboa: Centro de Estudos Fiscais, Ministério das Finanças, 1984, p. 678; BELLAN, Daniel Vitor. *Direito tributário internacional*, op. cit., p. 139/140.

30 Cf.LANG, Michael. *Einführung 2002,* op. cit., p. 118, m.n. 350.

that the article refers to civil companies. There are also those that encompass both civil companies and partnerships. Finally, the DTC with Russia 2004 includes corporations and partnerships. See a summary below:

Corporate Form	*Brazilian Convention*
Any other body of persons	Turkey 2010[31]
Civil company	Canada 1984, Czech Republic 1986, Denmark 1974; Hungary 1986, Italy 1978, Norway 1980, Philippines 1983, Slovakia 1986, South Korea 1989[32]
Company	Argentina 1980, Denmark 1974, Ecuador 1983, Mexico 2003, Spain 1974, Turkey 2010[33]
Corporations	Russia 2004[34]
Partnership	Canada 1984, Italy 1978, Luxembourg 1978, Norway 1980, Russia 2004[35]

The intention of the Brazilian negotiator is to not leave out of taxation in the source country also those compensations that while from services of medical, legal, accounting character etc., are exercised by professionals through offices which often are professional partnerships or that revolve around the ability and the name of the professional himself providing the services, or that have personal character, although it is invoiced by a company. This is a fact because of the understanding of the Brazilian federal administrative court, which has already expressed by the application of Article 14 only to individuals, when analysing the DTC with Portugal 2000, a case where there is no express mention of coverage to companies[36].

However, the generalization to all kinds of entities eventually enlarges the coverage field of the Article, comprehending entities that even remotely resemble professional partnerships.

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[31] Protocol, paragraph 4.

[32] Protocol, paragraph 9; Protocol, paragraph 4; Protocol, paragraph 4; Protocol, paragraph 7; Protocol, paragraph 6; Protocol, paragraph 7 "b"; Protocol, paragraph 8; Protocol, paragraph 4; Protocol, paragraph 5; respectively.

[33] Protocol, paragraph 9; Protocol, paragraph 4; Protocol, paragraph 6; Protocol, paragraph 7; Protocol, paragraph 6; Protocol, paragraph 4; respectively.

[34] Protocol, paragraph 4.

[35] Protocol, paragraph 9; Protocol, paragraph 6; Protocol, paragraph 5; Protocol, paragraph 7 "b"; Protocol, paragraph 4; respectively.

[36] See Federal Counsel of Tax Appeals – CARF, Appeal 136694, 4. Panel, Proceeding 10280.004154/2001-14. Decision n. 104-20124, of 12 August 2004.

We are talking, for example, of law firms with 800, 900, 1.000 lawyers or business consulting and auditing firms with more than 10.000 professionals, which make billions of Euros in revenue and whose service is sought by clients as a whole, objectively, no matter the figure of the professional itself, but anyone who is behind the brand. In this case, it concerns the brand of the product "service", the company that developed it, rather than the professional individual who has performed the activities. Nothing more obvious, therefore, to classify the income from these services as "business profits" as proclaim Article 7 of the model conventions, which coincides with the Brazilian conventions.

Thus, in our view, the income from this type of activity, exercised by an entity, will fall under Article 14 if: (i) it is expressly included in the text of the DTC or in the Protocol; (ii) the activities are, primarily, services; (iii) the activities have, in effect, the "individual" character as the essence of the article; and that (iv) the capital employed performs small role in the context.

If the activities do not attend, cumulatively, the four requirements above, the income should be classified in Article 7.

However, based on similar cases, it is very likely that the Federal Revenue interprets the article literally, including in Article 14 any entity and, for the unlisted activities, covering the largest number of activities possible, mainly when interpreting the word "technical".

Again, the principle of source is elected as the centre of the policies.

3.2. Considerations on the qualification of income from technical services in Article 7, 12 or 14

The qualification of services can be more complex than as exposed above, in cases involving technical services, especially the so-called technical services and technical assistance[37].

This complexity has a significance: the protocols of various conventions entered by Brazil submit "technical services and technical assistance services" to the "royalties" tax regime, notwithstanding those services are not explicitly referenced in the definition of royalties given in Article 12[38].

The concept encompassed by the Tax Administration in Normative Instruction SRF n. 252/2002, Article 17 (1) II "b", considers "technical assistance the permanent advisory provided by the assignor of the process or secret formula granted, in the form of techniques, designs, studies, instructions sent to

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[37] See our DUARTE FILHO, Paulo César Teixeira. *Os royalties* nos acordos brasileiros, op. cit., p. 321 et seq.

