The qualification of income derived from technical services in Brazilian double tax treaties has always been surrounded by significant controversy between tax authorities and taxpayers. This agitation is exacerbated by the challenges inherent to the taxation of the digital economy and its proposed alternatives. The present study aims to examine the possible impacts of including Article 12B, the recent United Nations (UN) proposal for the taxation of the digital economy, in the qualification of technical services in Brazil.

This objective demands a brief historical incursion into the troubled qualification of technical services in Brazil and an overview of the new Article 12B of the UN Model Convention. In addition, the possible impacts of the adoption of such a provision in the Brazilian scenario will be addressed and therefore expose the primary aspects of this new proposal. Ultimately, some conclusions are presented to trace a horizon around the Brazilian service taxation policy in the context of the digital economy.

1 INTRODUCTION

The present article aims to examine the possible impacts of the adoption of Article 12B. This is the new proposal of the United Nations (UN) to face the challenges of the digital economy in the controversial qualification of income derived from the provision of technical services in Brazilian double tax treaties. In this context, it is paramount to understand the Brazilian position regarding the qualification of technical services and its changes throughout history.

To examine the relevance and possible effects of including Article 12B in Brazilian treaties, this study is divided into four sections. Without neglecting the questions that are still unanswered on the matter, the first section intends to navigate through the Brazilian troubled understanding in relation to the qualification of income derived from the provision of technical services. It will specifically address Article 12A of the UN Model Convention that is included in the treaties recently signed by Brazil.

From the outlined historical context, the second part aims to present the structure and the main elements of the UN recent proposal for the taxation of the digital economy. Despite the efforts of the Organization for Economic Co-operation and Development (OECD) during the last years to achieve a difficult consensus on the taxation of the digital economy through the Unified Approach, the UN has hastened and, in record time, presented a new alternative, for which the relevance will also be addressed in the present article.

Finally, the third section identifies some problems/impacts from adopting Article 12B. In this part, the present study is going to demonstrate that this new proposal, no matter how well-intentioned it may be, is not beneficial. It will point out some conclusions about the taxation of technical services in the scope of double tax treaties within a highly digitalized and globalized economy.

2 THE TROUBLED BACKGROUND OF TECHNICAL SERVICES QUALIFICATION IN BRAZILIAN DOUBLE TAX TREATIES

Marta Castelon, in a historical interpretation, demonstrates the logic behind so many articles in double tax treaties dealing with income from the provision of services. The focus will especially be on the provisions related
Intertax, The Qualification of Technical Services in Brazilian Double Tax Treaties and the…

... to business profits, income from independent professional services, employment income, and fees for technical services.[1]

Likewise, Brian J. Arnold, in an in-depth study submitted to the UN Committee of Experts on International Cooperation in Tax Matters, has already warned that the taxation of services in double tax treaties represents an ‘incoherent, inconsistent and unprincipled mess’. According to the professor, the source state should tax income derived from technical services provided by non-residents without the threshold of a permanent establishment only if: (1) the services were performed in the source state; (2) a threshold was fulfilled so that the income derived from isolated activities is not subject to taxation in the source state; and (3) taxation occurred on a net or a gross basis at a limited rate.[2]

In this context, it is possible to state that Brazil has partially followed the statement of Professor Arnold since the national history regarding the qualification of income derived from technical services in double tax treaties is precisely an ‘incoherent, inconsistent and unprincipled mess’. On the other hand, Brazilian policy consists of taxing services on a gross basis without any material limitation and regardless of whether the service is provided in a Brazilian territory.

Technical services rendered by a foreign person and paid for by a Brazilian person are generally subject to a 15% withholding tax on the gross payments upon the remittance (25% if the payment is made to tax havens or jurisdictions with favoured tax regimes).[3] The place where the services were rendered is irrelevant, and no deduction of expenses is allowed at all. A further 10% tax on the consumption of such services is charged from the payer,[4] resulting in a (15% + 10%) taxation on any payment. If border adjustment (PIS/COFINS) and local services tax are considered, the final tax burden exceeds more than 40% of the amounts paid abroad.

In a brief historical digression, the Brazilian Federal Revenue Office (Receita Federal do Brasil – RFB) under Normative Declaratory Act No. 1/00 (ADN No. 1/00) understood that income as a remuneration for the provision of services by non-residents would be subject to Article 21 of Brazilian treaties (other income) that allow a cumulative taxation and adopt a different criterion from that provided in the OECD Model Convention (exclusive taxation in the residence state).

Based on this declaratory act widely criticized by Brazilian doctrine,[5] Brazil reserved the right to tax income from the provision of technical services and technical assistance, withholding tax when the payment source was located in Brazil. The divergence between Brazilian policy, Professor Brian J. Arnold’s proposal, and international practice becomes evident.

Such a fiscal position contradicted all international practice, leading to the termination of the Brazil-Germany tax treaty and political pressure from the Finnish Government.[6] Alongside the adverse political scenario, a jurisprudence against the conclusions of the ADN No. 1/00 was constructed, notably in the Copesul[7] and Iberdrola[8] cases, judged by the Brazilian Superior Court of Justice (STJ).

The analysis of these paradigmatic judgments which was concluded for the application of Article 7 (exclusive taxation in the residence state unless there is a permanent establishment in Brazil) and their implications are not part of the present study. However, it should be mentioned that many questions remain unanswered despite the progress made with these precedents, especially concerning the application of Article 12 (royalties) or 14 (independent personal services) and the extension of the concept of royalties via the protocol.[9]

As predicted by Vanessa Arruda Ferreira,[10] Brazilian tax authorities have indeed reviewed their previous understanding through Interpretative Declaratory Act No. 5/2014 (ADI No. 5/2014). It establishes (1) the application of Article 12 (royalties) when there is an extension in the protocol; (2) the provision of services related to technical qualification – Article 14; and (3) other cases – Article 7.

Moreover, it is worth mentioning that, in a very recent judgment,[11] the Brazilian STJ apparently changed its previous jurisprudence regarding the qualification of technical services that are commonly qualified as business income.
profits (Article 7). The court understood that the Federal Justice (from where the case was received) shall examine the contract to determine if there is any embedded payment of royalties.

Apparently, change matters because, in this case, the tax treaty with Spain allows taxation by Brazil for up to 15% on the remitted amount. Thus, the STJ determined that the details of the service should be examined before qualifying the income derived from technical services in the tax treaty.

Although the discussion is not final, the court has stopped automatically qualifying income from technical services as business profits (no taxing right to Brazil as a source state). In this author’s view, the novelty consists in the fact that, unlike previous cases (Copesul and Iberdrola), the STJ recognized that the protocols involved shall be examined to qualify the remitted income, addressing some of the questions that have been left unanswered since the previous judgements.

In this context, the fear of ‘whether the old and thought-to-be-over argument in respect of the application of the royalties article to such payments [income from the provision of technical services and technical assistance without the transfer of technology] will re-emerge in the expected new position of the Brazilian Federal Revenue Office’ [13] has become a reality. That is, there is still a strong possibility of applying Article 12 to payments derived from the provision of technical services without the transfer of technology.

Thus, the doctrinal debate on the extended concept of royalties to technical services and technical assistance without the transfer of technology or know-how remains. Concerning this discussion, Alberto Xavier contends that this extended concept encompasses only the transfer of technology in a complementary or accessory character [14][15].

Nonetheless, it should be borne in mind that there is no restriction on the extended concept of royalties from the protocols that are present in most Brazilian double tax treaties. Only the treaties signed with Austria, Finland, France, Japan, and Sweden do not provide an extension to the concept of royalties. On 19 March 2019, Brazil signed a protocol with Sweden that includes technical services and technical assistance in the definition of royalties. This protocol, however, still awaits approval from the National Congress [16].

