PROBLEMAS DE TRIBUTACIÓN INTERNACIONAL EN IBEROAMÉRICA
UNA VISIÓN DESDE LOS DIEZ AÑOS DEL OITI

UNIVERSIDAD EXTERNADO DE COLOMBIA
The taxation of technical services: Brazil's treaty practice in comparison (and deviation) with the UN and the OECD's policies
Summary: Introduction. I. The meaning of “royalties” in Brazilian domestic legal framework and its consequences for the qualification of income from technical services. II. The deviations practiced by Brazil in relation to the OECD. III. The deviations practiced by Brazil in relation to the UN. Conclusion. Bibliography.

INTRODUCTION

Whilst the fact that Brazil bases its double tax treaties on the OECD’s Model Convention (OECD MC)¹, it is one of those countries that have historically resisted to the international fiscal policy advocated by that organization, what is a typical profile of a developing country. Besides that, the taxation of royalties in cross-border transactions is one of the topics about which the UN’s policy is most opposed to the OECD’s. This explains why Brazil, even though basing most of its treaties on the OECD’s model (concerning the taxation of royalties), usually rejects such model and adopts mostly the UN model².

While the OECD Model allocates taxation of royalties to the source State³, the UN Model Convention (UN MC) balances cumulative powers among the residence and the source States. This explains why most developing countries usually negotiate their treaties’ Articles concerning royalties on the grounds of the UN MC, specially in the case of technical services, in which the OECD Model assigns taxation exclusively to the State of Residence. Whilst the UN MC only incorporated its new Article 12A on technical services in 2017, it had historically considered the position of some developing countries for the inclusion of such services under the very Article 12, making them assimilated to royalties.

It is easy to note that OECD’s and G20’s BEPS Project, specifically in its Action 1⁴, propose a modest review on the taxation of royalties and services

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which imply technology transfer. However, the Committee of Experts on International Cooperation on Tax Matters of the UN promoted an intense debate on the possibilities of radically changing the structure of double taxation conventions between developed and developing countries. A significant part of such efforts was (and still are) related to changing the allocation powers concerning royalties and technical services.

Then it is not surprising that Brazilian tax authorities’ practices often seem to be close to the UN’s proposals, including its most radical changes tending to shift the taxation for the source State. What is very interesting is that one of the main UN’s proposal was only implemented in 2017: the inclusion of the mentioned Article 12A on technical services. Such Article is not adopted by any of Brazil’s double tax treaties, except for the most recent ones, signed with Switzerland, United Arabic Emirates, Singapore and Uruguay, which have not yet entered into force.

However, Brazil has already amended many of its treaties by means of protocols in order to insert on Article 12 of such treaties the assimilation of technical services fees to royalties, somehow anticipating its treaty-net to the UN Model. These are the treaties with Argentina, Canada, Chile, China, Czech-Slovakian Republic, Denmark, Ecuador, Hungary, India, Israel, Italy, Luxemburg, Mexico, Norway, The Netherlands, Peru, Philippines, Portugal, Russia, South Africa, South Korea, Trinidad y Tobago, Turkey, Ukraine and Venezuela.

The treaty with Spain deserves special attention since it is the only one that asserts the technical services assimilation to royalties withholding taxation irrespective the existence of technology transfers. As I will explore later, Brazilian tax authorities interpret all the others protocols’ assimilations as if they had such wording.

The most recent treaties signed between 2018 and 2019 with Switzerland, Singapore, United Arabic Emirates and Uruguay, have its Articles 13 corresponding to Article 12A of the UN Model, concerning taxation of technical services. As mentioned, such treaties have not entered into force yet. Thus, if one takes an overview of Brazil’s treaty-net, she will note that what prevails is a structure with Article 12 including the fees for technical services and technical assistance and providing for source taxation. Nonetheless, such treaties do have any statement in the sense that the concept of technical services is not the one usually adopted in International Tax Law.
This work aims at analyzing the Brazilian practice and interpretation of tax treaties related to the taxation of technical services, to identify and differentiate the deviations from the OECD policy and the alignment with the UN’s policy, even though such alignment seems to have resulted from an (excessive) extensive interpretation of the treaties by tax authorities and such extensive interpretation is prior to the UN MC 2017.

I. THE MEANING OF “ROYALTIES” IN BRAZILIAN DOMESTIC LEGAL FRAMEWORK AND ITS CONSEQUENCES FOR THE QUALIFICATION OF INCOME FROM TECHNICAL SERVICES

The qualification of technical services as royalties has never been self-evident under the perspective of International Tax Law. Royalties mean the remuneration for the transfer or license of rights concerning intellectual property, including copyrights. They also refer to licensing or transferring the rights to explore natural resources, as mines, forests, oil and gas, for instance. Royalties are then usually paid for the very “circulation of intangible goods and technology transfer”.

In the context of double tax treaties, however, it is not new a sort of semantic extension of the term “royalties” in order to include the remuneration arising from transactions which are significantly different from “cession or license” of rights to intangible goods. Article 12 of the OECD Model Convention, for the sake of allocating powers to tax royalties, used to broaden its scope including fees for equipment rental (currently excluded) and the UN Commentaries to its Model Convention for a long time admitted the practice of some countries, of broadening the royalties regime to technical assistance and technical services, which are ancillary to the intangibles which give rise to royalties.

Under a historical perspective, this conceptual extension assumes a certain relationship between such businesses and the fruition of rights which typically give rise to royalties. This leads to the conclusion that all the activities which income is subject to Article 12 of the UN Model must be at least related to the transfer of technology as ancillary to it.