[38] Cf. TÔRRES, Heleno Taveira. Regime tributário da propriedade industrial e transferência de tecnologia nos contratos de serviços técnicos e de assistência técnica; *in* TÔRRES, Heleno Taveira. (ed.). *Comércio internacional e tributação.* São Paulo: Quartier Latin, 2005, p. 672.

the Country and other similar services, which enable effective use of the assigned process or formula". This concept was kept intact by the new Normative Instruction RFB n. 1.455/2014, which revoked the former 252/2002[39].

As already mentioned in the previous item, the concept of technical services as per tax administration understanding was formalized by the same Normative Instruction RFB n. 1.455/2014 to establish that as *technical services* are understood "the execution of a service that depends on specialized technical knowledge or that involve administrative assistance or consultancy, rendered by independent professionals or with employment relationship or originated from automatic structures with the clear technological content"[40].

Thus, depending on the circumstances and characteristics attached to it, technical services and assistance can be qualified as business profits of Article 7, royalties of Article 12, or income from independent professional services of Article 14.

Due to its specialty in relation to the other articles[41], we are going to depict first the qualification of the income from technical services within the scope of Article 12.

a) Qualification in Article 12

In its double tax conventions, Brazil tried to impose to the other contracting country the understanding that payments for technical services and technical assistance would be subject to the same rules of royalty payments for know-how[42], given that the withholding tax had already been guaranteed to this kind of income, as provided for in Article 12 (2) of the UN Model Convention.

The concept of royalties in the model means payments of any kind received by the use or the right to use copyright of literary, artistic or scientific work (including cinematograph films, films or tapes for television or radio broadcasting), patent, industry or trademarks, designs, plans, secret formula or process, as well as the use or right to use industrial equipment, commercial or scientific and for information concerning experience in industry, commercial or scientific.

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[39] Article 25 of the Normative Instruction RFB n. 1.455/2014.

[40] Article 17 (1) II a.

[41] See PROKISCH, Rainer G.; *in* VOGEL, Klaus; LEHNER, Moris. *DBA* (2003), op. cit., p. 1.266, m.n. 7; and VOGEL, Klaus; *in* VOGEL, Klaus; LEHNER, Moris. *DBA* (2003), op. cit., p. 899, m.n. 30 et seq.

[42] Cf. LEONARDOS, Gabriel Francisco. O imposto de renda na fonte sobre os pagamentos ao exterior por serviços técnicos – análise de um caso de renúncia fiscal do Brasil. *Revista Dialética de Direito Tributário* n. 40. São Paulo: Dialética, 1999, p. 32.

The provision of information concerning the experience acquired is part of the concept of know-how[43], *i.e.* all the technical information not disclosed, susceptible or not to be patented, which is necessary for industrial production, directly and under the same conditions[44].

The inclusion of technical services and technical assistance within the concept of royalties of the Brazilian DTCs was made through protocols. This practice is official and stated in the Brazilian domestic legislation, having Brazil expressly reserved its position on Article 12 (2) of the OECD Model Convention[45].

Some older Brazilian conventions do not have the inclusion of "technical services and technical assistance" in the definition of royalties: much due to the stage of development of the Brazilian policies and pressure imposed by other countries. These are the conventions with Austria 1975, Finland 1996, France 1971, Japan 1967 and Sweden 1975.

In order to transmit know-how, as expected and determined by the concept of royalties of the conventions, technical services and technical assistance shall be attached to a transfer technology agreement. That's why these kinds of services are distinguished from the general services agreement. While in the latter the provision of services is the contract's primary purpose, in the former, the rendering of services is merely instrumental to the contract's main purpose, which is the transmission of technological information.

In summary, "technical assistance and technical services" (at least as the expression is used by protocols for application of conventions) only occur when there is a complementary nexus or instrumentality to the transaction which in and of it seeks to "assist" and consists of the transmission of "know-how"[46] itself.

According to the Brazilian tax legislation, technology transfer consists of contracts subject to registration at INPI, which recognizes, at this moment, eight types of contracts[47], among them:(i) Technology Supply – defined as "contracts aimed at acquiring non-patented knowledge" or, rather, know-how. (ii) Rendering of Technical and Scientific Assistance Services – "contracts

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43 Clear in XAVIER, Alberto. *Direito tributário*, op. cit., p. 616. See also PÖLLATH, Reinhard; *in* VOGEL, Klaus; LEHNER, Moris. *DBA* (2003), op. cit., Article 12, p. 1.190, m.n. 81.