Likewise, Ramon Tomazela Santos argues that the qualification of a certain type of income in Article 12 does not depend on the reference to domestic law and, even if it was necessary to resort to domestic legislation, the definition of technical services brought by Normative Instruction No. 1,455/14 does not require a technology transfer [17].

This scenario changed significantly with Article 12A of the UN Model Convention (fees for technical services) that has already been adopted by the most recent Brazilian treaties. According to this article, the source state may tax income derived from the provision of technical services but is limited to a percentage defined by the contracting states.

### 2.1 New Path: The Inclusion of Article 12A in the Brazilian Double Tax Treaties

The introduction of Article 12A into the UN Model Convention derives from the practice of several countries and from a clear concern with the erosion of source states’ tax bases. Before its introduction, the existence of a permanent establishment or a fixed base was required for the exercise of the taxing rights by these jurisdictions in accordance with Articles 7 and 14, respectively [18].

Article 12A grants the source state the right to tax until the minimum threshold is reached to determine a level of presence in its territory under the terms of Article 5(3)b (Service PE), 7, or 14 of the UN Model Convention. If such a limit is fulfilled, Article 12A(4) provides that Article 7 or 14 applies instead of Article 12A.

This new provision is based on the erosion of the source states’ tax base for the attribution of a sufficient nexus to exercise its taxing rights (base erosion approach). It does not require compliance with certain limits (material or formal), applies only to technical services, and allows taxation at source on a gross basis.
Within this context, some criticisms arose regarding the scope of Article 12A and the absence of any limitation to taxation at source except for the rate to be defined by the contracting states. It was questioned whether it would be incorporated too soon with the challenges of the digital economy. Criticism is centred, in particular, on the fact that this provision applies to technical services regardless of the location of service rendering, that is, a nexus of payment source is adopted encompassing all payments made as consideration for technical services.

However, such criticisms must be dismissed as the so-called ‘base erosion approach’, the central foundation of Article 12A, contributes to the implementation of taxation at source and promotes greater legal certainty for taxpayers and tax administrations. Thus, the complex and controversial allocation of profits to a permanent establishment or to a fixed base is eliminated in addition to distancing itself from discussions about a virtual permanent establishment designed to encompass services that are provided remotely (without physical presence) that is characterized by its complicated profit allocation.

Likewise, Andrés Báez Moreno reinforces the use of the ‘base erosion approach’ as the primary and sufficient link for taxing services at source. The Spanish professor points out that the relationship between the deduction of payments made by residents and taxation works as a justification for the taxing right of source states. He adds that the withholding tax itself represents an important self-enforcing mechanism despite its deficiencies when attempting to effectively address illegitimate non-taxation which is one of the clear objectives of double tax treaties, especially after the changes promoted in the 2017 OECD Model Convention.

In addition, Monique Malan points out a number of advantages obtained with the inclusion of Article 12A in double tax treaties: (1) removes the difficulty of attributing profits to a permanent establishment or to a fixed base; and (2) provides greater practicability for taxpayers and tax administrations.

Pursuant to Article 12A, the service provider must present specialized knowledge, skills, and expertise for the benefit of the customer, always involving a certain level of specialization. However, it poses an important question: Which service does not involve the application of at least a certain degree of specialized knowledge, expertise, or skills? Stated differently, which service cannot be considered technical?

In this context, the UN Commentaries on Article 12A suggested a restrictive approach (technical services only) and an expanded approach (all services). Such limited understanding clearly left all of the questions raised above unanswered and, as argued in the present study, it is extremely difficult to identify a service that does not involve any degree, at least minimum, of technical knowledge and expertise.

Article 12A(3) received the complicated task of establishing, within the scope of the treaty, a definition of ‘technical services’:

| any payment in consideration for any service of a managerial, technical or consultancy nature, unless the payment is made: (i) to an employee of the person making the payment; (ii) for teaching in an educational institution or for teaching by an educational institution; or (iii) by an individual for services for personal use of an individual. |

As a result, a new path was cleared for the qualification of income derived from the provision of technical services in Brazilian double tax treaties. Previously, the focus was on an expanded concept of royalties that includes technical services and technical assistance, attracting the application of Article 12. There was no treaty definition of technical services and only applied Article 17, paragraph 1, II, of Normative Instruction RFB No. 1,455/14 (domestic concept of technical services).

**2.2 What Has Really Changed with the Inclusion of Article 12A?**

In this context, it is important to question whether the inclusion of Article 12A would promote, in practice, significant changes in Brazilian policy. Brazil adopted the UN Model for both Articles 12 and 12A with minor
deviations. Both provisions allow source taxation on a gross basis at a tax rate defined by the contracting states during the negotiation rounds (in general, 15% for royalties and 10% for technical services).

Table 1 Comparative Between Articles 12 and 12A

<table>
<thead>
<tr>
<th>Article 12</th>
<th>Article 12A</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Royalties arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.</td>
<td>1. Fees for technical services arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.</td>
</tr>
<tr>
<td>2. However, such royalties may also be taxed in the Contracting State in which they arise and according to the laws of that State, but if the beneficial owner of the royalties is a resident of the other Contracting State, the tax so charged shall not exceed ___ percent (the percentage is to be established through bilateral negotiations) of the gross amount of the royalties. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this limitation.</td>
<td>2. However, notwithstanding the provisions of Article 14 and subject to the provisions of Articles 8, 16 and 17, fees for technical services arising in a Contracting State may also be taxed in the Contracting State in which they arise and according to the laws of that State, but if the beneficial owner of the fees is a resident of the other Contracting State, the tax so charged shall not exceed ___ percent of the gross amount of the fees [the percentage to be established through bilateral negotiations].</td>
</tr>
<tr>
<td>3. The term ‘royalties’ as used in this Article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films, or films or tapes used for radio or television broadcasting, any patent, trademark, design or model, plan, secret formula or process, or for the use of, or the right to use, industrial, commercial or scientific equipment or for information concerning industrial, commercial or scientific experience.</td>
<td>3. The term ‘fees for technical services’ as used in this Article means any payment in consideration for any service of a managerial, technical or consultancy nature, unless the payment is made:</td>
</tr>
<tr>
<td>(a) to an employee of the person making the payment;</td>
<td></td>
</tr>
<tr>
<td>(b) for teaching in an educational institution or for teaching by an educational institution; or</td>
<td></td>
</tr>
<tr>
<td>(c) by an individual for services for the personal use of an individual.</td>
<td></td>
</tr>
<tr>
<td>4. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the royalties, being a resident of a Contracting State, carries on business in the other Contracting State in which the royalties arise, through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the right or property in respect of which the royalties are paid is effectively connected with (a) such permanent establishment or fixed base, or with (b) business activities referred to in (c) of paragraph 1 of Article 7. In such cases the provisions of Article 7 or Article 14, as the case may be, shall apply.</td>
<td>4. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of fees for technical services, being a resident of a Contracting State, carries on business in the other Contracting State in which the fees for technical services arise through a permanent establishment situated in that other State, or performs in the other Contracting State personal services from a fixed base situated in that other State, and the fees for technical services are effectively connected with: (a) such permanent establishment or fixed base, or (b) business activities referred to in (c) of paragraph 1 of Article 7. In such cases the provisions of Article 7 or Article 14, as the case may be, shall apply.</td>
</tr>
<tr>
<td>5. Royalties shall be deemed to arise in a Contracting State when the payer is a resident of that State. Where, however, the person paying the royalties, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment or a fixed base in connection with which the liability to pay the royalties was incurred, and such royalties are borne by such permanent establishment or fixed base, then such royalties shall be deemed to arise in the State in which the permanent establishment or fixed base is situated.</td>
<td>5. For the purposes of this Article, subject to paragraph 6, fees for technical services shall be deemed to arise in a Contracting State if the payer is a resident of that State or if the person paying the fees, whether that person is a resident of a Contracting State or not, has in a Contracting State a permanent establishment or a fixed base in connection with which the obligation to pay the fees was incurred, and such fees are borne by the permanent establishment or fixed base.</td>
</tr>
<tr>
<td>6. For the purposes of this Article, fees for technical services shall be deemed not to arise in a Contracting State if the payer is a resident of that State and carries on business in the other</td>
<td>6. For the purposes of this Article, fees for technical services shall be deemed not to arise in a Contracting State if the payer is a resident of that State and carries on business in the other</td>
</tr>
</tbody>
</table>
6. Where by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the royalties, having regard to the use, right or information for which they are paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case, the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention.