Under Brazilian domestic law, however, the term "royalty" is the type of remuneration paid in consideration of intellectual property and rights to exploit natural resources. On the other hand, the remuneration for transferring or licensing copyrights is referred by the word "copyright" (direito de autor). Therefore, in Brazil (not only in legal terms, but also in the day-by-day language) the remuneration that a licensee pays for the licensor of a copyright is not considered a "royalty", rather a "copyright". The term "copyright" is then plurisignifying and denotes both the type of right and the remuneration that corresponds to it.

Notwithstanding Civil and Commercial Law in Brazil consider royalties and copyrights as different remuneration related to different rights, Brazilian Tax Law, concerning some aspects, assimilate copyrights to royalties, by means of legal fictions. In other words, Brazilian private law prescribes different legal regimes for royalties—which are paid in consideration of intellectual property and the exploitation of natural resources—and for copyrights—which are paid in consideration of a license to exploit a "creation of the spirit" such as a book, a song or even a software, since Brazilian Copyrights Act assimilates software to all other intangibles subjected to copyright.

However, the Tax Law makes both types of income equivalent for some tax purposes. According to Article 22 of Act n. 4.560/1964, the payment of copyrights is subject to the same effects of the payment of royalties, concerning deductibility from the taxable basis of the Corporate Income Tax and concerning its taxation as income for purposes of the Individuals Income Tax.

This framework is significantly different in double taxation conventions. There the term royalties refer to both types of income, the remuneration for licenses concerning trademarks, industrial design, know-how and copyrights. This is very natural and almost obvious, since in English the term "royalty" refers to both types of intangibles, the copyright and all the other categories of intellectual property.

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7 About the nature of legal fictions, specially in Tax Law, see Schoueri (1996: 97-129).
9 It is possible to argue that the assimilation of copyrights royalties is prescribed by law only in the realm of individuals income tax and such interpretation makes a very strong case. This is the opinion of the author. The common interpretation, however, is that the assimilation is made for the purposes of taxing the copyrights as income and for the purposes of making them not deductible for the company that pays the copyrights.
However, the linguistic extension the word royalty has in English is not fully applied in double tax treaties, since both the OECD and the UN models exclude from the scope of the respective Article (12) the income derived from the exploitation of natural resources. If, by one perspective, the common sense of royalty if not fully adopted in tax treaties practice, under different point of view, it is broadened though. The UN current model and previous OECD models include in the scope of the royalties’ Article the rents for the use of equipment, what linguistically speaking is not a royalty at all.

Considering both the shortening and the broadening of the concept of royalties for tax treaties purposes, everything which is allocated under Article 12 of both model conventions have a common feature: they are all income derived from intangibles or from technology transfer. This explains, on one side, the exclusion of income arising from the exploitation of natural resources from such provisions of the model conventions and, on the other side, this is also consistent with the inclusion of truly rents in the scope of such Article, since such rents are paid in consideration of the use of equipment which are necessary to the performance of obligations included in the other businesses referred to by Article 12.

Something very similar can be seen in the case of technical assistance and some services, generically referred to as “technical services”. These services are often included in the scope of the royalties’ Articles of treaties between developing countries and between developing and developed countries. Brazil usually includes technical assistance and technical services in the realm of the royalties’ Articles of its treaties, by means of protocols. It is remarkable though that Brazilian tax authorities have been including an excessive range of services in the scope of the royalties’ Articles (of Brazil’s treaties) in the last years, by means of a very extensive interpretation of the concept of technical services.

In the past, the application of double taxation conventions by Brazilian authorities was very much driven by an extreme qualification of items of income as “other income”, under the rule of Article 21 of such treaties, which provide for source taxation. However, the Superior Court of Justice has blocked that “run towards Article 21” in the Copesul case. This explains tax authorities’ “shift” towards a qualification of any kind of income from

the render of services as royalties, either derived from technical services or any other goods of the digital economy (they currently do the same with software, even for the "off shelf software"). Since this work focus on technical services, it is worth analyzing the Copesul decision. The income in that case was paid in consideration for services.

The case was about the provision of services under the double tax treaties between Brazil and Canada and Brazil and Germany (this treaty was terminated by Germany in 2008). Residents of Canada and Germany provided technical services (and technical assistance) to a company resident of Brazil. According to tax authorities, the source in Brazil was supposed to have withheld the income tax, under the argument that the correct qualification of those payments was that one provided for Articles 21 of both treaties (Brazil–Canada and Brazil–Germany), according to which the State of Source may also tax the income.

According to Copesul, there was no withholding obligation, since those payments were to be qualified under Articles 7 of both treaties. This is because they were business profits, a very solid concept in tax treaties literature, not only international\(^{11}\), but also domestic\(^{12}\) literature. There are two explanations to tax authorities' position, all though they do not make it correct.

First, there was a long tradition of Brazilian tax administration broadening as much as possible the scope of Article 21 in detriment of Article 7 of the treaties, since source taxation of "other income" plays an important role in the Brazilian treaty-policy, what makes this policy a deviation from the OCED and the UN Models. On the other hand, concerning business profits taxation, Brazil does not deviate its policy from the OECD patterns, implying taxation by the State of Residence, except for permanent establishments. So according to most of Brazilian treaties (which Article 7 follows the OECD, but the 21 does not), qualifying services fees furnished with no permanent establishment was the most traditional way of taxing such income at source.