44 Cf. PROKISCH, Rainer G.; *in* VOGEL, Klaus; LEHNER, Moris. *DBA* (2003), op. cit., Article 12, p. 1.146 et seq.; See OECD Commentaries on Article 12 (2008), n. 11.

45 "7. Brazil, Gabon, Ivory Coast and Tunisia reserve the right to include fees for technical assistance and technical services in the definition of 'royalties'." (Non-Member Countries' Positions on the OECD Model Tax Convention 2008).

46 See XAVIER, Alberto. *Direito tributário*, op. cit., p. 620 et seq.

47 In respect to the first four, the procedures for recordation or annotation are reserved; for the others, the registration shall be done in the form of Article 211 of the Industrial Property Code – CPI/1996.

which stipulate conditions for attainment of techniques, planning and programming methods, as well as research, studies and projects, destined at execution of the provision of specialized services. In these contracts, an explanation is required, the manpower cost/hour detailed by technician type, the time period scheduled for rendering of the service or evidence that such service was already rendered, and the total value of the service rendered, even if estimated".

Thus, the income from technical service or assistance would be qualified under Article 12 if, and only if: (i) the protocol of the Brazilian convention includes technical services and assistance within the concept of royalties of Article 12; and (ii) these technical services and assistance are directly bound to a technology transfer agreement, as determined by the INPI.

b) Qualification in Article 14

Should the technical services or assistance be not qualified under Article 12, because the protocol of the convention does not include them in the scope of the article or/and these services are not directly bound to a technology transfer, then it is to prove if the income therefrom shall fall under Article 14. The analysis if the income is qualified under Article 14 has primacy over Article 7, due to its specialty in relation to business profits.

As extensively depicted during this article, once the technical services are of independent professional character, personally rendered by an individual (or through a company when expressly allowed by the convention), then the income therefrom shall fall under Article 14.

c) Qualification in Article 7

Article 7 of the model tax conventions and of the Brazilian conventions deals with corporate profits.

The scheme of the convention, Article 7 serves as a general rule of taxation of income from the business activity, not only applicable in existence of specific article for certain type of isolated income not attributable to permanent establishment located in the country of source[48] (*e.g.* dividends, royalties, interest etc.), in terms of its paragraph 4[49].

This qualification in Article 7 is logical and systemic, not having a reason for distinguishing between sales of goods or services[50]. Having in both cases

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[48] See LANG, Michael. *Introduction to the law of double taxation conventions*. Vienna: Linde, 2010, p. 90.

[49] It is the understanding of the OECD Commentaries on Article 7 (2008) – paragraph 71. Cf. ROTHMANN, Gerd Willi. *Taxation of services in Brazilian domestic and international tax law*. Vienna: Vienna University of Economics and Business, Institute for Austrian and International and Tax law, 2012, p. 4.

[50] See GALHARDO, Luciana Rosanova. Serviços técnicos prestados por empresa francesa e impos-

costs related to the generation of the income, the tax should focus on the effective gain, or profit, and not on the total gross amount of the compensation.

Thus, once the income from provision of technical services is not qualified as royalties in Article 12 or as remuneration for independent professional services, this shall fall under Article 7, being taxed in the country of residence or in the country of source, should the services be provided through a permanent establishment located therein.

d) The position of the Federal Revenue Office since 20 June 2014

The position of the Brazilian Federal Revenue is different from that exposed in the item 3.2 above. The Federal Revenue enacted the Interpretative Declaratory Act RFB n. 5 of 16 June 2014, which changed the former Declaratory Act COSIT 1/2000 to determine the following rules of interpretation of the Brazilian conventions about technical services and assistance:

1st Rule	Application of Article 12: payments resulted from contracts of technical assistance and technical services, with *or without transfer of technology*, when the convention equated these payments to the concept of royalties;
2nd Rule	Application of Article 14: in case of payments to independent professional or group of independent professionals, which render services related to their technical qualification, once the convention so determines;
3rd Rule	Application of Article 7: once the 1st and 2nd rules are not applicable, the remuneration for technical services and assistance shall fall under Article 7.

In our view, the General Attorney's Office and the Federal Revenue corrected a mistake by committing another, and above all in the name of not giving up tax revenue. There are more adequate manners to achieve the same objective[51].

The Brazilian Government now admits that, in general, technical services without technology transfer are covered by Article 7 (business profits) of the conventions, not by Article 21 (other income): great news for taxpayers and the governments of the other contracting countries. However, at the same time it also changed the previous understanding to qualify these services under Article 12 (royalties), whether implying transfer of technology or not,

to de renda na fonte. *Revista Dialética de Direito Tributário* n. 31. São Paulo: Dialética, 1998, p. 39 et seq.