7. Where, by reason of a special relationship between the payer and the beneficial owner of the fees for technical services or between both of them and some other person, the amount of the fees, having regard to the services for which they are paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case, the excess part of the fees shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention.

Should only the wording of the provisions at hand and its source taxation outcome be considered, the inclusion of Article 12A would not produce significant changes since there are not many differences between such provisions (*marked in red*). Otherwise stated, Brazil would still be withholding tax over payments without any material threshold.

However, one significant difference can be identified in the terminology itself. While Article 12 applies a general rate of 15%, Brazilian treaties with Article 12A provide a tax rate of 10% (Singapore, Switzerland, and Uruguay) [24] This is important for reducing the detrimental effects of withholding tax at a high rate.

Moreover, the definition of technical services provided by Article 12A(3) mentioned above is broader than the extension of royalties via the protocol (refers only to ‘technical services and technical assistance’). In the first case, there is a clear definition within the tax treaty whereas, in the latter, there is not a definition but only a mere extension.

The extended concept of royalties does not provide any element to qualify a service as ‘technical’, that is, there is no definition of technical services in the protocol nor in the conventional clauses which certainly leads to the question of whether this extended concept of royalties encompasses the services without a transfer of technology or know-how (see section 2).

In this context, the ‘new old battle’ mentioned by Vanessa Arruda [25] would no longer be an issue once the inclusion of Article 12A ends the discussion regarding the application of Article 12 to payments derived from technical services without the transfer of technology or know-how.

It is no longer necessary to resort to the domestic concept of technical services (Article 17, paragraph 1, II, Normative Instruction No. 1,455/14) to analyse whether the service that is rendered qualifies as ‘technical’, falling under the extended concept of royalties. Article 12A establishes a clear definition agreed by both contracting states, avoiding possible mismatches and unilateral changes via domestic law.

Finally, when the RFB applied Article 21 to income derived from technical services or technical assistance without the transfer of technology, treaty partners could disagree with the interpretation presented by the Brazilian tax authorities and consequently reject the source qualification, denying relief of double taxation. The refusal to eliminate double taxation by resident states under the violation of the conventional clauses by Brazil no longer has grounds under the new Brazilian position regarding the qualification of technical services.

In this sense, Article 12A provides a more accurate standard for the qualification of technical services since it avoids the problematic discussion about the application of Article 7, 12, or 14 depending on the indistinct nature of the service that is rendered that is still present due to the tax administration’s position mentioned before (ADI No. 5/2014).
In other respects, the doubtful application of Article 12, the extension of the concept of royalties, and the compatibility of such extended scope with the royalties' treaty definition would still be haunting taxpayers and tax administrations, promoting legal uncertainty. Since Article 12A clarifies that technical services fall under its scope, there is no need for a protocol or amendments providing a clear definition within the treaty level and securing tax revenues for Brazil as a source state.

For this reason, the treaties recently signed by Brazil with Singapore, Switzerland, the United Arab Emirates, and Uruguay included Article 12A to deal with the historical problem of technical services and their qualification. Although part of such treaties is still awaiting approval by the National Congress,\[26\] it is undeniable that they indicate a new path taken by Brazilian policy.

As stated by Vanessa Arruda Ferreira, ‘source taxation may be a harder battle for taxpayers, but at the same time also a pragmatic solution to international double taxation’, since:

\[
\text{taxpayers may benefit from the legal certainty of having a treaty limitation regardless of the internal policy adopted by Brazil and therefore may no longer be vulnerable to changes in domestic law aiming at increased domestic withholding tax rates – as was the case during the other income theory.}\[27\]
\]

Hence, according to the reasoning adopted in the present study, Brazil followed a more feasible path by including Article 12A in its most recent treaties, ensuring greater legal certainty for taxpayers and tax administrations despite the obvious problems that are inherent in source taxation on a gross basis.

3 THE NEW AND HURRY UN PROPOSAL FOR THE TAXATION OF THE DIGITAL ECONOMY: ARTICLE 12B

The Twentieth Session of the United Nations Committee of Experts on International Cooperation in Tax Matters was held online in June 2020 due to the COVID-19 pandemic. On this occasion, the organization’s secretariat issued a statement informing the creation of a group whose mission was to present the proposal of a new provision by the end of July of the same year.\[28\]

The committee decided to bring a group of experts together to draft a new article and its commentaries addressing the challenges of taxing the digital economy. The drafting group, composed of thirteen members of the committee, should present a draft for consideration by the entire committee comprising twenty-five members at the end of July 2020.

In record time, the drafting group submitted its full proposal in less than one month despite the efforts by the OECD in recent years to reach a consensus on the taxation of the digital economy. After receiving comments from the committee members, the UN published the revised wording of Article 12B on 11 October 2020.\[29\]

The committee of experts agreed at its twenty-first session, held on 9 November 2020, to introduce such provision in the UN Model Convention. Despite some minor changes introduced by the drafting group and the discussions within the committee, there would still be opportunities to propose changes to the wording.\[30\]

In this sense, on 6 April 2021, the group released its final draft of Article 12B and a commentary on income from automated digital services.\[31\] This final draft and its commentaries were presented to the committee of experts at the twenty-second session that was held virtually between 19 and 28 April 2021 at which time the inclusion of Article 12B in the 2021 version of the UN Model Tax Convention was approved. As admitted by the committee itself, such a proposal is surprising due to ‘the speed with which they had delivered a proposed solution to what was a highly contentious issue globally’.\[32\]
For instance, the UN initiated discussion on the implementation of Article 12A in 2007. The work, led by Professor Brian J. Arnold, continued for many years and a proposal for a provision and its commentaries was presented finally at the tenth committee meeting held in October 2014.

Nonetheless, even after years of meetings and discussions, there was a ‘notable dissensus’ and a lack of a ‘in-depth debate’, using the critical expressions attributed to Andrés Báez when commenting on the work that culminated into the inclusion of Article 12A in the UN Model Convention. The dissention was to the extent that some committee members proposed a return to a solution based on an expanded concept of royalties that was previously followed by Brazil. Others questioned the source of payment rule included in the projects while others, displaying an even deeper disagreement, suggested a discussion of the policy objectives of the conventional provision.

In short, a common denominator was reached: a new alternative version to the wording of the initial proposal would be elaborated. The aim would be its inclusion in the model convention and that the commentaries should examine the advantages and disadvantages of the new article and alternative options.

Thus, while Article 12A was discussed for many years until its inclusion in the 2017 UN Model Convention, the proposal of a new Article 12B was drafted in less than a month and debated and approved in approximately nine months. This occurred even though the debates and deliberations that culminated in this decision were criticized due to the level of divergence between the committee members and during a global pandemic when countries should be worried about protecting their citizens, which is surprising and inopportune to say the least.

3.1 The Structure and Relevant Points of Article 12B

Article 12B emerges as a UN proposal to deal with the challenges inherent in taxing the digital economy for which its scope is the so-called ‘automated digital services’.