The second possible explanation for the authorities case in favor of Article 21 was the difficulty on arguing for Article 12, because according to the OECD commentaries and the literature\(^{13}\) related to Article 12, there is a strong consensus that the fees for technical services (and technical as-

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\(^{11}\) For instance: LANG (2013: 91-97).
\(^{13}\) VOGEL/POLATH in K. VOGEL DBA (1996: 1013-1014).
sistance) which are subject to the same treatment of royalties—according to Article 12 of some treaties—are those fees paid in consideration of services or assistance which imply the transfer of technology or at least of activities that can be deemed as means for those services or assistance to be furnished.

The services provided for the German and the Canadian companies to Copesul were of a kind that could never be qualified in such conceptual framework, what somehow explains the option for Article 21 and not for Article 12 in that time. However, in its decision, the court has not only peremptorily rejected the qualification of that income as “other income”, but also stated very clearly its qualification as “business profits”. Thus, the court has not only asserted what those payments were not, but also ascertained what they were.

The court also confirmed the taxpayer’s argument asserting that the tax authorities’ interpretation had the absurd consequence of making the scope of Article 7 completely empty, since, following their rationale, almost any income could be qualified under the Article which is deemed by some authors the “core” of double tax treaties (obviously taking aside new trends in favor or source taxation, specially in the BEPS era).

As a practical consequence, since the Superior Court of Justice had only rejected the qualification as “other income”, but had not said anything about the qualification as royalties, the Federal Revenue of Brazil revoked its Normative Declaratory Act 1/2000, which asserted the qualification of any payment for “technical service” under Brazilian treaties as “other income”, and edited its Normative Declaratory Act 5/2014, stating that any cross-border payment made in consideration of technical services rendered by a non-resident, no matter implying or not the transfer of technology, should be qualified under Article 12 of Brazilian treaties and not as business profits.

As already mentioned, such interpretation is not sustainable, since the court had not only rejected the qualification under Article 21, but had also ascertained that those payments were to be qualified under Article 7[15]. Nevertheless, it started to be the tax administration’s position after 2014 referring to all Brazilian treaties that have technical services in the scope of Article 12, irrespective if in the concrete situation, such services implied or not the transfer of technology.

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As a matter of fact, Brazil has signed protocols to include technical services and technical assistance in most of its treaties’ Articles 12. In some cases, such protocols even include among technical assistance, scientific and managerial assistance (no matter what this can be).

However, none of the treaties currently in force\textsuperscript{16}, including the protocols’ amendments (except for the protocol with Spain), broaden the concept of technical services and technical assistance beyond the meaning they usually have, in relation to the transfer of technology. Therefore, assuming the relationship between the concepts of technical services and technical assistance and the transfer of technology in the context of Brazil’s treaties (and protocols), one shall not state that any kind of service could be qualified under Article 12.

Theoretically speaking, one could argue that, since the treaties (and protocols) have not explicitly broadened the concept of technical services (and technical assistance) in order to include those ones that do not imply the transfer of technology, they have also neither explicitly restricted such concepts in order not to include such services\textsuperscript{17}. This would be a wrong interpretation, though.

First under a logical perspective, because Article 12 does not concern to services in its essence. The widening of its scope in order to include income which does not exactly refer to royalties is \textit{per se} an exception and this would, therefore, be enough to imply that such widening should be restrictively interpreted: the exception confirms the rule. The good-faith that should govern the relationship between the States asserts that if it is agreed to broaden a concept, the parties expect that such broadening is practiced according to the limits under which it was agreed, simply because it is already a “widening” of a rule previously defined\textsuperscript{18}.

Besides that, the interpretation adopted in the Normative Declaratory Act 5/2014 is incorrect under a semantic perspective. Article 12 governs the taxation of income derived from intangibles and from activities directly related to them, as ancillary activities. This explains the need for the transfer

\textsuperscript{16} As will be seen Brazil has signed four new treaties with Switzerland, Singapore, United Arabic Emirates and Uruguay, with Article 13 concerning technical services, based on Article 12A of UN MC 2017.

\textsuperscript{17} Such interpretation was adopted by the Administrative Council of Tax Appeals (Conselho Administrativo de Recursos Fiscais –CARF–), in the Petrobras case. Decision n.\textsuperscript{º} 2202-003-063.

\textsuperscript{18} This reasoning was similarly adopted by \textsc{Xavier} (2015: 668).
of technology within the provision of these services for them to be deemed as technical services, according to the OECD Commentaries. It is worth noting that the UN does not reject this, but just mentions (and implicitly admits) the position of some developing countries for the rejection of such definition (paragraph 14, already in the 2011 Commentaries) and the adoption of another concept based on the “specialized knowledge having intrinsic property value relating to industrial, commercial or managerial processes” (paragraph 16, already in the 2011 Commentaries).

The other services, in general, which are the object of all other different businesses and deals, must be considered in the realm of the most wide and generic concept of “business profits” provided for Article 7, exactly because this provision is the general and residual rule. A general rule is not applicable only facing a special rule, which sets an exception to it, just like the case of Article 12 making an exception to Article 7.

At the end of the day, excluding every kind of technical service from the scope of Article 7 would imply, as matter of coherence, excluding the acquisition of every “good” of technical type, since there is no reason in double tax treaties for distinguishing business that have as their purpose the trade of goods from the ones that have services as purpose. Even in the Brazilian domestic tax law context, where such differentiation is historically adopted, it’s been each time more criticized.\(^{19}\)

In this sense, the interpretation that concludes for the qualification of payments for any technical service as royalties—no matter if the services imply or not technology transfer—would lead to the same rationale for the price paid for any “technical merchandise”, and this would one more time lead to an enormous deflation of Article 7. This result was absolutely rejected in the Copesul Case, though.

