



International Tax

## Brazil Tax Alert

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### Definition of “substantial economic activities” clarified for grey list

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Brazil’s tax authorities published a normative ruling (NR 1,658/16) on 14 September 2016, which clarifies the definition of the term “substantial economic activities” for purposes of determining whether a jurisdiction should be deemed to have a privileged tax regime and, therefore, be included on Brazil’s “grey list” of jurisdictions. A public consultation document on the definition of substantial economic activities had been issued on 30 May 2016. NR 1,658/16 also amends the list of black and grey jurisdictions for Brazilian tax purposes.

#### Definition of substantial economic activities

Based on a ruling that has applied since 2010, the Dutch and Danish regimes included on the grey list were specifically defined as those for holding companies that are “incorporated under local law but that do not engage in substantial economic activities.” No further guidance had been issued to define or explain what was meant by the term “substantial economic activities” until the May 2016 public consultation document was released.

According to NR 1,658/16, a foreign holding company will be deemed to carry out substantial economic activities if it has the operating capacity to appropriately meet its corporate purposes, as evidenced by certain factors, including having a sufficient number of its own qualified employees and adequate physical premises to enable the company to manage and effectively make decisions regarding the following:

- The carrying on of activities for the purpose of generating income from its own assets; or
- The administration of equity interests with a view to generating income from profit distributions and capital gains.

The revised language of NR 1,658/16 seems to have broadened the concept of substantial economic activities from the original version of the public consultation document, and it sets forth the conditions for meeting the concept in a more detailed manner.

The proposed language is in line with the recommendations under action 5 of the OECD BEPS project (“Countering Harmful Tax Practices More Effectively”) and the discussions of the Forum on Harmful Tax Practices. Although Brazil is not a member of the OECD, it participates as an “associate.”

NR 1,658/16 also makes the following changes to Brazil's black and grey-list jurisdictions:

- Three new jurisdictions are included on the black list of tax haven jurisdictions (Curacao, Ireland and St. Martin) and two jurisdictions are removed (Netherlands Antilles and St. Kitts & Nevis). (A blacklisted jurisdiction is a jurisdiction that does not tax income or that imposes tax at a rate lower than 17%, or does not allow access to information on a corporate structure or on the identity of the beneficial owner of income.) The black list now comprises 65 countries.
- Austrian entities incorporated as holding companies are included on the grey list.

## Comments

Inclusion on the black and grey lists triggers various negative tax consequences, such as immediate application of Brazil's transfer pricing rules and a reduced debt-to-equity ratio under the thin capitalization rules. In addition, the normal 15% withholding tax rate is increased to 25% where remittances are made to a tax haven jurisdiction.

The new rules apply retroactively as from 1 August 2016.

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