# Tax Residency of Companies in Brazil

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A Practice Note setting out the situations where a company is subject to Brazilian corporate income tax. It discusses when a non-Brazilian resident company is taxed under Brazilian law, including when a company is deemed to have a permanent establishment (PE) in Brazil. It also describes how the right to tax a company's profit may be allocated under a double tax treaty if a company is tax resident in two jurisdictions.

This Note describes the cases where resident and non-resident companies must pay Brazilian corporate income tax. It also describes how the right to tax a company's profits may be allocated between different jurisdictions under a double tax treaty in case of dual residence.

## Basis of Taxation: Tax Residence and Non-Residence

In broad terms, Brazilian corporate income tax applies to:

- Companies resident in Brazil for tax purposes, which includes companies incorporated in Brazil and foreign companies which are tax resident in Brazil (see Tax Residence under Brazilian Law).
- Non-resident companies which have income attributable to a permanent establishment (PE) in Brazil (see Permanent Establishment).
- Non-resident companies which source income from Brazil (not through a PE) (see Non-Resident Companies Without Permanent Establishment in Brazil).

## Tax Residence under Brazilian Law

Under Brazilian law, a company is considered tax resident in Brazil if any of the following applies:

 

- It is incorporated under Brazilian law.
- Its place of effective management is located in Brazil (see Place of Effective Management of Foreign Companies).
- It is incorporated abroad, but has branches, subsidiaries, agencies, or representations in Brazil.
- It is incorporated abroad and has principals in Brazil, with respect to the results of operations carried out by their agents or commissioners.

(Article 159, Decree No. 9,580/2018.)

## Place of Effective Management of Foreign Companies

Brazilian tax law does not define "place of effective management." However, the Brazilian Civil Code (*Código Civil Brasileiro*) (Law No. 10,406/2002, as amended) states that a company residency is defined by the place where either:

- The respective boards of directors and administrations operate.
- They elect a particular domicile in their articles of association or constitutive documents.

(Article 75, IV, Brazilian Civil Code.)

## Taxation of Brazilian Tax Resident Companies

### Taxable Base

A Brazilian resident company calculates Brazilian corporate income tax on their worldwide net income.

Taxation will depend on the calculation method adopted by the Brazilian entity, either:

- The real profit method.
- The presumed profit method.

In the real profit method (which is mandatory for companies that have profits, income, or capital gains from abroad), the net income is calculated in accordance with the profit and loss account results and considering certain tax adjustments under Brazilian law.

The presumed profit method is an alternative calculation system for qualifying companies. To qualify, companies must satisfy each of the following:

 

- Annual gross revenues of less than BRL78 million.
- No activity as a financial institution.
- No profits, income, or capital gains derived from abroad (except for export revenues).

The taxpayer can freely choose this simplified system. The tax calculation base in this system considers: [profit presumption coefficient] x [gross income from activity].

For corporate income tax, the coefficients are:

- 8% for the sale of goods.
- 32% for the provision of services.

For social security contribution on net profit, the coefficients are:

- 12% for the sale of goods.
- 32% for the provision of services.

### Adjustments to Tax Profits

In general, controlled foreign company (CFC) rules aim to prevent the artificial shift of passive income (such as interest, dividends, royalties, or lease rents) from one jurisdiction to other low-tax jurisdictions.

However, Brazilian CFC rules are broader. Profits realised by Brazilian companies directly or indirectly through CFCs are taxable in the hands of the Brazilian parent company, even if the subsidiary is not in a low-tax jurisdiction.

Law No. 12,973/2014 introduced a new wide-ranging regime of taxation of profits abroad, taxing passive and active income in Brazil of all controlled companies abroad.

Profits earned abroad by a CFC of a Brazilian company will be added to its net income in accordance with the following:

- The profits will be added in proportion to the participation in the CFC.
- The profits are those determined in the balance sheet or balance sheets prepared by the CFC during the accounting period of the Brazilian company.

 

- If the Brazilian company is dissolved during the tax period, it must add to its net income its participation in the profits of the CFC determined by the CFC balance sheets prepared up to the date of the closing balance sheet of the Brazilian entity.
- The Brazilian company must keep a copy of the financial statements of the CFC in its possession.
- Losses resulting from CFC operations are not offset against profits earned by the Brazilian company.

