

Tax News and Horizon Scanning Podcast Series on Tax Disputes

Episode 1: Tax Disputes in Brazil

<p>Zoe Andrews</p>	<p>Hello and welcome to our tax dispute series. I'm Zoe Andrews, co-host of Slaughter and May's regular tax news podcast.</p> <p>Across the world tax risk is on the rise. What should you be concerned about? And how can you prepare? In this podcast series, we will take you on a journey to G20 countries across 6 continents to answer these questions. I'm excited to begin our journey with Brazil. This podcast will be relevant to you if you're involved in a tax dispute with Brazil, or you're trying to avoid getting into a tax dispute in Brazil, or even if you currently have no business concerns in Brazil but take an interest in the global tax disputes landscape and you never know, your next investment may be in Brazil!</p> <p>I'm delighted to be joined by my colleague Tax Partner, Dominic Robertson and Ricardo Bolan, a Tax Partner at Lefosse who is joining us online from Brazil.</p> <p>Thanks for joining us today, Ricardo, please tell us a bit about yourself and your tax disputes practice.</p>
<p>Ricardo Bolan</p>	<p>First of all, thank you very much for the kind invitation to participate in this podcast. I am Ricardo Bolan. I am a Tax Partner of Lefosse. Lefosse is a full-service law firm here in Brazil. And I'm proud to say that we – not that we see ourselves - but I think the market in general sees ourselves as one of the four magic circle, so to speak, Brazilian firms.</p>
<p>Zoe Andrews</p>	<p>And Dominic, would you like to tell us about yourself and your experience?</p>
<p>Dominic Robertson</p>	<p>Yes, I'm Dominic Robertson, Tax Partner at Slaughter and May. I've been here for coming up to 20 years now. I do a very broad range of tax work, a lot of tax enquiries and disputes work, which we're focusing on today. And also a lot of transactional work at the same time.</p> <p>I'm currently, in fact, doing a deal in Brazil working with Ricardo, which is a great opportunity for our firms to work together. And I think that helps illustrate, Ricardo, you know Brazil is a country that's a real economic superpower at this point. It's grown rapidly over the last twenty to thirty years. There are lots of investment opportunities for other businesses in Brazil. And at the moment, Brazil is currently the President of the G20. That's clearly a great moment for Brazil to bring some initiatives of its own into the international arena. Could you talk a bit about what Brazil's doing with its Presidency of the G20?</p>
<p>Ricardo Bolan</p>	<p>Sure. This is actually a great opportunity for Brazil. Of course, you have all the financial and economic community here besides all governments of the G20 countries. So, it's an opportunity for Brazil, in terms of investments in the country,</p>

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	<p>to show the areas where the country is seen as a leader. So, when we talk about your renewables, green energy; this is certainly something that Brazil can take a lot of advantage of by having all those leaders here. There are some immediate gains I think, in terms of the infrastructure that is needed for the event because, this year, the event is actually occurring in many Brazilian cities. I think in terms of the agenda that Brazil and the current government wants to put forward relating to development with social inclusion, development with sustainability. I think this is a great opportunity to bring those themes to be discussed with this broader audience and having Brazil as a leader of those discussions.</p>
<p>Zoe Andrews</p>	<p>It certainly sounds like an exciting time to be in Brazil. I've heard that Brazil is a highly taxed, litigious environment and that it can take a long time to resolve disputes. Is that correct?</p>
<p>Ricardo Bolan</p>	<p>Yes. It is good maybe to divide the conversation into the history of the Brazilian tax litigation environment and what has been happening in the last few years because I think some developments, quite important developments in terms of trying to somehow shift the culture, are happening.</p> <p>But from a historical perspective, Brazil has always been seen as a very highly litigious tax environment. And that's due to a number of factors. Until four years ago, there were no tax settlements here in Brazil, so the law would not authorise tax settlements. Besides that, rules here are so that whenever a tax auditor audits a company and there is something with which he or she does not agree, so if the company takes a position, in relation to interpretation of the law, there is something with which that tax auditor does not agree, he is by law obliged to file a tax assessment. There are no open channels for discussion with tax authorities before a tax assessment notice has been actually issued against the taxpayer.</p> <p>So this, of course, leads to lots of tax assessments being issued. And because there were no tax settlement programmes, the tendency is that those would all go to court.</p> <p>First you have administrative courts and then, if the taxpayer loses the case at the administrative court, again, it can go also to the judicial courts to discuss the matter. And, public attorneys, they were also obliged by law to litigate the case until the very last instance, meaning they were obliged by law to always file appeals up until the very last high court that will have a say on the matter.</p> <p>So this all of course led to an environment where it is very, very rare to see companies that will not have, I would say, more than two handfuls of tax litigation cases, which might be something that is not that normal in other jurisdictions, but here in Brazil it is almost impossible to see a company with, let's say medium size, that has no tax litigation cases, and that has to do with this environment that I just described.</p> <p>To a certain extent we still have, but I think it's getting better, an environment where the tax authorities would always assume that the taxpayers would be trying to</p>