The practice of Brazilian tax authorities thus represents a very significant divergence from the OECD view on technical services, what is not surprising. However, when analyzing Brazilian deviations from the OECD patterns one can notice that such divergence departs also from the UN view on the topic, as can be demonstrated in the following sections.

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\(^{19}\) Xavier (2015: 576-577).
II. THE DEVIATIONS PRACTICED BY BRAZIL IN RELATION TO THE OECD

As already mentioned, the OECD Model Convention gives preference to residence taxation and notwithstanding this model be majorly adopted by Brazil, the royalties Article is an exception to it. Concerning this kind of income, Brazil usually adopts the UN model for its double tax treaties. According to such model, the States of residence and source have cumulative tax powers.

The contrast, however, goes far beyond the source taxation of royalties. According to the OECD, technical services, per se, are out of the scope of Article 12, since their remuneration is not conceptually a royalty, except if the provision of such services imply the transfer of technology. This had been the OECD position for a long time, but it was strongly reinforced by the addition to the commentaries concerning this issue, made by means of Annex A of the final report of BEPS Action 1.

Paragraph 11.1 of the Commentaries already stated the technology transfer as a condition to the payments in consideration of technical services to be qualified as royalties, since in order to provide technical services, the provider uses and applies her own technics and knowledge to execute or implement herself the activities in favor of the demander, the client (paragraph 11.2).

This was a rejection of the qualification of such services as know-how and thus a rejection of their respective payments as royalties. But BEPS 1 made an addition to the end of paragraph 11.2 of the Commentaries in order to clearly describe technical services, as a practice that, in general, do not imply technology transfer and thus “payments made in under the latter contracts generally are under Article 7”.

Besides that, BEPS 1 also edited paragraph 11.3 of the Commentaries. The new wording recognizes the difficulties in distinguishing sometimes payments for know-how and payments for technical services provision. They provide some criteria for such differentiation though. For instance, the payments are to be qualified as business profits arose from technical services when the activities in which the service consists of are executed by the beneficiary of the payments with the application of the technics that characterize the specific service, and such activities imply no technology transfer.

On the other hand, the same commentaries assert that in case of contracts of know-how assignment, generally speaking, the assigner must do very little
for the execution of the activities, except for the assignment information and technics in favor of the assignee. In such cases, the Commentaries add that very little expense is made by the assigner, in order to accomplish with the contract.

To ascertain the scope of Article 12, the OECD Commentaries have inserted some new wording to paragraphs 11.4 and 11.5 giving some examples of what would not be the kind of services to be qualified under Article 12 rather under Article 7. Among such services, the Commentaries refer to technical assistance and technical opinions given by independent professionals, like accountants, lawyers and engineers. Was it not enough, the Commentaries also asserted that even in cases in which a supplier needs to make information about a software available, for the payments to be deemed in consideration of know-how (and thus royalties), such payments must be made “in consideration of such information being made available” and such availability must be “provided for the acquisition of ideas and principles that underlie the software, as logics, algorithms, language or programing technics, in a way that such information be provided under the condition that the customer does not disclosure it without authorization and it is subject to any protection to the business secret in question”.

As a matter of fact, the OECD ascertains that royalties are the remuneration for the provision of know-how (paragraph 11), but also that this is the object of contracts in which the technical information is made available by the provider, for the client to use it on her own, without the provider executing any activity concerning the use of such information or knowledge by the client (paragraph 11.1) and besides this, the organization states that such kind of contract is to be distinguished from those contracts of services rendering in which one of the parts executes the use of the costumery technics of her designation in order to implement the provider herself the service in favor of the client (paragraph 11.2).

Finally, BEPS I Final Report has inserted an additional statement to this paragraph for that “payments made under this type of contract generally fall under Article 7”.

So the OECD develops the concept of royalties as a payment made in consideration for the economic exploitation of intellectual property rights and thus it only considers as royalties the income derived from activities which are ancillary to a specific form of provision of such intangibles, what is the know-how contract. On the other hand, the know-how contract has
the technology transfer as an intrinsic feature. The Brazilian tax authorities, however, have exactly the opposite position, according to which, the payment for any technical service must be deemed as royalties, irrespectively if such services imply or not the transfer of technology.

One should note that according to those authorities, technology transfer is not a necessary feature of technical services, at least concerning the assimilation to royalties. This opposition between the OECD and Brazilian tax authorities is not surprising at all, since Brazilian treaties usually assign source taxation under Article 12 (based on the UN Model) and Article 7 does not (based on the OECD Model). Then, following the UN framework for Article 12, Brazil naturally would tend to make a strong opposition to the OECD's view on this topic. What is somehow impressive is that the Brazilian view does not coincide to the UN perspective though.

III. THE DEVIATIONS PRACTICED BY BRAZIL IN RELATION TO THE UN

As already seen, the opposition between the developed and developing countries concerning fiscal policy is very well known and the parallel oppositions between the OECD and the UN as well, since in the former forum the interests of capital export countries (developed) are more taken into account and in the latter the interests of capital importer countries (developing) have some dominance.