The structure of Article 12B is quite similar to that adopted in Articles 10 (dividends), 11 (interest), 12 (royalties), and 12A (technical services). Regarding the allocation of taxing rights, the new distributive rule proposed by the UN adheres closely to Article 12A, insofar as it guarantees the right to tax to the source state when income arises in its territory, that is, the requirement of a permanent establishment or a fixed base was removed.

Concisely, the final version of Article 12B contains eleven paragraphs, three more than the previous drafts:

1. First paragraph: contracting states are entitled to a taxing right – in principle, the resident state;
2. Second paragraph: income from ‘automated digital services’ may also be taxed in the source state on a gross basis through a withholding tax at a rate negotiated by the contracting states;
3. Third paragraph: the beneficial owner is granted the optional regime of net basis taxation;
4. Fourth paragraph: included by the drafting group in its final version. This paragraph provides a definition of ‘multinational enterprise group’ and ‘group’ for purposes of the optional regime of net taxation;
5. Fifth paragraph: general definition of ‘automated digital services’;
6. Sixth paragraph: included by the drafting group in its final version which provides a list of ‘automated digital services’. By using the expression ‘especially’, it seems that the list is non-exhaustive;
7. Seventh paragraph: included by the drafting group in its final version which establishes that Article 12B shall not apply if the payments underlying the income from automated digital services qualify as ‘royalties’ or ‘fees for technical services’ under Article 12 or Article 12A.
8. Eighth paragraph: neither paragraphs one, two, and three will apply if the income from ‘automated digital services’ arises through a permanent establishment or if it is effectively connected to a fixed place in the source state. Instead, in this case, Articles 7 and 14 should apply;
9. Ninth paragraph: ‘sourcing’ revenue rule based on the residence of the payer (or permanent establishment or fixed base of the payor in the state connected with the obligation to make the payment) of the ‘automated digital services’;
(10) Tenth paragraph: income from ‘automated digital services’ is not considered to be arising in the residence state of the payor if it is borne by the payor’s permanent establishment or fixed base in another state; and

(11) Eleventh paragraph: non-arm’s length allocation of the income leading to a taxation in both contracting states for which the other provisions of the convention must be considered.

The applicable tax rate must be defined in negotiation between the contracting states while maintaining consistency with the other articles of the UN Model Convention. The Commentaries on Article 12B present some factors that should be considered by states when defining the tax rate such as: (1) choosing a high tax rate may cause the transfer of the cost of services to consumers (source states would increase their revenue at the expense of their own residents); (2) a high rate applicable on a gross basis can also result in excessive taxation; (3) a rate higher than the tax credit paid abroad may drive away investments.\[36\]

Such elements are commonly indicated as disadvantages of the gross taxation model.\[37\] On the other hand, it is a simple, reliable, and efficient system that allows the taxation of income derived from the provision of services by non-residents. This is in addition to facilitating the compliance of companies considering the clear asymmetry of physical and technical capacity between tax administrations that often have physical, technical, and budgetary limitations.

The main novelty of the proposal at hand consists of the option granted to the beneficiary of the income derived from the provision of automated digital services to be subject to taxation on a net basis in accordance with Article 12B(3). Pursuant to this provision, given the option of the beneficiary, the source state may tax the ‘qualified profits’ derived from such income, considered as 30% of the net profit. This matter will be further explored in the next section.

Another interesting aspect of the proposal concerns its scope. Article 12B(5) encompasses income derived from the provision of automated digital services which is understood as any payment for services provided on the Internet or an electronic network that involves minimal human intervention by the service provider. From such a provision, it is noteworthy that the automated digital services are composed of two main elements: (1) the services must be provided on the Internet or on an electronic network/structure and (2) minimal human intervention in the provision of services. To facilitate the understanding of this scope, the commentaries on Article 12B establish some principles for determining whether a certain service is covered and also list some activities that integrate the concept of ‘automated digital services’ and others that are excluded from this definition.\[39\]

Unlike Article 10 that does not apply to dividends paid by a company resident in a third state, Article 12B also applies to income from automated digital services paid by a resident of a contracting state or a third state where the payments are borne by a permanent establishment or fixed base that the resident has in the other contracting state.

In short, Article 12B allows source states to tax income from the provision of automated digital services regardless any physical presence in their territory (permanent establishment or fixed base). The sourcing rule in Article 12B(8) operates on the basis of ‘payment’ and not on that of the location of users.

### 3.2 General Comments

Commenting the UN proposal, the World Bank Group (WBG) members stated that Article 12B would be welcome by developing countries since it represents a less complicated mechanism to tax the digital economy and could substitute the digital services taxes (DST).\[39\] Nevertheless, it seems that the WBG understands Article 12B as an improved DST which is clearly not the case. A withholding tax (Article 12B) cannot be confused with a turnover tax (DST).

In the same context, the International Monetary Fund (IMF) provided observations on the proposed introduction of Article 12B considering that the UN proposal ‘preserves the taxing rights of developing countries and does so
Besides that, Article 12B would establish a more appropriate mechanism for combating unilateral measures adopted by some states.

On the other hand, the National Foreign Trade Council (NFTC) criticized the UN initiative since, according to its view, the OECD’s Inclusive Framework is the proper forum to address the tax challenges of the digital economy. In this sense, the UN proposal would represent a ‘signal to developing countries that unilateral digital services taxes are an appropriate tax policy tool.’

Likewise, Baker and McKenzie LLP states that ‘the work at the OECD, through the Inclusive Framework, provides the best (and perhaps only) path to a global consensus resolution to the debate over the taxation of the digitalized economy’. It is argued that Article 12B does not provide harmonization of agreed principles and practices but instead introduces a ‘highly unusual’ national level imposition of a withholding tax.

The commentaries on Article 12B have an express reference to Action 1 of the Base Erosion and Profit Shifting Project (BEPS) Project, suggesting an approximation between the work of the OECD and the new proposal headed by the UN. Nonetheless, the OECD has proceeded far beyond the final report released in 2015 by adopting the unified approach proposal and the blueprints published in October 2020.

Although the commentaries on Article 12B suggest an alleged approximation, or at least a concern with the studies developed by the OECD, the truth is that the UN proposal distances itself formally and materially from the current Pillar 1 and Pillar 2, limiting itself to only minimally acknowledging this vague reference to the BEPS Project and the optional taxation on a net basis to the OECD.

As stated by Vikram Chand and Camille Vilaseca, the UN proposal is based on ‘the “supply – demand” logic in the sense that both production countries and market countries are entitled to tax business income of a global enterprise’, representing a clear ‘departure from the view of the OECD States who have chosen to tax corporate income based on the “supply” framework.’

In this context, the drafting group has deleted all references to BEPS concerns in the revised commentary since the primary objective of the introduction of Article 12B is allocation of taxing rights to market jurisdictions. During the twenty-first session, some committee members pointed out that a broader scope should be adopted ‘to bring in the “user” jurisdiction to cover those jurisdictions with high numbers of users and not focus only on jurisdictions of payment’. However, there is still no clarity on which fiscal policy is adopted in this initiative.

Another difference relies on the fact that Article 12B does not provide any revenue thresholds nor a permanent establishment/fixed base whereas the OECD Pillar 1 proposal provides a global revenue threshold and a de minimis foreign in-scope revenue test. It also requires a revenue threshold for each specific type of activities (automated digital services and consumer facing businesses (CFBs)).

A small number of UN Committee members expressed the position that it would be desirable to include revenue thresholds in Article 12B(2) in order to reduce the excessive taxation derived from a source taxation on a gross basis to automated digital services. However, the majority understood that the conjunction of such provision with Article 23 (Methods for the Elimination of Double Taxation) deals with a possible excessive taxation that recommends a modest tax rate (3% or 4%).

