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DOUBLE TAX TREATY BETWEEN BRAZIL AND COLOMBIA

Last year, Brazil and Colombia signed a double tax treaty ("DTT") that is currently under Congress' approval. We highlight some aspects of the DTT that we consider can be particularly relevant.

Permanent Establishment ("PE")

The DTT includes a broad PE definition based on the UN tax treaty model. In addition to the fixed place of business PE and the dependent agent PE, it includes an extensive definition of **construction** PE and services PE.

The construction PE definition includes building sites, constructions, assembly or installation projects or supervisory activities that last **more than 6 months**.

A service PE will exist for the provision of **services** (which includes consultancy services) in the Other State for **more than 6 months.**

The **dependent agent PE** may be deemed to exist not only in cases where the **agent concludes contracts on behalf of the foreign enterprise but also when they play the principal role leading to the conclusion of contracts** that are routinely concluded without material modification by the enterprise.

Furthermore, a PE can be deemed to exist when **insurance companies collect premiums** within the territory of the State or **insure risks** located in the country.

The application of the extensive PE definition contemplated in this DTT must consider the Brazilian and Colombian **domestic legislations.** In particular, the current PE definition in Colombia is more limited than this DTT's definition. However, events triggering a **Significant Economic Presence** in Colombia should be interpreted under this DTT's PE definition if the foreign enterprise is a Brazilian tax resident.

Brazilian tax legislation, on the other hand, does not provide for the concept of PE, focusing on taxing income earned by foreign legal entities at source (WHT).

Dividends

As a general rule, the withholding tax on dividends is limited to **15%.**

This limit is reduced to **10%** if (i) dividends are distributed to a company that holds, directly or indirectly 20% or more of the capital, or (ii) the distributing company is beneficially owned by a recognized pension fund of the other State.

These limits do not prevent Colombia from using the corporate income tax recapture mechanism to tax with corporate income tax the dividends that were not already taxed at the corporate level. In this case, the DTT allows imposing a higher withholding tax.

Currently, dividends paid by Brazilian companies to foreign shareholders are not subject to WHT. However, there are Bills of Law under discussion in the National Congress that seek to introduce the taxation on dividends. The DTT could be an advantage if the WHT rate provided by tax legislation is higher than the limits provided by the DTT.

Interests

The applicable withholding tax on interests is limited to **15%**.

This limit can be reduced to **10%** for loans for the financing of the **purchase of industrial or scientific equipment** or for the financing of **infrastructure projects and public utilities**. In this case, the beneficiary owner of the interests must be a bank or a financial institution and the loan must have been granted for at least 5 years. This 10% limit is also applicable on loans granted by **pension funds**.

Interests related to **loans granted by one State to the other State** cannot be subject to withholding tax.

Interest on net equity (***Juros sobre capital próprio - JCP***) provided under Brazilian tax legislation are classified as "interest" for the purposes of this DTT.

Royalties

As a general rule, the withholding tax on royalties will be limited to **10%.**
For royalties derived from the **use or right to use trademarks**, the limit will be **15%.**

Fees for technical services

In line with the UN Model and recent DTTs signed by Brazil, this DTT contains a clause that specifically regulates the taxation of technical services. Fees for technical services rendered by an enterprise from the other State can be subject to withholding tax with a limit of **10%** (the beneficial owner clause must be respected).

From a Colombian perspective, this provision is atypical.

The concept of technical services under Brazilian tax legislation is extremely broad and encompasses almost all services.

Capital Gains

Unlike the OECD standard provisions on capital gains, this DTT does not establish a general rule conferring the taxation of capital gains only to the country of residence.

Regarding the **sale of shares** of a company domiciled in one of the contracting states, **this DTT does not limit the taxing rights of the source country** (where the company is domiciled).

From a Brazilian perspective, this provision is very common.

Taxation of international shipping and air transport

According to the DTT, profits from the operation of ships or aircrafts **in international traffic** shall only be taxed by the country of residence.

Profits subject to this limitation include profits from the rental on a bareboat basis of ships or aircraft; profits from the use, maintenance or rental of containers used for the transport of goods or merchandise; and profits derived from the participation in a pool, a joint business or in an international operating agency. In other words, this provision covers the disposal of any property other than real property allocated to the operation of ships or aircrafts.

It is important to bear in mind that there is currently a convention in force subscribed between Brazil and Colombia of 1992 that limits the taxation of the activities of maritime or air navigation companies **only to the country of which they are nationals.**

Income from Employment and Director's Fee

Income from employment is only subject to tax in the residence country unless the employment is exercised in the other country. This limitation requires that the individual is not present in the other state for more than 183 days a year and that the remuneration is not paid or borne by a resident or a PE in the other country.

The fees received by a member of the board of directors, or any similar organ may be taxed in the country where the company is located, even if the individual is resident in another country.

Wealth Tax

The DTT between Colombia and Brazil does not limit the imposition of a wealth tax.

Elimination of Double Taxation

The DTT establish that both Brazil and Colombia will allow a deduction of income taxes in an amount equal to the income tax paid in the other State. Such deduction, however, shall not exceed the fraction of the income taxes, calculated before the deduction, corresponding to the income that may be taxed in the State of residence.

Anti-abuse provisions

This DTT contains an UN-like provision on the entitlement to benefits conferred by the treaty.

In addition to a catalog of situations that make a resident a "qualified person" to be entitled to benefit from the DTT, article 28 provides a principal purpose test provision.

This provision allows for denying the application of treaty benefits if a company funnels funds through Colombia or Brazil to lower its tax burden. In addition, this rule includes a special provision in the case of triangulation schemes through a PE in a third jurisdiction.

General Remarks

The implementation of the DTT between Colombia and Brazil is a long-awaited fiscal development that is expected to expand reciprocal investments and cooperation between the two countries.

The DTT shall be subject to an approval process in both countries. In Colombia, it must be approved by the Colombian Congress and pass the constitutionality trial before the Constitutional Court and, in Brazil, the DTT must be analyzed by the National Congress for subsequent promulgation by the President.

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