	<p>evade taxes. So, the relationship, historically speaking, was never that good, which led to the creation of strict rules that would not allow a space for open dialogues between the tax administration and taxpayers. That has to do, of course, with the history but lately, some developments have been made and I think there is a serious commitment by the government and by the authorities to try to change this culture. And I can talk a little bit of some initiatives that have been taken lately that go in this direction of opening those dialogue channels.</p> <p>I think the first one is that a new tax settlement law was issued. So, nowadays there is a possibility of applying for settlements on tax disputes with tax authorities. There are restrictions in the law, many restrictions. What I mean by that is, the law foresees lots of limits in relation to discounts that can be given by tax authorities, the kinds of taxpayers that can receive those discounts, etc., etc, but it is already a very good step in the direction of creating this culture, you know, creating those open dialogue channels.</p>
<p>Zoe Andrews</p>	<p>Would you say that these new settlement rules are working well in practice?</p>
<p>Ricardo Bolan</p>	<p>I would say that there are basically two kinds of tax settlements that can be made according to the law. One is a tax settlement that is made by taxpayers directly with the tax authorities themselves and those would have to do with tax credits. They are being litigated only at administrative level still. And there is also the kind of tax settlement that can be made with public attorneys and that's just for tax credits that are already being litigated at judicial level.</p> <p>So, for instance, last year, 2023, here in the state of Sao Paulo, there were 54 tax settlement cases for federal taxes here in the state of Sao Paulo. It's still not a lot given this huge universe that I was talking about in terms of number of cases, but I think it's a start, definitely.</p> <p>For the settlements with the tax authorities directly, I think those are still in more early stages. There is this, let's say, a typical tax settlement where an individual taxpayer can propose to the tax authority in relation to the company's specific tax case to be discussed or the tax administration, you know, could actually propose to the taxpayer this discussion in individual case, but there is also what we call tax settlements by accession and those are created by law. So specific laws are issued saying that, for taxpayers that would have a specific kind of tax discussion and, let's say, up to certain value, we are offering you those discounts, those are the conditions, etc. And then the taxpayers will decide whether they want to adhere or not to this tax settlement or tax amnesty.</p> <p>For those kinds of tax settlements by means of accession, many programmes have been issued lately and those have been somehow a success in terms of resolving cases relating to certain specific matters.</p>