This explains the divergence of allocation of tax powers in both models. According to Article 12 OECD MC, royalties should be taxed exclusively by the residence State (confirm if there is any source-taxation), while according to Article 12 UN MC, the source State shall also tax them. Aside this "allocation of tax powers", which may be is the main difference among the models, there is also a divergence related to the concept of royalties. Even though the UN and the OECD models and respective commentaries are quite similar concerning software, they considerably differ for the sake of taxation of technical services.

While de OECD almost restricts the technical services income to know-how contracts (in order to be qualified under Article 12), the UN widens the

scope of its Article 12 to include a significant part of all technical services under it. Besides that, the UN Model Convention has a provision in Article 5 for the Service Permanent Establishment (Service PE), which enlarges source taxation even for business income qualified under Article 7. This means that even in cases of income not qualified under Article 12, the UN model asserted, since 2011, the concept of a Service PE, assigning taxation powers to the source State in case of services in general, no matter they are deemed "technical" or not.

Until 2017, the differences between the UN and the OECD in terms of source taxation are basically two: i) the UN assigned tax powers to the State of source in case of Article 12; ii) the UN enlarged the scope of this Article by means of inserting all types of technical services in it and technical assistance as well. This second difference has also another side, or actually an alternative: The Service PE definition.

So, superseding the problems of defining "technical services" the UN proposed an alternative solution to the taxation of such services that goes beyond the technical services themselves and asserts source taxation of all kinds of services, provided that they are rendered by means of a permanent establishment, which features are much less straight then the "traditional" Permanent Establishment. For instance, the physical presence of staff can be enough to characterize a Service PE.

In 2017 the new UN MC inserted in its text the so-called new Article (Article 12A) on technical services, which is somehow an alternative the Service PE that already existed prior to 2017 in the UN model. But, besides the position in favor of the new Article 12A, published in 2017, there were already remarkable differences between the two organizations, concerning the very Article 12.

While the OECD (still) takes most technical services (except for the know-how contracts) out of the scope of Article 12, the UN explicitly admitted in its commentaries (paragraphs 14 and 16) the interpretation of some developing countries, according to which most technical services (those which imply the transfer of technology) should fall under Article 12 of its model. And also, before the insertion of the new Article in its model, the UN alternatively had already inserted Article 5 (3)(b) in its model, providing for that all the other services (technical or not), even though inserted under the scope of Article 7, should have their income taxed by the source State, if they are rendered by means of a Service-PE, defined in Article 5 of the model.
The differences between the UN and the OECD views was already very clear prior to 2017. This could also be seen under the BEPS perspective. While BEPS (an OECD project) Action 1 proposes some modifications to the Model Convention Commentaries that do not imply any significant change in the allocation of tax powers between soured and residence states (on the contrary, they seem to aim exactly on keeping the bases to the State of residence), the UN Tax Experts Committee has, in the last years, many different proposals to the taxation of services by the State of source, also enlarging the definition of source itself (Article 12.5 UN MC 2017)\textsuperscript{22}.

Aside this, as an alternative to the Service PE provision and the widening of Article 12 of its model, the UN proposed a completely new Article in its Model Convention, exclusively concerning the taxation of technical services rendered by a non-resident with no physical presence in the source State. This new Article was added to the model in 2017. Thus, instead of implementing source taxation of all services rendered with physical presence, as asserted by Article 5 (3) (b), it proposes the taxation of only technical services at source, irrespective of the existence of any physical presence of the service provider\textsuperscript{23}.

By means of different alternatives, the UN has, thus, a radical position for the reallocation of tax bases concerning services provided in an international scenario, specially the technical ones. According to Baez\textsuperscript{24}, all though the so-called “base erosion approach” (from the original ideas of the BEPS project) give a considerable “practical theoretical support” (check if it is Andres expression) to the taxation of technical services in an international scenario, specially those inserted in the digital economy, it aims fundamentally at reestablishing the historical (according to the OECD patterns) levels of taxation by the State of residence.

\textsuperscript{22} Baez (2015, items 2, 3.1 and specially item 4 [second paragraph]).

\textsuperscript{23} Almost same proposal was made by Baez and Braunner as an alternative to their main proposal for taxing the digital economy (Baez/Braunner, 2019: 22–24). For these authors, if the withholding tax is not feasible, the second best option would be a general withholding tax on services. According to them, their second-option proposal coincides to the Article 12A of the UN MC. The new Article is not exactly the topic of this work, nor it is a discussion of the Baez and Braunner Paper’s proposal but one should note that such assimilation assumes that all cross-border services will fall within the realm of “technical services”.

\textsuperscript{24} Ídem.
On the contrary, the UN approach searches for "additional assignment" of tax powers to the State of source and this is very clearly noticed by an analysis of policy priorities. While "double non-taxation" and "international tax planning" are frequently used terms in the OECD's discourse (and the UN does not refer to it), the "erosion of national tax bases" by means of technical services render is an issued to which the BEPS Project makes no consideration, notwithstanding the UN repute it one of the most important, as stated by the same author\textsuperscript{25}.

In this sense, bearing in mind that such policies have different goals, it gets quite clear that the Brazilian practice is very divergent from the OECD. It is not so divergent from the UN view, specially if one considers the UN's new Article instead of the Service PE approach. Some comments about the trade-offs concerning these two alternatives may make the Brazilian position a bit clearer.

The Service PE provision is currently Article 5 (3) of the UN Model (there is no similar provision in the OECD Model Convention, rather in paragraph 42.3 of the Commentaries). As well-known, the permanent establishment is an exceptional condition for the source state to tax business profits of a non-resident\textsuperscript{26}. Its widening permits the taxation of income from services provided by non-residents in case of professionals’ physical presence.