Furthermore, Chand and Vilaseca add that the Amount A proposal establishes a ‘one stop shop type of mechanism wherein the taxpayer will have to register only with the tax administration of the Ultimate Parent Entity (and this tax administration is required to transmit the tax revenues to the respective market countries).’ Nevertheless, this type of mechanism depends on a complex exchange of information network that does not consider the reality of many developing countries (operational, personal, and budgetary limitations) and possible problems arising from the lack of transmission of tax revenues to the market country.

Now that the structure and the main elements of the new UN proposal have been presented in the present study, the discussion will delve into the controversies and sensitive points of this provision.
4 POSSIBLE IMPACTS AND PROBLEMS OF THE INCLUSION OF ARTICLE 12B

In this section, the present article aims to examine the relevance of Article 12B and its possible impacts on the historical discussion regarding the qualification of income derived from the provision of technical services in Brazilian double tax treaties.

Chand and Vilaseca, who clearly defend the Pillar 1 proposal, are very critical of Article 12B and the possibility of gross taxation. They state that the UN proposal might not be in the interest of developing countries for the following reasons: (1) there are situations in which developing countries will not be able to collect revenues from the digital economy as Article 12B would not include value generated by users (lack of revenue sourcing rules); (2) ‘it relies on bilateral negotiations which could be time consuming and perhaps not leading to the desired outcome’; and (3) OECD members will probably be reluctant to introduce Article 12B in their tax treaties.⁴⁷

Although the present study also criticizes the UN proposal, it does not accord with the reasons above listed since (1) the idea that the difficulties derived from B2C transactions lead to less revenues is not accurate; (2) as a member of the inclusive framework, Brazil is proof that bilateral negotiations work for the implementation of BEPS minimum standards, avoiding the many complexities of the multilateral instrument (MLI)⁴⁸; and (3) the reluctance of the OECD might be leading to a complex solution that will never reach consensus whereas many states are adopting detrimental alternatives such as DSTs.

Accordingly, four main controversial aspects about the UN proposal were identified that will be analysed separately to finally provide an objective conclusion on the matter, specifically: (1) mistaken assumptions of the proposal; (2) definition of ‘automated digital services’ and the intersection with Article 12A; (3) an optional tax regime on net basis for allocating taxing rights to market jurisdictions; and (4) conflict with Article 14 that is excluded from the OECD Model but included in all Brazilian treaties.

4.1 Mistaken Assumptions Regarding the Taxation of the Digital Economy

Proposals aimed at taxing the digital economy generally come from two rather questionable premises: (1) the value creation derived from user participation in highly digitalized businesses must be considered for the purpose of allocating taxing rights; and (2) the tax burden on the digital economy is substantially smaller in relation to the traditional economy. In the case of Article 12B, the same assumptions are present.

In addition to the points mentioned above, for the purposes of the present study, two other mistaken premises are intimately related to the UN proposal that are extracted from the Commentaries on Article 12B: (1) it expressly sustains the non-application of Article 12A to automated digital services without presenting any justification for doing so; and (2) market jurisdictions do not tax income derived from the provision of digital services.

Regarding the first element, it should be borne in mind that the value generated by the user, which represents a highly subjective concept and with multiple meanings,⁴⁹ is not necessarily beneficial to the company’s image and, consequently, to its economic activities, depending on the business model that is involved.

Under this reasoning, Professor Ana Paula Dourado correctly contends that ‘Value creation is inappropriate as a principle for justifying the attribution of taxing rights to the market state, and such inadequacy goes beyond the binomial OECD countries’ v. developing countries’ interests’.⁵⁰

There is not always an effective positive value creation with user participation. For this reason, its election as a proxy for the distribution of taxing rights is, at the very least, questionable. As already defended by this author in another study,⁵¹ the participation of users and the data derived from it should be treated, just as with any other input, as raw material for the exercise of economic activity.

Regarding the second premise, it is undisputed that Article 12B, as well as the other alternatives that are on the table, appears precisely to cover the supposed gap between the tax burden borne by technology companies and that borne by ‘brick-and-mortar’ companies, a fact that represents a discriminatory treatment of the digital
Intertax, The Qualification of Technical Services in Brazilian Double Tax Treaties and the…

This assumption derives from a study used by the European Commission for its DST proposal. Such study entitled ‘Steuerliche Standortattraktivität digitaler Geschäftsmodelle’ (Fiscal attractiveness of digital business models) from the Zentrum für Europäische Wirtschaftsforschung – ZEW (Centre for European Economic Research), which used data provided by PricewaterhouseCoopers (PwC), sought to assess the attractiveness of certain tax jurisdictions for activities with digital business models. In this research, two benchmarks were used: (1) cost of capital and (2) ‘effective average tax rate (EATR)’, which is not related to the effective tax burden on a specific taxpayer or sector but refers to the change in the value of a certain investment in relation to the tax burden.

The PwC itself expressly admitted through a press release that the study mentioned above has not considered the average effective rates nor does it work to verify whether the digital economy is under-taxed. Additionally, João Félix Pinto Nogueira clarifies that, even if there was such a tax burden gap, it should be questioned whether this gap would exist due to tax evasion, mismatches, or the particularities of digital companies.

Another quite vague aspect in the proposal offered by the UN Committee of Experts refers to the position, without any justification, that Article 12A cannot be applied to automated digital services. The UN Commentaries make it clear that, prior to the introduction of Article 12B, income derived from automated digital services was taxed exclusively in the provider’s state of residence unless a permanent establishment or a fixed base was characterized.

As a result, the UN recognizes the inapplicability of Article 12A to these services. However, as will be seen later in section 4.2, the present study defends the full applicability of this provision to the so-called automated digital services, and the introduction of another article in the model convention is irrelevant. At most, it would be necessary to make some amendments in the Commentaries on Article 12-A.

Finally, the fourth mistaken premise of the proposal at hand is highlighted: digital services are not taxed by the so-called source states which motivated discussions concerning a review of the permanent establishment rule and the ‘pandemic’ institution of digital taxes around the world. Conversely, some developing countries, including Brazil which adopts as a nexus the payment source rule for the taxation of services provided by non-residents, already tax these digital services.

In the Brazilian case, there are a few peculiarities that compel companies to establish themselves locally to exercise their economic activities in Brazil and access its consumer market such as the exchange control that requires the execution of an exchange contract for remittances abroad, reduced use of international credit cards, local invoice requirements, and payment in real by the local consumer. Thus, such companies are, in general, subject to regular taxation of their activities by the Brazilian Corporate Income Tax (IRPJ) and the Social Contribution on Net Profits (CSLL) at the combined rate of 34%, PIS/COFINS – Social Contributions (9.25%) and ISS – Municipal Tax on Services (2% to 5%).

In addition to taxes levied on local operations, the payment of IRRF – Withholding tax (15% or 25%), IOF – Financial Operations Tax (general rate of 0.38%, may reach 6.38% if payment is made via credit card), PIS/COFINS-Imports (9.25%), CIDE – Contribution on Economic Development (10% in some cases), and ISS (2% to 5%) levied on the import of services and licenses of the group’s companies.

In this sense, the ‘pandemic’ of DSTs and the possible introduction of a new conventional provision for the taxation of the digital economy threatens Brazil through the proposals sent to the National Congress for the creation of a digital tax and public statements made by the Brazilian Minister of Finance. The Brazilian problem at the local and international levels does not refer to the absence of taxation of digital businesses but in putting these activities into the existing tax categories, whether in domestic legislation or at a treaty level.

