



BEPS Action 2 Tax Challenges of the Digital Economy

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Key Features of the Digital Economy

- Impossibility of Ring-Fencing
- Continuous state of evolution (*e.g.* virtual currencies, advanced robotics and 3D printing, sharing economy, etc.)
- Mobility of intangibles, users, and business functions
- Centralization of functions at regional or global level
- Information as input

Some BEPS Risks

- Importance and mobility of intangibles (close relation with Action 8: Transfer Pricing)
- Ability to conduct substantial sales of goods and services into a market from a remote location (close relation with Action 7: PE Status)
- Possibility of allocating intangibles that generate income in the digital economy in a CFC in a low-tax jurisdiction (close relation with Action 3: CFCs)
- Impacts on indirect taxation

Tax Policy Challenges

- Review of allocation rules
- Taxation of businesses that do not require significant physical presence
- Characterization of payments (*e.g.* 3D printing)

Brazil: Major BEPS Issues

- Fictitious prices in import and export operations of goods, services and rights between related companies (transfer pricing)
- Corporate arrangements
- Artificial indebtedness between companies of the same group to generate undue costs on Brazilian companies in the mutual operations
- Fictitious transactions with residents in tax havens or under privileged tax regimes, and non-transparent jurisdictions
- Artificial transfer of tax residence to avoid the Brazilian tax

See: <http://www.un.org/esa/ffd/wp-content/uploads/2014/10/ta-BEPS-CommentsBrazil.pdf>

Brazil: Most Relevant BEPS Actions

- Action 4 – Limit base erosion via interest deductions and other financial payments
- Action 8 – Assure that transfer pricing outcomes are in line with value creation: intangibles
- Action 9 – Assure that transfer pricing outcomes are in line with value creation: risks and capital
- Action 10 – Assure that transfer pricing outcomes are in line with value creation with reference to other high risk transactions
- Action 12 – Require taxpayers to disclose their aggressive tax planning arrangements
- Action 13 – Re-examine transfer pricing documentation

See: <http://www.un.org/esa/ffd/wp-content/uploads/2014/10/ta-BEPS-CommentsBrazil.pdf>

Brazil: Challenges of the Digital Economy

Crisis of Indirect Taxation

- Brazil's Federal Constitution of 1988: the most detailed tax Constitution in world?
- Delegation of taxing powers based on economic factors of the industrial age (*e.g.* industrialized products, real state ownership, sales of goods, services etc.)
- Royalty payments itself are not the taxable event of any of Brazil's indirect taxes – IPI, ICMS, and ISS
- Alternatives: (i) constitutional reform, or (ii) interpretative solution (long-term tax litigation)

Brazil: Challenges of the Digital Economy

Crisis of Indirect Taxation

- Case: Download of software and Mato Grosso's ICMS Law
 - Mato Grosso State's Law No. 7098/98 established that the download of software is taxed by the ICMS
 - This law was challenged before the Supreme Court, under the argument that the download of a software does not configure transfer of ownership
 - The prevailing opinion in ADI MC No. 1945 was that the download of a software is equivalent to the sale of a software in a CD-ROM

Brazil: Challenges of the Digital Economy

Crisis of Customs Taxation

- Customs taxes focus on the physical entry of the good or service in the country's territory
- Download of intangibles such as software, movies, and songs is eroding the tax basis of customs taxes

Brazil: Challenges of the Digital Economy

Direct Taxation

- Brazil's domestic tax regulations have several mechanisms to avoid BEPS
 - Tax withholding on royalty payments at 15% or 25% (when payments are made to low-tax jurisdictions). Such payments are also subject to CIDE-Technology at a 10% rate
 - Non-deductibility of payments to low-tax jurisdictions and preferential tax regimes unless some conditions are met
 - Application of transfer pricing rules to any transaction with an entity located in a low-tax jurisdiction or a preferential tax regime
 - Broad CFC regulations

Brazil: Challenges of the Digital Economy

Direct Taxation

- Tax authorities' controversial interpretations are also restrictive of BEPS
 - Contract fragmentation and the characterization of royalties as services
 - The recent interpretation regarding the taxation of data centers
 - Centralization of costs via cost-sharing agreements and its recent characterization as service provision

Brazil: Challenges of the Digital Economy

Direct Taxation

- Taxation of the digital economy is one of the targets of the Ministry of Treasury
- Permanent establishment: how to update a concept that has never been used in Brazil?

**Thank you for your kind
attention.**

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