

Global Tax Alert

News from Americas Tax Center

Brazil places Dutch holding companies without “substantial economic activity” back on list of privileged tax regimes

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The Brazilian Revenue Authority has, in effect, put Dutch holding companies without “substantial economic activity” back on its list of privileged tax regimes via Declaratory Act No. 3/2015 of the Secretary of the Revenue, dated 18 December 2015. The Declaratory Act was published in the *Brazilian Gazette* on 21 December 2015, and takes effect as of the date of publication.

For tax purposes, Brazil has had lists of low-tax jurisdictions (LTJ) and privileged tax regimes (PTR) for many years. Placement on the PTR list triggers a series of potentially adverse tax consequences in Brazil, both from an inbound and an outbound perspective.

From a transfer pricing standpoint, the transactions performed with PTRs will be considered as controlled transactions, even though the parties are not related.

For inbound investments, different thin capitalization rules apply when a debt is taken up by a Brazilian company from a PTR entity (the maximum allowed debt-to-equity ratio is 0.3:1, rather than the general ratio of 2:1). Also, additional requirements must be satisfied for the deductibility of expenses (such as, identification of the “real beneficiary” of the entity, additional documentation to attest the cost of assets bought or services rendered by the PTR entity and proof of the operational capacity of the entity). Payments of interest to a PTR entity are generally not subject to a withholding rate that is higher than the general rate (interest paid to an LTJ entity typically is subject to a higher withholding rate).

From an outbound perspective, the presence of a PTR entity may affect the outcome of Brazil's tax on foreign profits. When a PTR entity acts as an intermediary holding company of a Brazil-based group, it as well as its direct and indirect subsidiaries will be unable to participate in a consolidation when the Brazilian parent calculates its foreign profits (so-called contamination effect).

In June 2010, the Brazilian Revenue Authority published an updated list of LTJs and PTRs. Initially, Dutch holding companies were placed on this list. Later that month, two

changes occurred. First, the list was changed so that it only captured Dutch holding companies without substantial economic activity. Second, the effects of the listing were "suspended" because the Dutch Government requested a review.

Declaratory Act No. 3/2015 states that the June 2010 suspension is lifted because the Dutch Government has failed to provide a justification for not listing such holding companies as PTR entities. Official guidance as to the meaning of "substantial economic activity" does not exist.

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