4.2 The Scope of Article 12-B: ‘Automated Digital Services’
Article 12B(5) encompasses the income derived from the provision of ‘automated digital services’ which is understood as any payment for services provided on the Internet or on electronic network that involve minimal human intervention by the provider. However, it was not mentioned how this degree of minimal human participation in the provision of services would be measured.

It is interesting to note that the final version presented by the drafting group and approved by the committee includes paragraph 6 that lists examples of services that may constitute automated digital services. Nonetheless, the commentaries expressly state that ‘Paragraph 6 therefore simply provides an indication that an activity may constitute an automated digital service; it does not provide that an activity listed therein necessarily is an automated digital service’.[57] Otherwise stated, if ‘it does not provide that an activity listed therein necessarily is an automated digital service’, what is the purpose of listing it in the first place? It seems that there was no purpose at all.

A minority of the committee members contended that payments by individuals for automated digital services for personal use should be specifically excluded from the definition of ‘income from automated digital services’. This is due to the difficulties related to withholding obligations in B2C transactions[58] and some disadvantages of the B2C exclusion (loss of revenue suffered by the market states).

As argued by Andrés Baez, the B2C exclusion is not as problematic as some authors might present since (1) B2C services represent a small component of the entire services market, and (2) the loss of revenue derived from the exclusion of B2C transactions ‘would be compensated, at least in the perception of the market/source countries, by the increased taxation rights in relation to the current situation according to the traditional PE regime (including service PEs)’.[59] Therefore, limiting the application to payments for services made by enterprises might be the best possible (feasible) alternative.

However, the approved Article 12B and its commentaries also apply to automated digital services provided to individuals for their personal use. The committee only mentions alternative collection mechanisms that are already adopted in some jurisdictions which clearly does not resolve the problem.[60]

Automated digital services have two primary elements: (1) the services must be provided on the Internet or through an electronic network; and (2) there must be minimal human intervention in the provision of services. Indeed, the UN Commentaries on Article 12B, from which it is possible to extract ‘general principles’ to determine whether a certain service is covered by the article or not, listed some activities that match the concept of ‘automated digital services’ and others that are excluded from this definition.[61]

In this sense, the present study highlights the following ‘general principles’:

1. A certain service is considered automated when the user can make use of the service because of equipment and systems made available by the provider that allow the user to obtain the service automatically instead of requiring a tailored service with the supplier (excludes, therefore, on-demand services);
2. Human intervention by the user must be ignored;
3. Focus on service provision and, therefore, does not include human interventions in the creation, support, or maintenance of the system necessary for the provision of the service;
4. Minimal human intervention limit would not be exceeded when the provision of services to new users involves a very limited human response to the user’s individual requests;
5. Ability to increase, reach, and provide the same type of service to new users with minimal human involvement (a non-automated digital service would, in the UN’s view, have a proportional increase in unit costs in relation to the provision of services to new customers); and
6. Irrelevance of the distinction between different Internet or electronic network transmission methods for considering a service as automated digital.

These general principles represent, in fact, core elements that, in the UN Committee of Experts’ standpoint, assist in qualifying certain services as ‘automated digital services’, an expression composed of three words of
complicated interpretation. After all, a service, in principle, can be digital but not automated or automated but not
digital without knowing for sure what effectively distinguishes one from the other or what even defines services.
A simple and quick analysis of these principles leads us to a series of questions mainly about the requirement
of minimal human intervention since all services, no matter how digital they may be, depend on human action. Determining this minimal level proves to be a very complicated task for taxpayers and tax administrations as current contracts usually involve a large myriad of services that are often completely different.
Furthermore, the understanding that ‘automated digital services’ presupposes an ability to increase reach and provide the same type of service to new users with minimal human involvement while non-automated digital services would require a proportional increase in costs per unit in relation to the provision of services to new customers is questionable. This statement was made without any study or criteria which leads to the belief that it is another mistaken assumption brought by the Article 12B proposal.

Services included in this definition were listed in the article itself and the commentaries alongside a brief
description of their respective scopes (online advertising; online intermediation platform; social media; digital
content services; cloud computing; sale of user data; standardized online teaching).

On the other hand, some activities that would be excluded from the scope of Article 12B were listed only in
the commentaries (customized services provided by professionals; customized online teaching services;
services providing access to the Internet or the electronic network; online sale of goods and services other than
automated digital services, broadcasted services including simultaneous transmission over the Internet, digital
services composed of a physical good regardless of network connectivity – ‘internet of things’). Customized
services, therefore, are excluded which allegedly distinguishes this new provision from Article 12A. These
exclusions could be covered by the definition of CFBs under Amount A of Pillar1.

The present study does not intend to analyse whether, in fact, the activities included and excluded by the UN
Commentaries are effectively in accordance with the general principles. It is only to offer an overview of the
scope chosen for Article 12B and to question whether a new provision is needed, especially considering the
recent Brazilian policy of including Article 12A in its treaties.

It is also interesting to note that the Commentaries on Article 12B provide the possibility of a ‘mixed taxation’
when automated digital services are encompassed within Article 12A in whole or in part. The drafting group
simply added a new paragraph 7 in its final version that provides that the provisions of Article 12B shall not
apply if the payments underlying the income from automated digital services qualify as ‘royalties’ or ‘fees for
technical services’ under Article 12 or Article 12A. However, no criteria were presented on how to segregate
these activities between the two articles (Articles 12A and 12B) nor were any examples offered of this situation.

It would be entirely possible to tax part of the services in accordance with Article 12A (taxation at source – gross
basis) and the other part by means of Article 12B and its optional net taxation regime. In this sense, Professor
Ana Paula Dourado states that ‘a combination of net and gross taxation introduces substantial complexity to the
administration of allocation of taxing rights’.[62]

In this context, a question arises. By the means described in the commentaries, can ‘automated digital services’
receive the treatment provided for in Article 12A of the UN Model Convention, that is, do they constitute technical
services? In a rapid and analytical answer, the present study would say yes.

As previously seen, technical services according to Article 12A are defined as:

\[
\text{any payment in consideration for any service of a managerial, technical or consultancy nature, unless the payment is made: (a) to an employee of the person making the payment; (b) for teaching in an educational institution or for teaching by an educational institution; or (c) by an individual for services for the personal use of an individual.}
\]
First, it clearly demands technical knowledge, skill, or expertise of the provider as it is difficult to identify any service that does not involve these elements, even to a smaller degree.

The present study argues that digital services, whether automated or not, fall under the scope of Article 12A since they have elements of technical and consultancy services that definitely require expertise and advanced technical knowledge from the service provider.

In accordance with the reasoning developed in this study, it should be noted that the protocol of the double tax treaty between Brazil and Argentina,[63] when extending the concept of royalties to include technical services, defines these services under its Article 20, as technical services, and technical assistance the performance of services ‘as a result of automated structures with clear technological content’. In addition, the protocol expressly excludes the application of Article 14 to technical services.

Therefore, the present study understands that Article 12A is perfectly applicable to digital services, especially to online advertising services qualified as ‘automated digital services’, and have been the object of DSTs introduced worldwide. In fact, there is an express statement of Brazil in the protocol signed with Argentina that the definition of technical services encompasses digital services exactly as described in the Commentaries on Article 12B.

Even if an autonomous interpretation of the expression ‘technical services’ under the treaty level is adopted, it is unnecessary to resort to domestic law. It should be noted that this conclusion can also be drawn from the Brazilian domestic definition of technical services provided by Article 17, paragraph 1, II, Normative Instruction No. 1,455/2014. The final part of this provision makes it clear, in the present study’s opinion, that the ‘automated digital services’, the core element of the UN proposal, in fact correspond with technical services when using the expression ‘or, still, derived from automated structures with clear technological content’ following the terminology provided in the protocol signed with Argentina.