Actually, the UN Model provision is not so different from the OECD Commentaries put in paragraph 42.3, but a remarkable difference is that the OECD suggests some requirements for the characterization of a Service PE that tend to be a problem for developing countries, specially the criteria for physical presence characterization. Andres Baez\textsuperscript{27} points out that this is very hard to be controlled and besides that, since it is a very formal and objective criterion, it is somehow easy to be avoided by foreign service providers. But maybe the main problem according to his view—and he seems to be right—is that the need for physical presence ignores the increasing reality of the majority of the services rendered in the digital economy.

Therefore, even if in the UN Model the presence criteria for the Service PE are more flexible, they may still be a problem.

\textsuperscript{25} Ídem.
\textsuperscript{26} LANG (2013: 92-93).
\textsuperscript{27} BAEZ (2015, item 3.2.1.1.2).
Another critical comment made by that author is that a Service PE must be treated as a resident in the sense that it must be taxed on its net income and compared to a withholding tax on gross income, to audit such entities can be difficult to many developing countries.

It is worth asserting that such net basis taxation of services implements the ability to pay principle, specially some of its corollaries like the net income principle (objectives netto Prinzip) and thus the taxation of services in an international scenario stays much more in accordance with the Constitutional framework of most countries\(^2\text{8}\), since many Constitutional orders impose the ability to pay as a condition for a fact to be taxable and also that the taxes are levied according to such pattern\(^2\text{9}\).

Obviously one can argue that the ability to pay principle is not a matter of double tax treaties. For instance, even Klaus Vogel classical commentaries avoid such discussion, arguing that it rarely leads to a clear result (führt selten zu einem eindeutigen Ergebnis)\(^3\text{0}\). But this is not the core issue here. The point is that if one argues in favor of a net basis taxation on the grounds of equality based on ability to pay, so she must have in mind the consequent need for a very complex balance to be made among a fundamental right principle (the ability to pay) on one side, and a very important and current collective good on the other side: the practicability of taxation\(^3\text{1}\).

This is why one of the best ways of adapting the Service PE model to a net basis taxation could be providing predetermined margins of profit for such establishments, as suggested by Andrés Baez\(^3\text{2}\), just like Brazil makes currently concerning the taxation of small and medium business (as an option made by the taxpayer) or even concerning transfer price adjustments. But this, on the other side, also implies that the practical effects of such measure are very similar to simply adopting very low rates applied to gross income (what is much simpler), as it was advoked by Baez and Brauner\(^3\text{3}\) in a very recent paper. Thus, implementing a concept of Service PE in double

\(^2\text{8}\) SC Haumburg (2011: 66-69, margin numbers 4.7 and 4.10); Seer (2013: 25, margin number 83 and 29, margin number 95).


\(^3\text{0}\) Vogel (1996: 99-100, margin number 14) (free translation from the German).


\(^3\text{2}\) Baez (2015, item 3.2.1.1.2).

\(^3\text{3}\) Baez and Brauner (2019).
tax treaties, even under the UN’s perspective, is not an option which is free of discussions.

The same occurs with the alternative solution, which is the new Article 12A to address specifically the taxation of technical services. Such Article sets cumulative tax powers to the States of source and residence. Under the perspective of the source State it has the advantage of not depending on any physical presence and under this point of view the new Article is wider than the Service PE provision, since this last one requires physical presence, which, on its turn, is very criticized by some authors, especially because of the difficulties concerning the assessment of its presence criteria34.

Under the perspective of the type of services to be subject to source taxation though, the new Article is narrower than the service PE, since that one aims at technical services only, while the Service PE provision is proposed to enable taxation of (at least in principle) any kind of services, except for the very specific ones included in the scope of other Articles of the treaty (like independent professional services, in case Article 14 is adopted)35. Besides being narrower in terms of services covered, the new Article is based on the very concept of “technical services”, which problems of definition are very well known36, specially in Brazil37 (except for the fact that this provision defines technical services as “managerial, technical or consultancy”38, what maybe gives a little bit more definition to the concept itself).

It is interesting to note that notwithstanding being in principle narrower, the Article for technical services, could, at the end of the day, become wider than the Service PE provision, in case one argues that such definition does not depend on any transfer of technology, like Brazilian Tax Administration39 does—and this will be addresses ahead. However, the UN’s view does not seem to be so broad, since its proposal excludes from the scope of such Article the services rendered massively, like those ones of database access. This shows that Brazilians Tax Administration’s view goes further than that one of the UN’s, even considering the new Article 12A solution.

34 Baez (2015, item 3.2.1.1.1).
35 See paragraphs 15.4 to 15.12 of the Commentaries to UN Model Convention, addressing some issues on this.
36 Baez (2015, topic 3.2.1.2.2).
38 E/C. 18/2014/CRP. 8, paragraphs 50-60.
39 ADI RFB n.º 5/2014.
Even though not being so wide, the UN’s deserves some critical view. If “technical services” (in a wide sense) is already difficult to define, the terms “managerial, technical (in a narrow sense) and consultancy services” can be even more. For instance, should managerial services be of any kind be in the scope of Article 12 A or only those “higher-level managerial services”? Would it include services which even though have a technical feature (research, for instance) are only “ancillary” to a managerial service?

