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The Superior Court of Justice resumes the trial of the taxation on profit of subsidiary located abroad

On March 25, 2014, the First Panel of the Superior Court of Justice (STJ) resumed the trial of Special Appeal no. 1.325.709/RJ, which deals with the taxation on subsidiaries located in countries with which Brazil has treaties to avoid double taxation.

In the case in question, Vale S.A. directly controlled companies domiciled in Belgium, Denmark, Luxembourg, and Bermuda, Brazil having entered into international treaties with Belgium, Denmark, and Luxembourg to avoid double taxation.

At the beginning of the trial, on Nov. 26, 2013, Justice Napoleão Nunes Maia Filho (Rapporteur) viewed that profits earned in countries in which subsidiaries controlled by a Brazilian parent company are located must be taxed only in the respective countries of the subsidiaries, provided that there is an international treaty for the avoidance of double taxation. This position was concluded from the observance of the provisions in executed international treaties and, consequently, to the detriment of the Brazilian internal legislation, pursuant to article 98 of the National Tax Code (CTN).

At that time, Justice Sérgio Kukina developed a divergence in relation to the position of the Rapporteur, since he viewed that this is possible in Brazil and in the country where the subsidiary is located. For such, he interpreted that article 7, item 1, of the treaties based on the OECD (Organisation for Economic Cooperation and Development) model conforms to the Brazilian internal legislation, a situation that caused Justice Ari Pargendler to request the case for analysis of the matter.

On March 25, 2014, Justice Ari Pargendler cast his vote partially conforming to the Rapporteur's position, when concluding that the existence of international treaties between Brazil and countries in which some of the subsidiaries are located (Belgium, Denmark, and Luxembourg) prevents the double taxation, thus the Brazilian legislation cannot prevail. He affirmed that the double taxation is prohibited by article 7, item 1, of the international treaties entered into pursuant to the OECD model, and that this model is compatible with the anti-tax avoidance measures created by the CFC (Controlled Foreign Corporations) legislation, which seeks to prevent unfair tax competition and the erosion of the taxable basis by the countries.

In this regard, he also affirmed that the presupposition of this model are the contracting states that have similar tax systems to those of Brazil concerning the taxation of income, as in Belgium, Denmark, and Luxembourg, as verified by the treasury authority itself.

In relation to the subsidiary domiciled in Bermuda, since Brazil does not have an international treaty under the OECD model, Justice Pargendler affirmed that the domestic legislation is to be applied, but with reservations. According to him, article 7, heading, of Normative Rule (IN) no. 213/2012, of the Federal Revenue Office, by seeking to regulate article 74 of Provisional Measure (MP) no. 2158-35/2001, proved to be anachronic, as it was not aligned with the context of the period when using the expression "equity accounting method" (assessment of investments considering the proportional equity value) which, on the date IN no. 213/2012 was created, neither the commercial nor the tax legislation had been incorporated.

Therefore, in conclusion, he found that Vale S.A. is not subject, by force of international treaties, for

purposes of taxation in Brazil, to add to its own profits that ones earned by subsidiaries located in Belgium, Denmark, and Luxembourg. However, the profits earned in Bermuda are considered to be available to Vale S.A. on the date of the balance sheet in which they were computed (subject to taxation in Brazil, despite not being distributed), but the result of the contra-entry of the adjustment of the investment value by the equity method are not part of them, due to the illegality of article 7, heading, §1 of IN no. 213/2012.

Therefore, Justice Ari Pargendler praised the position made by the Federal Supreme Court (STF) in the Direct Action for the Declaration of Unconstitutionality (ADI) no. 2.588, which interpreted it according to the Federal Constitution of 1988 to article 74 of MP no. 2.158-35/2001, meaning this provision is not applicable to companies located in countries with which Brazil has international treaties according to the OECD model, and provided that such countries are not considered tax havens by the Brazilian legislation.

Due to the points made as to the subsidiary in Bermuda, Justice Rapporteur requested to analyze the matter relating to taxation in countries with which Brazil does not have international treaties to avoid double taxation in more depth, Justice Arnaldo Esteves Lima still having to vote in order for a position to be settled in the First Panel of the STJ on the taxation of profits earned abroad by subsidiaries.

The topic is relevant within the current Brazilian economic development scene, as it directly reflects on the transactions for the internationalization of a number of companies based in Brazil, meaning that this matter, in the future, may still be dealt both by the Second Panel and by the First Section (note: body composed of justices from the 1st and 2nd Panels that settle the Court's position on tax matters) of the Court.

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