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<p>Dominic Robertson</p>	<p>Can I ask a question on this, Ricardo? Do these settlements all work by basically saying to taxpayers: you can resolve this case if you pay, say, 70% or 80% of the disputed tax? Or is there something more to it where actually you try and resolve things on a technical basis?</p>
<p>Ricardo Bolan</p>	<p>That's an excellent question, Dominic. So I think that, differently from other countries, and that's I think one of the elements that I meant that I have taken in consideration when I said that the rules are quite strict, is that the tax authorities or the public attorneys, they would always offer only discounts, so this is the amount of discounts you would have on penalties and interest etc, but the merits of the cases, they are never discussed on those tax settlements, whether those are individual tax settlements or tax settlements, as I call them, by accession.</p>
<p>Dominic Robertson</p>	<p>So, it always involves accepting that the tax itself is due and then the settlement is: we'll give you a reduced level of penalty or interest.</p>
<p>Zoe Andrews</p>	<p>How does that compare with the UK, Dominic? How does that compare with the way that the UK does settlements?</p>
<p>Dominic Robertson</p>	<p>It's very different to the UK settlement process. In the UK, we've got a published Litigation and Settlement Strategy from HMRC which, in broad terms, says: you can't do deals with the tax authority where you agree there's a dispute over a binary issue, we can't resolve that, let's split the difference and save ourselves the trip to court. So HMRC are very clear that they will only settle cases on a basis which is a possible technical outcome if this was litigated.</p> <p>So, if you have a binary case, actually you have to settle at one end or the other, either the tax is due or it isn't, and a big part of a lot of tax settlement work is actually trying to find a way to make a binary case into a case where there are a range of different outcomes. Say, can you treat this as a transfer pricing case? Do you have to pay the interest if the tax is due? There was one case about 14 years ago where HMRC accepted that a large bank didn't have to pay interest and that cost the head of HMRC his job when that became public.</p> <p>In relation to penalties, there is scope for HMRC to set them at a discretionary level, but there's a lot of guidance and policy again around treating taxpayers consistently, particularly to deal with the public concern that there's a perception amongst some of the public that businesses were getting a better deal than individuals. I'm not sure that was actually ever right, but that perception had to be dealt with politically.</p>
<p>Ricardo Bolan</p>	<p>Interesting. Yeah, that's radically different from what's going on in Brazil. So, for instance here in Brazil, there are no technical discussions involved on the merits of the case. There is somehow an assumption that the taxes would be due or many times the taxpayer would have to admit, expressly admit, you know, that the taxes are due, etc. And then the size of discounts, they have usually to do only with the</p>

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	financial capacity of that taxpayer. So, the worse the financial capacity of the taxpayer is, the higher the size of the discounts that can be granted.
Dominic Robertson	The appeal for businesses in accepting the settlements is it saves them the time and cost of litigating dozens of tax cases. How long does the litigation normally last?
Ricardo Bolan	<p>There have been improvements. In Brazil, it still takes quite long but nowadays, for a case in an administrative court, it would take approximately 4 years for that to be resolved. If taxpayer wins the case at the administrative court level, this is the end of it. The tax authorities can never file an appeal against a final decision by the administrative court. So, a case could take “only” four years to be resolved at administrative court level. If the case has to go to judicial level, for instance, because the taxpayer lost the discussion at the administrative level, then on average it can take another seven years for the case to be resolved. I’d say that this is an improvement in relation to what we had because some years ago we would say, maybe, between 7 and 8 years at administrative level plus 11 or 12 years at judicial level, which is, I know, ridiculously long for a case to be resolved.</p> <p>And more than that, I think it's also important to mention, a system has been created for some precedents to be binding with an <i>erga omnes</i> effect, meaning effect for all taxpayers. So, for certain matters, when you have a Supreme Court decision on that specific matter, there can be practical cases where an individual tax litigation case will take, a very short period of time. I know it may sound obvious that this happens, but until a few years ago we did not have this binding precedent system in Brazil. So this is also a good development that we had in the country.</p>
Dominic Robertson	That's a major improvement for, actually both tax authority and taxpayers that, once you've got a lead case deciding a point, everyone has relative certainty at that point that the issue will be resolved and resolved quite quickly.
Ricardo Bolan	Exactly.
Zoe Andrews	The UK has a precedent system too, doesn't it, Dominic?
Dominic Robertson	We do. So, we have any decisions of our Upper Tribunal or above creates a binding precedent. So that makes it very easy in principle to resolve those cases. The reason I say “in principle” is: we currently have one of our most important Supreme Court tax cases in the last 10 years, a case called <i>Anson</i> . HMRC have recently put out a press release saying that they disagree with it, and they think it's wrong, they're not going to abide by it, which is, in my view, extraordinary. But that's probably a topic for another podcast.
Ricardo Bolan	Interesting. Really interesting.