Besides that, as Andrés Baez⁴⁰ points out, if the typical feature of a technical service is the application of specific technics and knowledge inherently to their render, then the proposal loses its consistency, since the provision of some services, even though massively practiced, require some technics and knowledge which can be much more specific and even sophisticated than other ones which are customized or even “taylor-made”. The inclusion of the new Article 12A in the UN model, thus presents problems which seem to be as difficult to solve than those implied by the adoption of a Service PE provision and besides that, keeping the “technical services” as key-concept for its application, such Article maybe should not be deemed so new.

In a very short balance of both proposals, the Service PE is wider than the Article on technical services in terms of services covered (not only technical) but narrower than it in terms of tax base (net basis). Besides this, it depends on physical presence. This balance facing the two most “mature” proposals in the realm of the UN’s Committee—an already added to the Model Convention—leads to conclude that none of them is free of challenges aiming at allocating additional tax powers to developing countries as source States.

Brazilian Tax Administration position, however, maybe circumvents a significant part of those challenges. According to the wording of Article 12 usually adopted in Brazilian treaties and to the interpretation Tax Administration gives to them, the result is as follows: there is no need for physical presence (as in the Service PE context) on one side; on the other side, taxation is not – in practice – limited to technical services, or to what is usually interpreted as technical services, since almost any service is subject to be included in such conceptual framework, according to the tax authorities position declared in the Interpretative Declaratory Act n. 5/2014 (ADI RFB n. 5/2014).

⁴⁰ Baez (2015, topic 3.2.1.2.2).
It is true that some judicial decisions have already declared such Act illegal, but such decisions have no wide and general effects. Besides that, some other decisions took an extreme opposite position, maybe widening too much the general—and somehow residual—Article 7 of the treaties. Such decisions seem to be an exaggerated judicial reaction to the (also) exaggerated position taken by tax administration by publishing the ADI RFB n. 5/2014.

Notwithstanding the excess, maybe such decisions had the side-effect of leading to some moderation in the interpretive practice of tax administration. To better understand this issue, it is worth to contextualize the evolution of such positions and their current status.

Since the Superior Court of Justice (Copesul case) thoroughly rejected the qualification of income from technical services under Article 21 (as “other income”), the tax authorities tried to circumvent Article 7 in order to warrant source taxation by means of a very broad interpretation of services “as technical” and thus qualifying them under Article 12 of many Brazilian treaties, according to which, the State of source could also tax the respective income.

A very significant part of the Brazilian treaty-net has the assimilation of income from technical services and technical assistance to royalties. Some of these treaties also assimilated to royalties the income from managerial and administrative services. Almost any service could then be qualified under Article 12, specially in the cases of treaties which include managerial and administrative services. Most Brazilian treaties do have the extension of Article 12 to include technical assistance and technical services, but not managerial and administrative (only few treaties include it). Thus, the focus will be in these “majority” treaties.

Even though the Commentaries consider that technical services are the ones which imply the transfer of technology and technical assistance necessarily has a an ancillary character in relation to the intangibles or rental which are described in Article 12 (which give raise to royalties), Brazilian tax authorities have a position stating that all technical services are to be qualified under Article 12, being irrelevant if they lead or not the transfer of technology.

Normative Instruction n. 1.455/2014 of Brazil Federal Revenue (from now on, IN RFB 1.455/2014)\(^{41}\) defines technical services, for the sake of

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\(^{41}\) Instrução Normativa RFB n.° 1.455/2014.
interpreting domestic legislation as "the execution of a service which depends on specialized technical knowledge or that include administrative assistance or consultancy rendering, practiced by independent professionals or employees or even by automated structures with clear technological content". As one can see, the concept is not only very broad but also confuse.

It is hard to assess what "administrative assistance" is and "specialized technical services" as well. Normative Instructions issued by Tax Administration in Brazil are acts for the interpretation of legal statutes and for their implementation. Since a legal act provides for the source taxation of cross-border payments for technical services, one could expect that a normative instruction would make the statute clear and practicable. However, besides being not clear, this definition seems to go beyond what could be deemed a technical service. Administrative assistance can be the set of activities daily practiced by a secretary or assistant in a law firm.

Besides this normative instruction—which asserts a domestic law definition—the already mentioned Interpretive Declaratory Act n. 5/2014 was issued to ascertain the scope of technical services for the interpretation of Brazilian double tax treaties, stating that, in order to be qualified as such, a service does not need to imply the transfer of technology, rather such services just need to fit in the definition provided by Article 17 of IN 1.455/2014. This is the current position of tax Administration in Brazil.

Such interpretation was confirmed by the Administrative Court of Tax Appeals (Conselho Administrativo de Recursos Fiscais—CARF—) in the Petrobras case. In an individual ruling issued in 2018 (SC Cosit 65/2018) this understanding was confirmed in a case related to treaty with Sweden, when it was ascertained that in that exceptional case, source taxation would not be applicable because that specific treaty has no provision for the assimilation of technical services fees to royalties. But it was clearly stated that the services of software customization (notwithstanding minimal) would be a technical service irrespective of any technology transfer.

In the case of the treaty with Canada, another individual ruling (SC Cosit n. 5/2017) had already stated that, since there was a provision for the assimilation of technical services fees to royalties, Article 12 was applicable no matter there was no technology transfer provided by the terms of the contract. The same conclusion, concerning the same treaty, was achieved in the individual ruling SC Cosit n. 58/2018.
One of the only situations in which tax authorities do not qualify services as “technical” is the case of travel agency (SC Cosit n. 598/2017), when it was ascertained, concerning the treaties with Denmark, Finland and Sweden, that such services, even though depending on some “specific knowledge”, such knowledge do not have a “grade of specialization which make them peculiar enough to be deemed specialized technical knowledge”. Thus cross-border payments to residents of Denmark, Finland and Sweden were qualified under Article 7 of the treaties.

