An Old Idea and a New Start: Brazil-U.S. Tax Treaty Negotiations

by Daniel Hora do Paço and H. David Rosenbloom

Daniel Hora do Paço is a master lawyer at Petrobras Legal Department in Rio de Janeiro. H. David Rosenbloom is a member with Caplin & Drysdale Chtd. in Washington, director of the international tax program at New York University School of Law, and a member of Tax Analysts' board of directors.

In this article, the authors consider the need for Brazil and the United States to conclude a tax treaty.

Consider José, a new investor in the Brazilian stock exchange. Like many Brazilians in recent years,[1] and following the reduction of Brazil's sovereign interest rate[2] and the consequential reduction of the profitability of Brazil's fixed-rate mutual funds, José became familiar with the home-broker system and set out to learn about a myriad of financial products. After a while, a more experienced friend convinced José to take a further step: explore the more diversified U.S. financial market, something easier in the digital age. After filling in a few forms and sending funds abroad through new and cheaper exchange platforms, José was thrilled to begin taking advantage of opportunities not available to common investors in Brazil just a few years ago. But there was a surprise to come.

Having achieved several investment successes, José decided to collect some of the gains. The capital gains, derived from the difference between the price paid and the price received on sale, presented no problems. The United States does not generally impose tax on capital gains of nonresidents who are not U.S. citizens.[3] Brazilian tax authorities, on the other hand, exempt foreign capital gains up to BRL 35,000 (about $6,580) on shares and exchange-traded funds.[4]

Dividends, however, are another story. When José went to collect those, he encountered a hard reality: Unlike his U.S. citizen neighbor John, who is not subject to U.S. withholding tax and benefits from the Brazilian exemption for dividends, José learned that his online broker, following U.S. tax legislation, must withhold on dividends at a rate of 30 percent.

In contrast with many other foreign persons who invest in the United States, José resides in a country that doesn't have an income tax treaty with the United States. Of the 25 largest economies (considering nominal GDP),[5] only Brazil (ninth on the list), Saudi Arabia (18th, and which does not have an income tax), and Nigeria (25th) are in that situation.[6]

[1]The number of Brazilians investing in the Brazilian stock exchange nearly doubled in one year alone, from 1.6 million in 2019 to 3.17 million in 2020. *See* Bianca Alvarenga, "Bolsa dobra o número de investidores em 2020 e vê maior diversificação," *Exame*, Dec. 14, 2020 (in Portuguese).

[2]After several consecutive cuts, the sovereign interest rate was reduced from 14.25 percent (June 2016) to 2 percent (February 2020).

[3]Capital gains are generally not taxable if the investment is not in a U.S. property interest and the investor was present in the United States for less than 183 days during the year. For more information and exceptions, see IRS Publication 519, "U.S. Tax Guide for Aliens," at chapter 4 (2020).

[4]Receita Federal, "Solução de Consulta Cosit No. 264" (Sept. 24, 2020) (in Portuguese).

[5]Caleb Silver, "The Top 25 Economies in the World: Ranking the Richest Countries in the World," Investopedia, Dec. 24, 2020.

[6]Brazil-U.S. Business Council and U.S. Chamber of Commerce, "A Roadmap to a U.S.-Brazil Tax Treaty," at slide 5 (Mar. 2019). Brazil also does not have tax treaties with 10 of 25 of the world's larger economies, including Germany, the United Kingdom, Australia, Indonesia, Poland, and Thailand.

The Brazil-U.S. Relationship

Why is that the case? Brazil has a long-standing relationship with the United States. It was not a major U.S. focus after World War II — the United States being much more concerned with the reconstruction and political restructuring of Europe and the former Axis countries — and yet even though it received only modest economic help and some military cooperation, Brazil remained solidly in the Western capitalist block. It can fairly claim to be the largest nation in the Western Hemisphere with a strong cultural identification with the United States.