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<p>Zoe Andrews</p>	<p>Shall we move on to the subject of cross-border tax disputes? One of the ways taxpayers are protected from double taxation is through double tax treaties which provide for the allocation of taxing rights between the treaty partners. But inevitably there are sometimes disagreements on how the tax treaty should be applied and the mutual agreement procedure (or MAP) enables the interaction of competent authorities of tax treaty partners in order to resolve international tax disputes. But Brazil doesn't have a good track record of engaging with MAP, does it, Ricardo?</p>
<p>Ricardo Bolan</p>	<p>Unfortunately, it doesn't. We hope that this gets better, and I think the expectation is that it gets better as Brazil is applying to become a permanent member of OECD. But history is not that good. So we have only one concrete case of a MAP which was one between Brazil and the Netherlands to discuss how an instrument that we have in Brazil called interest on net equity should be treated according to the double tax treaty between Brazil and the Netherlands. Interest on net equity is one of the potential ways that Brazilian companies can remunerate their shareholders. So, it's a kind of hybrid instrument between dividends and interest. So, of course, the discussion was as to what extent the Netherlands, according to the Netherlands internal legislation, but also according to the treaty, whether this interest on net equity should be treated as interest or as dividends, so this has been resolved by means of MAP.</p>
<p>Dominic Robertson</p>	<p>What was the answer?</p>
<p>Ricardo Bolan</p>	<p>The answer is that it should be treated as interest which is not really the very best answer in terms in in terms of tax savings for investors from the Netherlands.</p> <p>I'll go back a little bit in time here. The history is not so good in Brazil. If you take exactly 20 years ago, so in 2004, Germany denounced its double tax treaty with Brazil exactly because countries could not reach an agreement on the interpretation of Article 7 of the double tax treaty and Brazilian tax authorities, they had this interpretation (and to a certain extent, they still have) that, whenever services in general are provided by a resident of the other country, so let's say Germany in that instance, to a Brazilian contractor, that the treaty would allow Brazil to withhold taxes on payments of income for those services even if there is no permanent establishment of the German company in Brazil. And they took a view that, for services or technical services, this should be included under the provision of "other income" of the double tax treaty which would basically allow both countries to tax this income. And so, the result of that conversation was, Brazil was clearly taking a position that is in disaccord and disalignment with all other OECD countries.</p>
<p>Dominic Robertson</p>	<p>And it's actually a point of massive contention, not just with Brazil, but very generally between traditional OECD members, say Europe, US, Japan and other countries. And in fact, the UN Tax Committee has recommended a new article for the treaty, which actually does exactly what you've just outlined was Brazil's position and which says, well, if you are providing services from say, Germany or</p>

	<p>the UK to, say, Brazil, we would treat that provision of services as having a source in Brazil as paying country and giving Brazil a right to tax.</p> <p>But I think, my perception as an outsider in terms of Brazil's engagement with tax treaties is that Brazil is now actually much more willing to engage and compromise in the interests of resolving treaties. And the example I always use is, I mean, the UK has a very good tax treaty network generally and, until recently, we had treaties with all but two of the world's fifty largest economies. Those two exceptions were Iran, which I suspect has its own reasons for not signing a treaty with us, and Brazil, which was the big hold-out and HMRC were very often asked: can you please agree a treaty with Brazil? It's a country that British businesses do a lot of trade with, they want to do more with Brazil, there's lots of opportunity. And the answer from HMRC historically was: well, there's no point because the Brazilian government's attitude to that was we want a treaty which preserves 100% primary taxing rights for Brazil. So we're not getting anything by signing up to that treaty. We have now got a treaty in place with Brazil which I think indicates to me that actually both countries have been able now to reach a compromise where actually we have been able to look at different taxing rights and say, well, let's actually agree how to split these.</p>
<p>Ricardo Bolan</p>	<p>Yeah, the solution there, as you probably know, Dominic, is that Brazil has been including, on its double tax treaties, a provision to expressly state that, at least for technical services, at the source country can tax income related to technical services up to a rate of 15%, usually that's what's included in the treaties. And then the issue comes to the definition of technical services.</p>
<p>Dominic Robertson</p>	<p>I have a couple of cases at the minute, actually with India rather than Brazil, where exactly that point is in dispute - are the services technical services? - and that's one of the drivers behind the UN recommendation to bring in this new broader article which just says "services" to remove that particular dispute.</p> <p>Can we move off from treaties to transfer pricing, where I understand that in Brazil, there's been a huge reform in transfer pricing to move towards an arm's length model rather than a formulary model is that right? And if it's right, could you tell us a bit more about that?</p>
<p>Ricardo Bolan</p>	<p>Yes. So, this was a huge change in Brazil: it's two years now that we have those new rules being fully applicable. Until two years ago, there were all sorts of issues when applying Brazilian transfer pricing rules, meaning many times double taxation of the same income basically because Brazil had a very formulary system. So, you had mathematical formulas that would really deviate many times from what would be the arm's length price. So, two years ago, we have rules; they are valid and they are very much aligned with the OECD guidelines and transfer pricing. So now it's really an arm's length base transfer pricing system that we have in Brazil.</p> <p>Companies are still learning here in Brazil how to manage this new system of course, but the advantage is that for international companies, many are not Brazilian multinationals but rather multinationals investing in Brazil. This is far</p>