(Article 76 to 80, Law No. 12,973/2014.)

### Tax Rates

Brazilian corporate income tax is applied at a standard combined rate of 34% (15%, plus 10% of additional rate for profit that exceeds BRL20,000 per month, plus 9% of social contribution on the net income, which has virtually the same rules as corporate income tax).

This rate is increased for the following types of entities:

- Banks: 45% (15%, plus 10% of additional rate and 20% of social contribution on the net income).
- Other financial institutions: 40% (15%, plus 10% of additional rate and 15% of social contribution on the net income).

(Article 3, Law No. 9,249/1995; article 3, Law No 7,689/1988.)

## Dual Tax Residence

Dual tax residence may occur where a company incorporated under Brazilian law is also considered resident in another jurisdiction by virtue of the local rules. For example, a company incorporated in Brazil which has its effective place of management in the other country may be considered resident in both Brazil and the other country.

Dual tax residence may lead to double taxation of the same profits.

Domestic law and **double tax agreements** (DTAs) (also known as double tax treaties or conventions) aim to prevent or solve this double taxation issue. For an introduction to the purpose and interpretation of DTAs in a UK context but relevant more widely, see Practice Note, Double tax treaties: an introduction.

### Double Tax Treaty Protection

In the case of dual tax residence, the country of tax residence is determined by the DTA existing between Brazil and the other country. It is necessary to look at the relevant DTA for the terms of the tie-breaker rule (that is the rule of the DTA that determines which of the two countries is the country of tax residence where the company will pay corporate income taxes).

 

Brazil has entered into a network of DTAs with 38 jurisdictions. DTAs are largely based on the **Organisation for Economic Co-operation and Development** (OECD) Model Tax Treaty on Income and on Capital 2017 (OECD model tax treaty), a standard form that many countries use as a starting point when negotiating a DTA. For background on the OECD model tax treaty, see Practice Note, Double tax treaties: an introduction: Interpretation of DTAs.

A general overview of how the issue of dual tax residence is typically dealt with based on the OECD model tax treaty and the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI) is set out in the following sections.

## OECD Model Tax Treaty

The OECD model tax treaty (Article 4) states that a company is resident in a country if it is liable for tax in that country by reason of its domicile, residence, place of management, or any other criterion of a similar nature.

The OECD model tax treaty (before being amended by the MLI) provided that, should a company be resident in two countries, it should be treated as resident in the jurisdiction where its place of effective management is located (Article 4(3)). This is the place where key management and commercial decisions that are necessary for the conduct of the company's business as a whole are made. To determine this, all relevant factual circumstances must be examined.

Determining where a company is effectively managed may be difficult, given that senior directors are often highly mobile individuals and that meetings are often carried out and decisions adopted through electronic communication.

## Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI)

The MLI is a multilateral treaty signed by more than 95 countries that amends and supplements existing DTAs with various anti-abuse provisions, depending on the elections made by the signatories. The MLI was published on 24 November 2016 (see Legal Update, OECD publishes multilateral instrument on BEPS (detailed update)). It was opened for signature on 31 December 2016. For further information, see Practice Note, OECD multilateral instrument on BEPS.

Brazil has not signed the MLI. However, in 2017 it requested to join the OECD as a full member, and for that reason Brazil has started to include some anti-abusive standards in its tax treaties (for example recent treaties with the United Arab Emirates, Switzerland, Singapore, and Uruguay).

Article 4 of the MLI changes the tie-breaker for dual resident companies by providing that the place of residence of a company resident in both countries is to be determined by the competent authorities of both countries by mutual agreement, considering the place of effective management, the place where the company is incorporated, and any other relevant factors.

For jurisdictions for which mutual agreement procedures apply, a company is considered a dual resident until the competent authorities reach an agreement.

## No Double Tax Treaty Protection

 

Where there is no applicable DTA, the company will be resident in both Brazil and the other jurisdiction. The company will therefore be subject to the tax laws of that other jurisdiction as well as to Brazilian tax on its worldwide profits and may be taxed twice on some or all of its profits. This position is, obviously, highly undesirable and companies should avoid this situation arising wherever possible. To do so, companies should take any measures necessary to ensure that the requirements for residence either in Brazil or in the other jurisdiction are not (or cease to be) met.