According to both the definition of ‘technical services’ provided in Article 12A of the treaties recently signed by Brazil and the domestic definition itself, the so-called ‘automated digital services’. are, indeed, technical services. This makes the introduction of a specific provision for the digital economy into a completely unnecessary measure, especially under Brazilian reality.

Likewise, this conclusion is evident in the document sent by Tatiana Falcão and Bob Michel to the UN Committee of Experts as a contribution to the debates around the inclusion of Article 12B in the model convention, demonstrating that digital services, such as online advertising, may fall under the scope of Article 12A either as (1) pure technical services, (2) technical and consultancy services when human interaction is involved; or (3) as general services in the broad sense of an expanded definition.[64]

As a consequence, Falcão and Michel advised the UN Committee to change the wording of Article 12A to make direct reference to digital services or to leave the article as it is and change the commentaries to explore how the provision may be applied to digital services.

The current terminology of Article 12A allows the qualification of digital services within the concept of technical services without the need to change its wording or include a new provision in the convention, as already recognized by the Brazilian domestic legislation and its protocol with Argentina. Therefore, Brazil already has an alternative for taxing services in the context of the digital economy. A new and deficient article would only bring further complications to the already controversial qualification of payments derived from technical services in Brazilian double tax treaties.

There is no perfect solution that resolves every situation in the digital economy world and proportionately distributes taxing rights to all states and securing sufficient tax revenues for each one. However, only a juridical and politically feasible solution can be offered that ultimately avoids double taxation and non-taxation and is overall more effective in the attempt to effectively resolve the current problems.

4.3 The Optional Net Taxation Regime
The main novelty of Article 12B consists of the option granted to the beneficiary of the income derived from the provision of automated digital services to be subject to taxation on a net basis instead of a classic taxation at source on a gross basis. This represents minimal acknowledgement to the efforts made by the OECD to reach consensus within the scope of the Unified Approach, especially Pillar 1 and its Amount A. Such an option would be interesting in cases when the taxpayer has a lower tax burden than that related to withholding tax and in cases when a global business loss or a significant loss in the economic segment is identified during the taxable period.

Once this option has been exercised by the income beneficiary, the source state may tax, according to its domestic rate, the ‘qualified profits’ derived from this income. These profits correspond to 30% of the total resulting from a calculation described in the Commentaries on Article 12B. A minority of committee members expressed the position that 30% of group consolidated profits for net taxation may be too high, and consideration should be given to bilaterally negotiating a rate that more accurately reflects the particular facts and circumstances. Nevertheless, this percentage was retained in the article.

Pursuant to the commentaries, this calculation involves the application of the ‘profitability ratio’ of the beneficiary or of the automated digital business segment, if possible, on the annual gross revenue related to the provision of automated digital services from the state where the income arises. Besides that, when the income beneficiary is part of a multinational group, the applicable ‘profitability ratio’ must be that referring to the group or, if possible, the economic segment of the group related to this income.

This ‘profitability ratio’ is understood as an instrument for measuring the profits of a company or group that derive from annual profits divided by total revenue for the year as stated in the consolidated financial returns of the beneficiary or group to which it belongs or of the economic sector, depending on the case. The amount resulting from this calculation (net profit) will be taxed according to the internal rate of the source state. In addition, it should be noted that the Commentaries on Article 12B recognize the need for domestic law to regulate the exercise of this option, including the form of submission of tax returns and the registration of service providers.

In this sense, profitability would be calculated based on a profit before tax approach and extracted from the:

accounts of the beneficiary owner (possibly the tax administration of the source country may not get this information unless they go through the Exchange of Information mechanisms), or the consolidated accounts of the multinational group, in the latter case applying the financial accounting standard used by the ultimate parent entity

From this optional net taxation regime, it is possible to make brief observations: (1) underdeveloped proposal for net taxation; (2) the relationship between this regime and the Brazilian system of taxation at source; and (3) use of country-by-country reports to calculate the net basis. The present study does not intend to stress these points, which may be the object of future studies but only to demonstrate that there are many unanswered questions with this mixed regime proposed by the UN Committee.

First, the UN proposal does not offer further details on how to calculate these ‘qualified profits’. It also does not mention the treatment of losses and whether they can be carried forward and for how long. It only recognizes the necessity of domestic law for regulating the exercise of this optional regime. In this sense, the simplicity and practicability intended by the committee receive a major disadvantage that requires further refinement.

Likewise, the NFTC argues that such an optional approach would increase double taxation, global complexity, and disputes if it does not provide details on apportionment factors. Article 12B is unclear on ‘whether companies
will have to do separate valuations of such factors in order to operationalize apportionment under Article 12B’s net income solution, which is likely to increase disputes.’[69]

Concerning the second aspect, the adoption of consolidated financial returns to calculate the ‘profitability ratio’, one of the elements of the net basis, may indicate a departure from the current ‘separate entity approach’ that considers the entities individually for a group taxation approach. At this point, it presents some similarity to the OECD proposal in the Unified Approach. From the Brazilian perspective, it is interesting to wonder how this optional regime would be applied with Law No. 12,973/14 that regulates the taxation of profits obtained abroad and allows consolidation only in specific cases and only until the year 2022.[70]

Moreover, it is difficult to imagine that Brazil would allow an optional tax regime on a net basis in the case of services provided by non-residents despite the potential to attract foreign investments. Admittedly, this regime would represent a total departure from the historic Brazilian service taxation policy and contradict the inclusion of Article 12A in the treaties recently signed by Brazil.

Finally, the potential use of country-by-country reporting, the object of Action 13 of the BEPS Project,[71] might be questioned for purposes of calculating taxation on a net basis by means of the optional regime granted by Article 12B(3). In this context, the commentaries recognize that the enactment of domestic law is necessary to regulate the beneficiary’s exercise of such an option and to examine the presented tax returns.

Normative Instruction No. 1,681/2016 that regulates the CbC Reporting in Brazil is worth mentioning as its legality might be questioned since there are many inconsistencies and disadvantages, such as the increase in compliance costs for tax collection and reconciliation information, confidentiality problems and risk of information leakage, a potential for increasing inspections, and issuing tax assessments based exclusively on CbC reporting.

Likewise, as recognized by the IMF’s staff, this hybrid regime would have to be ‘backstopped by robust access to information arrangements and anti-avoidance measures to safeguard collection under the preserved taxing rights’. There are many difficulties (not solved by Article 12B) on determining ‘group profitability for the purposes of applying net basis taxation, and measures to combat the contrived use of an offshore related entity to make the payments to the non-resident supplier to defeat gross basis taxation’.[72]

As perfectly argued by Professor Ana Paula Dourado, such a combination of gross and net taxation ‘is leading to complexity such as combining taxation Amounts A, B, and C and the UN proposal of a new Article 12B added to Article 12A and net taxation of profits in the event that there is a permanent establishment’.[73] Such a hybrid regime, besides producing substantial complexity for both taxpayers and tax administrations, represents an ‘incoherent, inconsistent and unprincipled mess’, offering apologies to Professor Arnold for the use of his expression.

4.4 The Complicated Intersection Between Article 12B and Article 14

In the early 2000s, the OECD created a working group to study Article 14 (Independent personal services) which concluded that this provision should be removed from the model convention as it produced controversies regarding the material (activities), subjective (subject) scope differences with Article 7.[74]

However, the solution adopted by the OECD that sought to bring greater legal certainty in the taxation of services has not achieved the desired result as many developing countries (among them, Brazil) and some developed countries kept Article 14. In this sense, the idea that OECD members would not include Article 12B in their treaties is very questionable as some of them are introducing DSTs (for instance, France and the United Kingdom) and also acknowledged their position as capital importers.