Yes, there is anti-American feeling in the Brazilian population, and 20 years of U.S. support for the Brazilian military dictatorship, as well as the United States' inclination to act militarily without U.N. consent, have contributed to that feeling. At the same time, Brazil probably has one of the highest percentages of fans of American music and movies and users of common Americanisms, such as "email," "self-service," "diet," "crush," "drive-thru," "funk," "hobby," "jeans," "smartphone," "stress," and "spoiler," even though Portuguese is the language of Brazil and a huge majority of the populace does not speak English.

The relationship between the Brazilian and U.S. governments dates back centuries. Early independence conspirators in Brazil wrote letters to Thomas Jefferson, the U.S. ambassador in France (and later U.S. president), asking for help.[7] After Brazilian independence (which the United States was the first nation to recognize), there were difficulties during the monarchy, but a first treaty was ratified soon after installation of the republic in 1889.[8] Today, there are many treaties and agreements between Brazil and the United States, covering fields such as tax information exchange, social security, national defense, customs administration, criminal law, science, and technology.[9]

Even so, the commercial relationship between the United States and Brazil is far from being at its best. Despite the reported personal relationship between President Jair Bolsonaro and former President Donald Trump, trade numbers are the worst they have been in the last 11 years, with a 25 percent reduction in 2020 compared with the prior year.[10] That reduction is not an isolated phenomenon but still reflects a continuing decrease of the U.S. position as a preferred Brazilian partner.

The United States ended the 20th century with impressive percentages of investment and international trade with Brazil: In 1999 it accounted for 29.33 percent of the total amount invested in Brazil, 22.2 percent of total Brazilian exports, and 23.9 percent of total Brazilian imports. But that did not extend to the next century: Exports dropped from 22.9 percent in 2003 to 9.6 percent in 2011; imports dropped from 19.8 percent in 2003 to 15 percent in 2011, and investments dropped from 18.2 percent in 2003 to 11.7 percent in 2010.[11] There was some recovery during President Dilma Rousseff's administration, but Edward Snowden's disclosure of Rousseff's personal data and matters regarding Brazilian oil company Petrobras did not help. By 2013, the United States was Brazil's second-biggest commercial partner.

Many reasons can explain the United States' loss of position as Brazil's preferred commercial partner, including: (i) Brazilian foreign policy reorientation during President Luiz Inácio Lula da Silva's administration; (ii) the ascent of the BRIC countries; (iii) the increasing importance of commodities produced by the United States; and (iv) the rise of a protectionist policy in the United States.[12] Although there was some controversy on the matter,[13] judging from the experience of many

[7] Marcelo da Fonseca, "Nossa história: brasileiro troca cartas com Thomas Jefferson sobre independência do Brasil," *Estado de Minas Gerais*, July 4, 2015 (in Portuguese).

[8] Gabriel Terra Pereira, *Relacionamento Brasil — Estados Unidos* 85 (2009) (in Portuguese).

[9] Government of Brazil, "Conheça os principais acordos vigentes entre Brasil e EUA" (Mar. 10, 2020) (in Portuguese).

[10] Victor Irajá, "Comércio entre Brasil e EUA atinge pior marca em 11 anos," *Veja*, Oct. 15, 2020 (in Portuguese).

[11] Uallace Moreira Lima, "As Relações Comerciais Entre Brasil e Estados Unidos No Período 2000-2014," Texto para Discussão 2941, at 16 (July 2019) (in Portuguese).

[12] Israel de Oliveira Andrade, Nilton de Almeida Naretto, and Luiz Gustavo Aversa Franco, "Relações Comerciais E Cooperação Econômica Entre O Brasil E Os Estados Unidos Nos Anos 2000," 23 *Boletim de Economia e Política Internacional* 13 (May-Aug. 2017) (in Portuguese).