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	<p>easier because they have all the experience by dealing with those arm's length-based transfer pricing rules for quite some time.</p> <p>And this is very good for the investment environment in Brazil in general, right, because now we can, I think, much more successfully avoid those very odd situations where the taxpayer would end up, in practice, paying taxes on both countries on the same income.</p>
Dominic Robertson	<p>And how's the Brazilian tax authority dealt with that? I know it's very early days for implementation but it must be quite a challenge for them to actually move to a world where they are applying rules which are very novel for the tax authority, but where actually a lot of the inbound, or all of the inbound, multinationals doing business in Brazil will themselves have a lot of familiarity and experience in working with the arm's length principle. Has that worried the tax authority?</p>
Ricardo Bolan	<p>I would say that they really did a good job preparing themselves for the new rules. There was some time between when the new rules became actually valid and applicable and when they were created. So, the tax authorities had some time really to prepare themselves, to instruct themselves. Of course, practice is a different thing, meaning that they still have to learn, I think, with practice. We all do somehow even for companies with inbound investments in Brazil. But I don't see, to be honest, Dominic, Brazilian tax authorities very concerned that they are not well prepared, let's say, to deal with those new rules and I think that's good news.</p>
Dominic Robertson	<p>Can I move on from one massive tax reform in Brazil to another and get a bit of detail from you about the indirect tax reforms which are coming in? I chaired a panel in the UK in January about what heads of tax in British multinationals were worrying about for the year ahead, and item 2 on the agenda was indirect tax reform in Brazil which I think gives you an indication, one of quite how important Brazil is as a market for British multinationals now, but also quite how significant and wide-ranging these reforms are. So really good, I think, to get your five-minute summary on what's happening.</p>
Ricardo Bolan	<p>Yes, well that's a big theme as you already know.</p>
Dominic Robertson	<p>Five minutes is tough.</p>
Ricardo Bolan	<p>Yes. So, this was actually a constitutional tax reform that we had in Brazil and this was something that business community would expect in Brazil for at least, I would say, 20, maybe 30 years. So, there was a huge, huge achievement to have this this tax reform to be passed in Congress because a constitutional amendment was necessary to, you know, to implement this indirect tax reform.</p> <p>Just to indicate how relevant this is in terms of a development because, politically, it has always been very, very difficult because, here in Brazil, we always had a system where VAT is a state tax. Not really a VAT, but a VAT-like tax is a state tax</p>