## Non-Brazilian Tax Resident Companies with Permanent Establishment (PE)

Companies which are not tax resident in Brazil are still subject to Brazilian corporate income tax if they have a PE in Brazil (see Permanent Establishment).

For the taxation of a non-tax resident company located in Brazil without a PE in Brazil, see Non-Resident Companies Without Permanent Establishment in Brazil.

### Permanent Establishment

Brazil does not have clear and specific rules about the configuration and taxation of a PE. However, certain rules and similar issues on the taxation of PE are contained in (and triggered by) the Brazilian Corporate Income Tax (CIT) legislation.

As a general principle of Brazilian law, the provisions set out under international treaties prevail over domestic legislation. However, the Brazilian rules apply where no DTA is available.

### Permanent Establishment under Brazilian Law

Brazilian tax rules provide for the taxation of profits generated in Brazil as summarized in the following types of PE-related taxation:

- **Formal fixed base.** This applies when there is a formal branch, office, or other fixed place of business through which the foreign entity carries on its activity in Brazil (see Permanent Establishment as a Fixed Place of Business).
- **Informal fixed base.** This applies when a business is materially carried out on and from Brazilian territory without the proper and formal incorporation.
- **Dependent agent.** Dependent agent PE or "Agency PE" issues under Brazilian corporate income tax rules arise in two scenarios:
    - activities of a foreign company being performed in Brazilian territory through commissionaires or attorneys in fact; or
    - direct sales through agents (see Dependent Agent as Permanent Establishment).

 

## Permanent Establishment under Double Tax Agreements

Nearly all DTAs entered by Brazil are based on the OECD model tax treaty. The OECD commentary to Article 5 of the OECD model tax treaty is generally considered an important aid to interpreting a DTA to establish whether a PE exists in Brazil.

Under Article 5 of the OECD model tax treaty, a company has a PE in a jurisdiction if either:

- It has a fixed place of business in that jurisdiction through which its business is wholly or partly carried on (see Permanent Establishment as Fixed Place of Business).
- A person acting for the company has and habitually exercises in that territory authority to conclude contracts in the company's name (the dependent agent). See Dependent Agent as Permanent Establishment.

For more information on how a double tax treaty based on the OECD model applies generally in a jurisdiction, see Practice Note, Companies: UK residence and permanent establishments: Permanent establishments and double tax treaties.

## Permanent Establishment as Fixed Place of Business

Under the OECD model tax treaty, a fixed place of business through which the business of a foreign company is wholly or partially carried out can be any of the following:

- A place of management.
- A branch.
- An office.
- A factory.
- A workshop.
- A mine, an oil or gas well, a quarry or any other place of extraction of natural resources.
- A building site or construction or installation project that lasts more than 12 months.

(Article 5.1, OECD model tax treaty.)

For the last situation mentioned above, DTAs entered by Brazil differ from the OECD model, with most of them stipulating a period limitation of six months or, in fewer cases, nine months for construction or installation projects.

Under the commentary to the OECD model tax treaty, "fixed" means that there must be both:

 

- A link between the place of business and a specific geographical point.
- A certain degree of permanency.

This requirement excludes any temporary place of business.

Activities that are purely preparatory or ancillary to the main business carried out by a non-resident company will not be considered to be carried out at a PE even where they are carried out through a fixed place of business (Article 5.3, OECD model tax treaty). This includes:

- Storing, displaying, or delivering the company's goods or merchandise.
- Maintaining the company's goods or merchandise for the purpose of:
  - storage, display, or delivery; or
  - processing by another person.
- Purchasing goods or merchandise for the company.
- Collecting information for the company.

(Article 5(4), OECD model tax treaty.)

## Dependent Agent as Permanent Establishment

A dependent agent is a person acting for the company which habitually exercises in that territory authority to conclude contracts in the company's name.

The OECD commentary states that this includes contracts that bind the company even if they are not literally in the company's name. The commentary also specifies that this should be taken to refer to contracts that relate to the company's business proper (as opposed, for example, to contracts concerning only the company's internal operations).