[13] Anna Braunschweig, "Double Taxation Treaties' Impact on Intermediate Trade," Lund University School of Economics and Management (Autumn 2014).

other countries in the world, another factor can be added: the absence of an income tax treaty.[14]

China: Brazil's Largest Investor

According to data from the Foreign Affairs Ministry released in 2019, Chinese investment in Brazil came to $72 billion between 2013 and 2019, around 37 percent of the total invested by foreigners.[15] The Chinese invested $20 billion in Brazilian assets in 2017, 68 percent higher than in 2016. Thus, in 2017 Brazil became China's second-largest target of infrastructure investment, behind only the United States.[16] The Brazil-China Business Council reported that Chinese companies' investments in Brazil from 2017 to 2018 reached $100.5 billion, involving almost 200 ongoing and finalized projects.[17] In November 2019 China made $100 billion available to Brazil through investment funds.[18] From 2015 to 2021, the Chinese bought 21 Brazilian companies totaling $21 billion. The Brazilian electrical sector is the leading beneficiary of Chinese investment at 43 percent, followed by the oil and gas sector with 28 percent.

Chinese investments gained a substantial presence after 2010, with the acquisition of a 40 percent stake ($7.1 billion) in Repsol Brazil by Sinopec. From 2011 to 2013, Sany and Chery, important players in the industrial sector, came in, and in 2013 the China Construction Bank acquired a 73.96 percent stake in BicBanco for $810 million.[19] In 2017 China Merchants Group, a government-controlled public company, paid BRL 2.8 billion for the container terminal at Paranagua port, the second-largest in Brazil (in 2020 government-controlled funds took over a portion of the business).

From 2014 to 2018, Chinese investments were made in energy, technology, infrastructure, and extraction, as well as in construction projects in the electrical sector (with State Grid buying CPFL Energia in 2020 and the China Three Gorges Corporation buying CESP hydroelectrical units and Duke Energy assets). As of 2018, capital ran to technology, with the acquisition of 99 Taxi by Didi Chuxing for $600 million and a contribution of $90 million at Nubank by Chinese giant Tencent. In 2020 government-run China Communications Construction Co. invested BRL 2 billion to build a port in Maranhão state and negotiated a new BRL 1 billion project for a grain terminal in Santa Catarina state.[20]

In the oil sector, the Chinese National Petroleum Corp. and government-run China National Offshore Oil Corp. partnered with Petróleo Brasileiro SA, or Petrobras (a Brazilian mixed-capital oil corporation), for a joint-acquisition in the giant Libra field (both for 10 percent). Repsol Sinopec, mentioned above, is a partner of Shell and Petrobras at Sapinhoá field, the second-largest Brazilian field. Taken as a group, Chinese production was the third-largest in 2019, after Petrobras and Shell. Those numbers are expected to grow soon, considering that some recent investments have not reached the production phase.

Chinese dockyards have also played a relevant role in construction plans for floating, production, storage, and offloading vessels. Between 2000 and 2019, 20 of 39 vessels that were partially or entirely built abroad were from Chinese harbors. Since 2014, almost all vessels were partially or totally built or converted in Chinese dockyards. In 2019, four platforms were still under construction in China.[21]

While other international financial institutions were reluctant to finance Petrobras, Chinese institutions offered loans when the company needed additional funding or was facing severe economic crises from domestic and

[14] Eric Neumayer, "Do Double Taxation Treaties Increase Foreign Direct Investment to Developing Countries?" 43(2007) *J. Dev. Stud.* 1501 (June 5, 2008).

[15] Felippe Hermes, "Isso é o que a China já comprou no Brasil," InfoMoney, Oct. 23, 2020 (in Portuguese).

[16] "Chineses querem investir US$20 bilhões no Brasil," *Jornal do Comércio*, Mar. 19, 2021 (in Portuguese).

[17] "Investimentos de empresas chinesas no Brasil superam US$100 bilhões," Sociedade Nacional de Agricultura, Jan. 16, 2020 (in Portuguese).

[18] "China dispõe de US$100 bilhões para investimentos no Brasil," Poder360, Nov. 15, 2019 (in Portuguese).

[19] Bruna Belasques et al., "As incertezas com relação aos investimentos chineses no Brasil," Observatório de Política Externa e da Inserção Internacional do Brasil (undated) (in Portuguese).

[20] Hermes, *supra* note 15.