[51] More in our DUARTE FILHO, Paulo César Teixeira. Os *royalties* nos acordos brasileiros, op. cit., p. 321 et seq.

when it is expressly established and agreed in the protocol to the convention. So far, clear and justifiable: as a convention, both countries can determine in common sense how to qualify the income. The point is that no Brazilian convention establishes definitively that the payments for technical services and assistance, regardless of whether or not there is technology transfer, are inserted in the concept of royalties. When present, the dispositive in the protocol only disposes about "any kind of payment received for the provision of technical services and technical assistance".

In other words, the understanding has changed in relation to Article 12. Previously, technical services, when non-adherent to a technology being transferred, not accessorial but the main object of a contract, would not be qualified in Article 12. When accessorial, part of and supplementary to a technology transfer agreement, then these were qualified as royalties (Article 12).

Now, in case of technical services, whether main or accessorial object of a contract, whether there is know-how transfer or not, and if referred to in the concept of royalties in the protocol, the qualification admitted by Brazilian tax authorities is as royalties of Article 12.

Thus, Brazil is still not giving up withholding income tax at the source when the convention equates payments for technical services and assistance to the concept of royalties. Among all Brazilian DTCs, only five do not contain such dispositive: with Austria 1975, Finland 1996[52], France 1971, Japan 1967 and Sweden 1975.

In our opinion, the former understanding of the Government of only including technical services in the concept of royalties should these services have been linked to transfer of technology, is the most appropriate in this very particular point, because it makes no sense to equate these payments for pure services to royalties that do not even remotely resemble[53]: for example, when a foreign company is hired only to fix a machine.

The complementary nature of technical services and assistance in relation to the transmission of know-how is what allowed Brazil to negotiate the inclusion of the remuneration within the concept of royalties (Article 12) of the conventions. In some conventions, it was expressly stated that the income "with origin in the provision of technical assistance and technical services" would be included in the expression "for information concerning industrial,

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[52] Remembering that the starting point of the whole discussion about the Brazilian position was a Notification of the Finnish Ministry of Finance to its counterpart in Brazil, threaten to terminate the DTC.

[53] Similar position in XAVIER, Alberto. O imposto de renda na fonte e os serviços internacionais – análise de um caso de equivocada interpretação dos arts. 7º e 21 dos tratados. *Revista Dialética de Direito Tributário* n. 49. São Paulo: Dialética, 1999, p. 14/15.

commercial or scientific experience", part of the concept of royalties in Article 12[54] that refers, specifically, to know-how[55].

Therefore, by the very nature of the activities developed, qualifying the compensation for "technical assistance or technical services" can only be included in the concept of royalties when: (i) there is express provision in the protocols and, cumulatively, (ii) such assistance or service is intimately and inextricably linked to technology transfer, *i.e.* it has instrumental character in relation to contracts of transfer of technological capital[56].

As per item "ii" and based on the current Brazilian conventions, it is determinately excluded from the concept of royalties the remuneration for technical services or assistance that are ends in themselves, being principal object of the contract and do not imply any transfer of knowledge, but only the end result of their activity.

The previous understanding of the Federal Revenue in this point was based in a correct interpretation – historical, systemic and teleological; the current understanding, only in a literal interpretation, with opportunistic purpose.

We are also very concerned about the interpretation the tax authorities will provide to technical services and assistance in the conventions without express inclusion in the concept of royalties, in particular in relation to the qualification in Article 14: a technical and convention-complied interpretation seems unlikely.

e) Considerations and issues in international affairs

The blind fiscal position, which does not fit the logic of the conventions and the texts negotiated and approved with the other contracting countries, remains with the same problems of interpretation. This error can still generate many negative effects: either by the double taxation on the income of the services providers and, consequently, the increase of the costs to the service taker that bear the burden of the double taxation inserted within the prices practiced; there still are risks of other countries terminating the conventions, as happened with Germany; it increases the difficulty for other countries to accept entering conventions with Brazil.

As demonstrated in our work about Article 12[57], the way Brazil taxes the mentioned income verges on bad faith. Should the country want to tax remu-

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54 Example used: Protocol to the DTC with Israel 2002.

55 Cf. Pöllath, Reinhard; *in* VOGEL, Klaus; LEHNER, Moris. *DBA* (2003), op. cit., p. 1.063.

56 See XAVIER, Alberto. O imposto de renda na fonte e os serviços, op. cit., p. 14/15. Also in ROCHA, Sergio André. *Tributação internacional.* São Paulo: Quartier Latin, 2013, p. 285.