	<p>at the municipal level. We also had taxes on services which are also indirect taxes and, also the federal level, we had also a VAT-like tax at the federal level which created an extremely, extremely complex system.</p> <p>And VAT, let's say the state VAT, is charged (as a general rule) on the state of origin of the merchandise which created what we used to call a fiscal war among states which meant that states would grant VAT benefits to companies so that the companies would install themselves in their territory. And this led to all kinds of inefficiencies from an economic perspective because companies would have structures in Brazil that, from a logistics perspective, would make no sense whatsoever but just so that they can make use of those benefits that were granted by states.</p> <p>To summarise the indirect tax reform is about simplification. So, all those taxes that I was mentioning, they are to become in essence only two. So, we will have a federal VAT tax, which is really VAT meaning full credits for all acquisitions. You know, there were lots of discussions also here on what kinds of purchases or expenses or costs would or not grant credits. So, in the new system, you know, it would really be a VAT tax (or federal VAT) and a state VAT. And for the state VAT, taxation or the taxes would always be paid to the state of destination of a certain good also to end what we call this tax war. Many, many details still to be discussed. There are certain special regimes for specific sectors.</p> <p>Although, of course, it creates some worry for taxpayers to really understand the new rules, the new system will completely change. But I think the messages is that this is very, very positive. There is a transition period that will be quite long. But once the system is fully in place, this will definitely represent a huge simplification of the existing system.</p>
<p>Dominic Robertson</p>	<p>So effectively, it's shifting a lot of the taxing power here from state to federal level, removing some of these internal barriers to trade and inefficiencies. India went through a similar exercise with national unification of their sales tax system a few years ago, and I think that must be right. But in the long term, it's a big benefit to business and the economy to say we've put in a much simpler nationwide system of sales taxes. The big challenge, which will now be a challenge for probably the next 7, 8, 10 years, is that transitional period where people are used to working with one regime and have to adapt to working with something new.</p>
<p>Ricardo Bolan</p>	<p>Yes, definitely. There is a lot that needs to be learned and that will only happen with experience and the transition period, as you say, Dominic, there might be, you know, some turbulence, but I think that's somehow expected on all those kinds of really substantial changes on a certain tax system.</p>
<p>Dominic Robertson</p>	<p>And are there many disputes in in this area? Are most of the disputes on corporate taxes?</p>

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<p>Ricardo Bolan</p>	<p>There are many disputes on those areas. The number of cases is incredibly high. It's even higher than for income taxes. Expectations are that, once the reform is fully implemented, it will drastically decrease the number of tax litigation cases for indirect taxes, of course. But then overall, it will represent a significant decrease in tax litigation.</p>
<p>Zoe Andrews</p>	<p>We're coming to the end of the podcast now, so I will do a quick recap of the key things to take away about tax disputes in Brazil.</p> <p>The first point I've noted is that although historically, Brazil has been very litigious and litigation has taken a long time to resolve, the tax disputes landscape is improving and the culture is becoming less litigious. The new settlement rules are a great benefit to taxpayers, enabling them to pay the tax but get a discount on penalties and interest and avoid the cost and the time of litigating. Litigation is now quicker to resolve, particularly where there is a Supreme Court decision that sets a precedent to be followed.</p> <p>The changes required in order for Brazil to become an OECD member will benefit taxpayers and investors in Brazil by improving tax certainty and dispute resolution. For example, with Brazil participating more fully in MAP and as the new transfer pricing rules are bedding down.</p> <p>And finally, the significant indirect tax changes that Ricardo just explained to us so concisely that are coming in over a number of years will, once business gets used to them, be an improvement, but inevitably there will be a period of uncertainty during the transition, which may result in more disputes in the short term, but certainly in the long term, it should save a lot of disputes getting to court.</p> <p>I've really enjoyed our discussion in Brazil. Thanks to Ricardo and Dominic for joining me today to share their expertise and experience.</p>
<p>Dominic Robertson</p>	<p>Yes, thank you, Ricardo, that was an absolute <i>tour de force</i> and I think illustrates Brazil is one of the most, I think, exciting and interesting tax economies at the moment because there's so much happening. And really valuable to get your insights into all the different changes and what companies can look forward to in the years ahead.</p>
<p>Ricardo Bolan</p>	<p>Thank you very much. It was really a pleasure to have this conversation here. Really interesting to share experiences with you guys.</p>
<p>Zoe Andrews</p>	<p>And that leaves me to thank you for listening. And you will actually hear from Dominic again in the next episode, which is going to take us to the US. Our Tax PSL Counsel, Tanja Velling and Dominic will be speaking to Clark Armitage of Caplin & Drysdale.</p> <p>If you subscribe to Slaughter and May's Tax News podcast or our Horizon Scanning Show, you'll be notified when the new episode is released.</p>

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