The Brazilian Superior Court of Justice decides that Double Tax Agreements shall prevail over internal rules of Income Tax.

The Second Chamber of the Superior Court of Justice (STJ) decided that international agreements against double taxation are special laws.

The decision dismissed the special appeal (Resp 1161467 – RS) brought by the National Treasury in face of a decision that had benefited COPESUL a petrochemical company and denied the incidence of withholding income tax at the rate of 25% in payments of services rendered to a national client by a foreign company not established in Brazil.

Decision's summary:

TAX. INTERNATIONAL CONVENTIONS AGAINST DOUBLE TAXATION. BRAZIL-GERMANY AND BRAZIL-CANADA. ARTS. VII AND XXI. INCOME RECEIVED BY FOREIGN COMPANIES REGARDING SERVICES RENDERED TO A BRAZILIAN COMPANY. CLAIM OF NATIONAL TREASURY OF WITHHOLDING INCOME TAX AT THE REMITANCE. CONCEPT OF "PROFIT OF FOREIGN COMPANY" IN ART. VII OF THE TWO CONVENTIONS. EQUIVALENCY TO "INCOME". PREVALENCE OF THE CONVENTION OVER THE ART. 7 OF LAW 9.779/99. PRINCIPLE OF SPECIALTY. ART. 98 OF THE TRIBUTARY CODE. CORRECT INTERPRETATION.

1. The author, now defendant, hired foreign companies to provide services to be performed abroad without transference of technology. In face of the prediction of the art. VII of the Conventions between Brazil-Germany and Brazil-Canada, that "the profits of an foreign company of a Contracting State shall be taxable only in that State unless the company carries on business in the other Contracting State through a permanent branch there located", the withholding Income tax was not collected.

2. Because of the nonpayment, the taxpayer was assessed by the Internal Revenue Service, who understood that the payment of services not covered by the concept of "profit of the foreign company," provided in Art. VII of the two Conventions, since the profit is determined only at the end of the financial year after the additions and deductions determined by the laws of regency. Thus, the income tax should be collected in Brazil - which required withholding tax by the customer of its services - since it would involve income not expressly mentioned in the two Conventions, pursuant to art. XXI: "the income of a resident of a Contracting State from the other Contracting State not dealt with in the foregoing Articles of this Convention may be taxed in that other State."

3. According to the arts. VII and XXI of the Convention against Double taxation agreements between Germany-Brazil, Brazil-Canada, the income not expressly mentioned in the Convention shall be taxable in the State where they originate. Have those expressly mentioned, among them the "profits of the foreign company," will be taxable in the country of destination, where resident who receives income.

4. The term "profits of the foreign company," contained in art. VII of the two Conventions, is not limited to "actual profit", otherwise the convention would become not applicable to any case, because any payment remitted abroad is - and always will be – subject to additions and subtractions throughout the financial year.

5. The taxation of the income only in the State of destination allows adjustments to the calculation of the effectively taxable income. If we allow early retention - and therefore final - as claimed by the Treasury, these adjustments will be unviable, away from the possibility of compensation, if the company has tax losses to the end of the financial year.

6. Therefore, "the foreign company's profits" should be interpreted not as "real profit" but as "income" provided in arts. 6, 11 and 12 of Decree-Law n. º 1.598/77 as "the result of activities, principal or accessory, which is the objective of the legal entity", which include, of course, the revenue for rendered services.

7. The supposed contradiction between the norm of the Convention and the domestic tax law is solved by the rule of specialty, although the internal rule is subsequent to the international.

8. The art. 98 of the CTN must be interpreted in light of the principle “lex specialis derrogat generalis”, no, exactly, revocation or repeal of the internal rule by the international, but only suspension of effects, only in situations involving the subjects and the elements described in the two conventions.

9. The internal rule loses its applicability in this specific case, but does not lose its existence or validity in relation to the internal regulatory system. There is a "functional withdrawal" in the phrase coined by Heleno Torres, which makes the internal rules inapplicable to those situations provided for international treaties, involving certain people, situations and specific legal relationships, but does not result in the revocation of the internal rules, strictly speaking, for other legal situations involving elements not related to the Contracting States.

10. In this case, art. VII of the Convention between Brazil-Germany and Brazil-Canada should prevail over the rule embodied in the art. 7 of Law 9.779/99, as the international agreements are special and apply solely to avoid double taxation between Brazil and the other two signatory countries. At all other legal relationships not embraced by the Conventions apply fully and without reservations, the internal rule, which determines the income tax to be held in Brazil.

11. Special appeal denied.

JUDGMENT

Seen, reported and discussed the case in which the parties are above, the Ministers of the Second Chamber of the Superior Court of Justice agree in "continuing in the trial, after the vote-view of the Minister Humberto Martins, accompanying the Minister Castro Meira, the Panel unanimously dismissed the appeal, pursuant to vote of the Minister- referendary. "Messrs. Ministers Humberto Martins (vote-view), Benjamin Herman, Mauro Campbell Marques and Cesar Asfor Rocha voted with selected. Brasilia, May 17, 2012 (Date of Judgment). Minister Castro Meira Selected.