[21] Pedro Henrique Batista Barbosa, "Petrobras-China Relations: Trade, Investments, Infrastructure Projects and Loans," 24 *Revista Tempo do Mundo* 319 (Dec. 2020) (in Portuguese).

global factors.[22] Thanks to those loans, Chinese banks became Petrobras' main creditors by 2019, representing almost 20 percent of the $160 billion the company borrowed between 2009 and 2019, surpassing traditional lenders, such as Spanish and North American financial institutions. Of the company's $107 billion in international loans, China's dispersed loans of $32 billion account for 30 percent.

Chinese acquisitions in the electrical sector, essential public services, and infrastructure projects are likely to continue. China's presence will be strengthened by the opening of the financial arm of the Xuzhou Construction Machinery Group to finance machinery for civil construction and mining. Among the companies planning a presence in Brazil, especially in the energy, transportation, and agribusiness sectors, some — such as Shanghai Electric, China Southern Power Grid, State Power Investment Corp., and China Guodian Corp. — are still unknown by Brazilians.

Several deals are in progress. Shanghai Electric plans to take over transmission lines from Eletrosul (an Eletrobras subsidiary) with investments nearing BRL 3.3 billion,[23] and State Power Investment plans to buy the Santo Antonio hydroelectrical power plant for BRL 9 billion.[24] China Communications Construction bought Brazilian construction company Concremat and is planning other acquisitions, including of construction companies and railroads.[25] Pengxin bought agri-companies Fiagril and Belagrícola in 2016 and is negotiating the acquisition of a stake in bank Indusval SA.[26] Sources say there are plans for Pengxin to raise a $1 billion fund to invest in agriculture.

When it comes to international trade, the rise of China as a supplier of industrial goods dramatically changed Brazil's situation. In 1998 China was Brazil's 14th-largest export market and 12th-largest import market; by 2009, it was the largest destination for Brazilian sales and, by 2013, the largest origin of Brazilian imports. For example, Petrobras' exports to China between 2006 and 2019 multiplied by 10, and China's share in the company's global crude exports rose from 12 percent to 71 percent.[27]

The Chinese share of Brazilian exports has been mostly growing since 2015, with a considerable slowing between 2018 and 2019. At the beginning of the coronavirus pandemic, China's share of Brazilian exports grew 4 percent. In one year (2020), Brazilian exports to China rose from $63.4 billion to $67.8 billion (a nominal 7 percent increase), while the total Brazilian exports fell from $225.4 billion in 2019 to $209.9 billion in 2020, because of the international crisis. In the same period, Brazilian exports to the United States fell from $29.7 billion to $21.5 billion, a dramatic 27.6 percent drop.[28]

For 2021 a 5.3 percent rise is expected for exports to China (soy, iron ore, and oil account for 75 percent of the total), with a 5.8 percent rise for imports.[29]

One important point: Brazil and China have had an income tax convention since 1993.

Brazil's U.S. Treaty Programs

The U.S. treaty program has been whittled back. A new U.S. model income tax treaty was released in 2016, containing provisions to address potential double nontaxation that were criticized as overly broad and complicated. Besides, the required Senate approval of U.S. tax treaties allows easy blocking of any completed treaty, and no full U.S. tax treaty has been approved since 2010, although four protocols were approved in 2019.

---

[22] The company's coefficient ratio of net debt to earnings before interest, taxes, depreciation, and amortization increased from 0.85 in 2008 to 5.31 in 2015.

[23] "Shanghai Electric fará proposta para assumir obras de R$3,3 bilhões da Eletrosul," *Jornal do Comércio*, Mar. 3, 2021 (in Portuguese).

[24] "Empresa chinesa deve comprar Hidrelétrica Santo Antônio," *Jornal do Comércio*, Feb. 10, 2021 (in Portuguese).

[25] Concremat, "Revista Exame relata os investimentos da China Communications Construction Company (CCCC) no Brasil" (May 16, 2019) (in Portuguese).

[26] "Chinês Shanghai Pengxin Group negocia compra do banco Indusval," *O Estado de S. Paulo*, June 7, 2016 (in Portuguese).

[27] Barbosa, *supra* note 21, at 320-321.