It is worth mentioning that tax authorities have been respecting the specific scope of Article 14 in relation to Article 12. In a very recent individual ruling concerning the treaty with Mexico (SC Cosit n. 135/2019), tax administration acknowledged that engineering consultancy services were of a technical kind (notwithstanding implying no technology transfer at all), but fell under the scope of Article 14, for it is a special rule in relation to Article 12.

Such “run for Article 12” currently undertaken in Brazil by tax administration (and confirmed by administrative courts) has been counteracted by another maybe also exaggerated position, taken by judicial courts, as mentioned above. In Iberdrola case, the Superior Court of Justice has decided in 2015 that consultancy services were not technical services if they did not imply technology transfer, thus qualifying consultancy services under Article 7 (not in Article 14, which was not even discussed). Besides that, in 2017 a lower court in southern Brazil has decided (Yara case)\(^4^2\) that technical services and even technical assistance were out of the scope of Article 12 and under Article 7, if they did not imply a transfer of technology. Such decision was recently (2018) confirmed by the 4\(^{th}\) Region’s Federal Court of Appeals\(^4^3\).

It is remarkable that in Yara, the courts assumed that the services under discussion were technical services and there was also technical assistance in that case. But their premise was that the technical services which income can be qualified under Article 12 are only the ones which imply technology transfer. They even asserted that, since in Brazil there can be no technology importation without registration before the National Authority of Intellectual

\(^4^3\) Tribunal Regional Federal da 4\(^{a}\) Região. Apelação/Remessa Necessária n.º 5051622-65.2016.4.04.7100/RS.
Property (Instituto Nacional de Propriedade Intelectual—INPI—) only technical services and technical assistance provided by means of contracts which were registered before that organ shall be qualified under Article 12 of the treaties.

Thus, there is a strong opposition in Brazil between tax Administration (supported by administrative tax courts) and judicial courts. However, if one considers the tax authorities view, it seems Brazil has been practicing a solution which is close to the UN’s new Article on technical services. According to the Brazilian (administrative) practice: 1) technical services can be taxed at source with no need for physical presence by the service provider; 2) taxation is based on gross amounts; 3) technical services is an expression of a concept which is much wider than the classical one, based on the transfer of technology and technical assistance is also much wider than the classical definition based on the ancillary character which the assistance has in relation to an intangible; 4) technical services can even include consultancy and managerial and administrative activities.

In a nutshell, almost any payment in consideration for a service furnished by a non-resident is subject to source taxation in Brazil. This seems to be very aligned with the UN’s view on technical services, specially the adoption of Article 12A, but also with a trace of the Service PE solution, since almost all services are taxed that way. Such conclusion is not correct though and the next and final section aims at reinforcing the assertion that the Brazilian practice deviates even from the UN’s view and even form the very wording of most of the treaties in force.

CONCLUSION

Analyzing the way Brazil’s tax administration deals with the challenges of taxing services, specially the technical ones, shows that it goes beyond both the UN’s main solutions: the Service PE and the technical services Article. It does not face the linguistic limits of technical services—in case of the new Article—nor the territoriality limits of physical presence—in case of the Service PE proposal. This is not a problem, in principle, since there are some sound arguments in favor of source taxation on income, specially some kinds of income as those ones classified as “passive income”44.

What makes the Brazilian position somehow problematic is that such approach lacks legal grounds, specifically on the wording of the treaties. First, the argument in favor of a qualification as “other income” is completely flawed, as asserted by the Superior Court of Justice (Copesul case). Second, the treaties (or protocols) signed which contain the assimilation of fees for technical services to royalties give no textual frame for disregarding the transfer of technology as a tie-breaker criterion for defining technical services.

The assimilation of such fees to royalties is already an enlargement of the very concept of royalties, thus it is somehow an exceptional rule. As such, this rule must be interpreted within the straight limits of its wording. To tax technical services fees as royalties is already a conceptual “extension” and should be interpreted as so.

Finally, it should be retained that technical services is historically a concept that is intrinsically linked with the transfer of technology and if the parties of the treaty have agreed not to use the consolidated concept, but a larger one, this should have been minimally indicated with the text of the treaty or its protocol. There is no treaty signed by Brazil—except for the one with Spain—that explicitly provide for a concept of technical service which makes the transfer of technology irrelevant.

The exception of the Spain treaty confirms the rule. If there is a treaty explicitly enlarging the scope of Article 12 to include any technical services, no matter if their furnishing implies or not technology transfer, it is because in the other treaties such widening is not provided. The most recent treaties’ wording confirms this conclusion.

If the various protocols by means of which Brazil has amended most of its treaties in order to include technical services and technical assistance in the royalties Article were enough to provide legal ground for tax administration’s practice, there would be no need for adopting the new Article 12A of the UN MC 2017, as Brazil did in the four newest treaties already mentioned. The significant differences in the wording of the new Article (Article 13 of the mentioned newest treaties) and the protocols signed to amend Article 12 of former treaties seems to be self-explaining.

There would be no need for Article 12A of the UN MC (now Article 13 of the newest Brazilian treaties) if the very wording of Article 12 of most of Brazilian treaties provided legal support to the practice of tax authorities related to withholding income tax.
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