However, the activities of an agent do not give rise to a PE if the agent is of independent status and is acting in the ordinary course of his business (Article 5(6), OECD model tax treaty).

## How to Allocate Profits to a Permanent Establishment in Brazil

Generally, Brazil follows the authorized OECD approach for the attribution of profits to a PE, as described in OECD 2010 Report on the Attribution of Profits to Permanent Establishments dated (22 July 2010) (PE Report).

 

The authorized OECD approach, as contained in the PE Report, sets out a functionally separate entity approach, which entails that profits are attributed to a PE as if it were an independent enterprise.

### Taxation of Non-Resident Companies with Permanent Establishment in Brazil

Non-resident companies that obtain income through a PE in Brazil must pay taxes in the country on the worldwide income attributable to the Brazilian PE.

The taxable base of a Brazilian PE for non-resident income tax purposes is determined by the provisions on corporate income tax, subject to the following:

- The transfer-pricing regulations. The Brazilian position on transfer pricing rules is not in line with the OECD Transfer Pricing Guidelines until the end of 2023. However, new legislation in line with these guidelines will enter into force in 2024. The recently edited Law No. 14,596/2023 is based on the arm's length principle, meaning that the calculation of CIT on transactions between related companies should be based on values that would be used in similar transactions involving independent companies.

- Payments that the PE makes to the non-resident parent company for royalties, interest, commissions, consideration for technical assistance services and for the use or assignment of assets or rights can be deductible if some specific requirements are met, which can vary depending on the type of operation.

The tax rate applicable to Brazilian PEs is generally equal to 34%.

Importantly, there are few cases of recognition of PEs in Brazil, which is reflected by limited administrative and judicial precedent on the subject. Brazilian tax legislation and the Federal Revenue Service (*Receita Federal do Brasil* (RFB)) tend to opt for source taxation, which is much more convenient and easier than determining whether a PE exists. The consequence is an increased taxation of operations, which are subject to income tax on revenue rather than profit.

However, this scenario may be subject to change given Brazil's submission to become a full member of the OECD, as the application requires the alignment of Brazilian practices with those established by the organization.

## Non-Resident Companies Without Permanent Establishment in Brazil

Income sourced in Brazil is generally taxable there unless a DTA or a domestic exclusion or exemption prevents taxation.

Subject to the existence of a DTA or domestic provision preventing taxation, under Brazilian law some types of income are subject to taxation in Brazil when obtained by non-residents without a PE in the country. Some of the most significant items of income for companies that carry out economic activities in Brazil without a PE include:

- Income directly or indirectly derived from real estate assets located in Brazilian territory or from rights relating to those assets.

- Capital gains deriving from:

 

    - securities issued by legal persons resident in Brazil; and
    - the alienation of non-current assets located in Brazil.

- Remuneration for services in general.
- Remuneration for technical services, technical and administrative assistance, and royalties.

Article 17 of the RFB's Normative Instruction No. 1,455/2014 defines "technical service" as the execution of a service requiring specialized technical knowledge or that involves administrative assistance or consulting, performed by independent professionals or with an employment relationship, or even resulting from automated structures with explicit technological content.

The same normative instruction defines "technical assistance" as the permanent advice provided by the licensor of a process or secret formula to the licensee through:

- Technicians.
- Drawings.
- Studies.
- Instructions sent to the country.
- Other similar services which enable the effective use of the process or formula granted.

"Royalties" include:

- Any income arising from the use, enjoyment, or exploitation of rights, such as the right to harvest or extract vegetable resources, including forests.
- The right to research and extract mineral resources.
- The use or exploitation of inventions, manufacturing processes and formulas, and trademarks.
- The exploitation of copyright, except when received by the author or creator of the good or work.

"Services in general" are all services not included in the categories above.

Dividends received by shareholders (resident or not in Brazil) are exempt from CIT. This scenario may change, however, as the Brazilian government is planning an income tax reform that ends this exemption.

Taxes to non-resident companies are normally levied as a withholding tax. Where withholding tax is imposed, the payor is required to account for the tax and file a withholding agent tax return.

 

## Tax Residency: Flowchart