[28] Estadão Conteúdo, "Dependência comercial do Brasil em relação à China bate recorde em 2020 — e deve ficar ainda maior," InfoMoney, Feb. 15, 2021 (in Portuguese).

[29] "Comércio entre Brasil e China teve alta inédita em 2020," Grupo Serpa (Jan. 15, 2021) (in Portuguese).

Brazil has always lacked a clear and consistent tax treaty policy, but it has recently been working on cooperating with foreign tax authorities to exchange information and fight tax evasion. In this regard, it has negotiated new tax treaties with Singapore, Switzerland, and the United Arab Emirates; renegotiated previously signed treaties with Argentina and South Korea; and signed a tax information exchange agreement with the United States.[30]

In 2017 Brazil applied for admission to the OECD and is increasingly adopting the legal framework needed for acceptance. It has adhered to 99 of the 245 required rules (roughly 40 percent of convergence), with most of its adhesion occurring in 2019 and 2020.[31] That gives it more adhesion than any potential OECD member. That may imply a new approach on issues, especially in transfer pricing, that have been obstacles to negotiating tax treaties with the United States and other OECD members.

An Old Idea and a Possible New Start

Thus, the recent past has been marked by the following phenomena:

- Brazil's position as one of the largest economies without a tax treaty with the United States;
- erosion of the Brazil-U.S. commercial relationship and historical alliance, with commensurate ascension of Chinese trade and investment; and
- Brazil's eagerness to join the OECD and commitment to do what must be done to be accepted, including making major changes to tax legislation.

There appears to be an opportunity for Brazil and the United States to revive the idea of an income tax treaty, which could strengthen commercial relations and promote new investments.

In 2009 we listed the biggest challenges to a treaty: Brazil's insistence on a tax sparing clause and on imposing withholding tax on payments for services rendered outside the country for in-country consumption, as well as its unique transfer pricing legislation; and the United States' requiring complete information exchange and favoring the lowering or elimination of withholding taxes.[32]

The United States will not agree to a tax sparing provision, but the concept has lost a great deal of its international acceptance, and Brazil may be ready to cede on that point. On the other hand, Brazil's position on exchange of information has evolved as a result of its Supreme Federal Court's jurisprudence,[33] and Brazilian tax authorities are likely to accept more complete regimes than in the past. Brazil's eagerness to adhere to OECD rules may soon mean a change in its transfer pricing legislation to make it more like the traditional arm's-length standard and empower tax authorities to compromise in dispute resolution.

Brazil will likely ask the United States to provide special rules for the taxation of services. There are, however, some creative provisions the United States has agreed to with other countries and might agree to with Brazil, including the performance of services for a specific number of days creating a permanent establishment, source-country taxation for technical services, and a 5 to 10 percent withholding rate on interest and royalties.[34]

Conclusion

We believe it is high time for officials in both Brazil and the United States to renew efforts to conclude an income tax treaty – which, incredibly, have been underway since 1967. They have always foundered for one reason or another but largely, in our opinion, for want of a sustained and focused effort to resolve differences. With Brazil-U.S. relations at a remarkably low point, we think the time is ripe to try again. ■

[30] Roadmap, *supra* note 6.

[31] Governo do Brasil, "Acessão do Brasil à OCDE é importante para recuperação econômica, segundo CNI" (Apr. 1, 2021) (in Portuguese).

[32] Daniel Hora do Paço and H. David Rosenbloom, "Thoughts on the Brazil-U.S. Tax Treaty Negotiations," *Tax Notes Int'l*, Nov. 16, 2009, p. 517; *see also* "Considerações Sobre a Negoçiacão de um Tratado Para Evitar a Dupla Tributação da Renda com os EUA," 174 *Revista Dialética de Direito Tributário* (Jan. 2010) (in Portuguese).

[33] Supremo Tribunal Federal, Recurso Extraordinário 601.314 São Paulo (Feb. 24, 2016) (in Portuguese).

[34] *See*, respectively, the 2007 Canada-U.S. fifth protocol, the India-U.S. tax treaty, and the U.S.-Vietnam tax treaty (signed but not yet ratified).