57 See DUARTE FILHO, Paulo César Teixeira. Os *royalties* nos acordos brasileiros, op. cit., p. 321 et seq.

neration for services at the source, it could have, for example: (i) included specific provision for services in the convention, as there is in relation to independent professional services of Article 14, which allows the taxation by the country of source; or (ii) extended the concept of permanent establishment of Article 5, to the point of including them more easily, creating, for example, the concept of "service PE"[58]; or (iii) signed additional conventions or exchange of notes, to formally clarify its current position, as Brazil did with Spain[59], reducing the scope of application of Article 7.

The main point, however, is to be transparent in their purposes and make clear the intention of having the services, any of them, taxed by the country of source of income.

As mentioned in item "iii", Brazil has adopted an intermediate position with Spain[60], reducing the scope of application of Article 7.

The Secretary of the Federal Revenue, with a view to a friendly agreement by exchange of notes, concluded on 26 February 2003, with the Spanish tax authority, and issued the Interpretative Declaratory Act SRF n. 27 of 21 December 2004, as seen above.

Therefore, in relation to the DTC with Spain 1974, the Brazilian tax authorities were very clear in their position and followed a coherent qualification, applicable to all taxpayers legitimate to the DTC: (i) no distinction is made between technical services or technical assistance with or without technology transfer, including all within Articles 12 (royalties) or 14 (independent professional services) of the DTC with Spain 1974; (ii) it is clear that Article 22 ("other income") should under no circumstances be applied to technical services; (iii) on the other hand, it states that, to technical services, does not apply Article 7 ("business profits"), because the former are qualified under more specific articles of the convention (Articles 12 and 14)[61].

We believe that a similar solution can be implemented with other countries. Otherwise, Brazil will be, in our view, clearly violating the conventions.

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[58] In LANG, Michael. *Introduction to the law of double taxation conventions*. 2. ed. Last Reviewed 1. January 2013. IBFD, 2014. Also in SCHOUERI, Luís Eduardo; SILVA, Natalie Matos. *Brazil, in* LANG, Michael; PISTONE, Pasquale; SCHUCH, Josef; STARINGER, Claus (ed.). *The impact of the OECD and UN Model Conventions on bilateral tax treaties*. London: Cambridge University Press, 2012, Chapter 5, p. 177 (171-202).

[59] The Secretary of the Federal Revenue, in virtue of the amicable agreement through exchange of notes, concluded on 26 February 2003, with the Spanish tax authorities, related to the Convention Brazil-Spain, enacted the Interpretative Declaratory Act SRF n. 27, of 21 December 2004, as, afterwards, the Interpretative Declaratory Act SRF n. 4, of 17 March 2006.

[60] Interpretative Declaratory Act SRF n. 4, of 17 March 2006.

[61] Cf. ROTHMANN, Gerd Willi. A denúncia do acordo de bitributação Brasil-Alemanha e suas conseqüências; *in* ROCHA, Valdir de Oliveira (coord.). *Grandes questões atuais do direito tributário*. São Paulo: Dialética, 2005. v. 9, p. 152-155.

4. Final considerations

Brazilian tax conventions treat the income from the performance of independent professional activities in the Article 14, following the basic structure of the 1963 OECD Model, but including, among others, a relevant difference related to the allocation of taxing power: the source of payment is entitled to tax the income in concurrence with the country of residence.

One of the main issues in the application of Article 14 is the possible interpretation given by the Brazilian tax authorities, especially in relation to the qualification of technical services and the activities performed by entities, when the convention does not expressly allow its coverage by the article.

Brazilian tax authorities have enacted the Interpretative Declaratory Act RFB n. 5 of 16 June 2014, which interprets the conventions on how to qualify technical services and assistance, showing serious mistakes. This Act can result in many problems with the contracting partners of double tax conventions, situation already experienced by Brazil with the predecessor of the current Act.

The income paid by a Brazilian source for taking independent professional services from a foreign provider is subject to a 15% withholding income tax over the gross value of the remuneration, along with many other indirect taxes that all together sum over 42%. The point is that 15% of a gross basis is very far from a reasonable tax burden and the method of credit, largely used in the Brazilian conventions for this kind of income, has no practical use.

Reducing the income tax rate over services is not necessarily waiving tax revenue, but rather cheapening essential costs to Brazilian economy, helping to increase the competitive ability of local companies.