Likewise, Fernando de Man criticizes the solution adopted by the OECD as the discussions regarding the taxation of services at source have not been silenced by this exclusion. In fact, it has only increased, for instance, the inclusion of a service permanent establishment in the OECD Commentaries on Article 5.[75]
Most Brazilian treaties contain a special provision in the protocols broadening the scope of Article 14 to include the provision of professional services by legal entities. Vanessa Arruda mentions the treaties with Mexico in which the protocol indicates that ‘it is understood that the provisions of Article 14 shall also apply if the activities were performed by a company’, and Italy that states ‘the provisions of Article 14 shall apply even if the activities are exercised by a partnership of a civil company (sociedade civil)’.[76]

Thus, professional services provided by legal entities would be covered by Article 14, allowing source taxation, and not Article 7 (business profits – exclusive taxation in the residence state).

This historical controversy inherent to the taxation of services has gained yet another disagreeable aspect with the inclusion of Article 12B in the UN Model Convention. The commentaries clarify that, before its introduction, income derived from automated digital services was taxed exclusively in the provider’s state of residence (Article 7) unless a permanent establishment or a fixed base was characterized (Article 14).

Concerning the relationship between the new Article 12B and Article 14, in paragraph 20 of the commentaries, it is argued that both provisions can hardly be applied to automated digital services. In any case, if the beneficiary exercises independent professional services in a contracting state through a fixed base from which income from automated digital services arises, Article 14 will prevail. This is mere clarification on an obvious point. If there is a fixed base through which income is derived related to the provision of automated digital services and is effectively connected to this fixed base, Article 14 will be applied. The same reasoning is used when a permanent establishment is characterized with the application of Article 7.

However, due to a dubious assumption, the Commentaries on Article 12B failed to clarify the material differences (scope) between Articles 12B and 14. According to the UN proposal, the only difference between these two provisions consists of whether there is a fixed base. Such delimitation is important in the Brazilian reality, since the national service taxation policy is guided by the principle of territoriality (source of payment). As already emphasized in the present study, Article 14 of the Brazilian treaties allows taxation at source irrespective the existence of a fixed base if the payment source is located in Brazil.

Therefore, the eventual inclusion of Article 12B in Brazilian treaties may create an overlap with Article 14 so that the scopes of these provisions become inseparable. This is another reason for not including Article 12B in any Brazilian treaties considering that its presence will only bring further complications to the already controversial and difficult qualification of income from the provision of technical services.

5 Conclusion

The qualification of income derived from the provision of technical services under Brazilian double tax treaties has always been surrounded by much controversy and is characterized by the adoption of quite questionable positions by the tax administration. In this context, Brazil has chosen to adopt an extended concept of royalties including technical services by means of a provision in the protocols so that Article 12 of the treaties would be applicable, in principle, to such income.

However, the treaties recently signed by Brazil present a change in national policy on this point insofar as they include Article 12A of the UN Model Convention. Despite that some of these treaties are still awaiting approval by the National Congress, the fact is that Brazil decided to follow, on one hand, a different path regarding the taxation of services provided by non-residents. On the other hand, it is preserving its classic taxation at source regardless of the existence of a permanent establishment or a fixed base.

It turns out that the challenges inherent to the taxation of the digital economy have stimulated countries to search for a solution to the erosion of their tax bases. In this sense, the UN proposed an alternative to these issues in record time, specifically, the inclusion of Article 12B which contemplates the so-called ‘automated digital services’ and practically adheres to the same structure as Article 12A.
In view of this recent and hasty proposal, the present study sought to analyse, from a Brazilian perspective, the potential impacts of adopting Article 12B on the historical qualification of income from the provision of technical services, without prejudice to presenting a position regarding the (im) pertinence of this provision.

Therefore, for purposes of this study, four controversial points of the proposal were identified: (1) mistaken assumptions (among them, the low taxation of digital services); (2) the definition of ‘automated digital services’ that is already covered both by Article 12A that is present in the most recent Brazilian treaties and in the domestic concept of technical services; (3) the optional tax regime on a net basis for allocating taxing rights to market jurisdictions; and (4) the intersection between Articles 12B and 14.

Aside from the points mentioned above and without prejudice to other questionable elements of the proposal, a conclusion has been made. Article 12A was discussed for many years until its inclusion in the UN Model Convention (2017) and, even then, its debates and deliberations were criticized. The proposal for the new Article 12B was drafted in less than one month and was debated and approved in approximately nine months. This was all in the midst of a global pandemic which is, at the very least, surprising and inopportune.

Indeed, the present study argues that Article 12A is perfectly applicable to digital services, especially to online advertising services, qualified by the UN as ‘automated digital services’ that have been the object of the so-called DSTs worldwide. It is noteworthy that the protocol signed with Argentina establishes that the definition of technical services encompasses digital services which is exactly as described by the UN Commentaries on Article 12B.

Hence, the current Brazilian policy for the taxation of services that is characterized by the adoption of Article 12A represents a feasible alternative even to deal with the challenges of the digital economy. For this reason, the rush and inopportune inclusion of Article 12B in the 2021 UN Model Convention lacks, even more in the Brazilian treaties’ perspective, any usability and, in fact, produces overlaps and more controversies in the already complicated qualification of technical services in double tax treaties.

There is no perfect solution that encompasses every scenario in the digital economy world and proportionately distributes taxing rights to all states and securing sufficient tax revenues for each one. Only a juridical and politically feasible solution that ultimately avoids double taxation, non-taxation, and is overall more effective in attempting to competently resolve the current problems is needed.
7 Finland threatened to terminate the double tax treaty with Brazil if Brazilian tax authorities kept the application of Art. 21 (other income) to levy withholding tax on service payments instead of applying Art. 7 (Business Profits). The intention was presented through a notification issued by the Finnish Ministry of Finance on 27 Feb. 2013 and later analysed by the Coordination of International Relations (‘CORIN’) through Memo No. 64/2013 of 19 Apr. 2013 and Technical Note No. 23/2013 on Aug. of 2013.

8 BR: STJ, Special Appeal No. 1,161,467, Justice Castro Meira, judged on 17 May 2012.

9 BR: STJ, Special Appeal No. 1,272,897, Justice Napoleão Nunes, judged on 19 Nov. 2015.


11 Ferreira, supra n. 6, at 429: ‘it is expected that, in the near future, the Brazilian Federal Revenue Office officially abandons the position that the payments for the provision of technical service and technical assistance without the transfer of technology falls in the scope of the other income article and that a new declaratory act is enacted to revoke Declaratory Act COSIT 01/2000’.

12 BR: STJ, Special Appeal No. 1,759,081/SP, Justice Mauro Campbell Marques.

13 Ferreira, supra n. 6, at 429.


21 Malan, supra n. 19.


24 Only the tax treaty with the United Arab Emirates provides a 15% tax rate for technical services.

25 Ferreira, supra n. 15, at 429.


27 Ferreira, supra n. 15, at 255.


36 UN Committee of Experts on International Cooperation in Tax Matters, supra n. 31, para. 29.

37 See Moreno, supra n. 20, cap. 3.2.1.2.1.

38 UN Committee of Experts on International Cooperation in Tax Matters, supra n. 31, paras 56–60.


Chand & Vilaseca, supra n. 43, s. 3.

Ibid., s. 8.


UN Committee of Experts on International Cooperation in Tax Matters, supra n. 31, para. 57.

Chand & Vilaseca, supra n. 43, s. 4 (a).

Moreno, supra n. 20, s. 3.2.1.2.4.

UN Committee of Experts on International Cooperation in Tax Matters, supra n. 31, paras 64–65.

UN Committee of Experts on International Cooperation in Tax Matters, supra n. 31, paras 53–54.

Dourado, supra n. 50, at 4.

See BR: Decree No. 9,482, 27 Aug. 2018.


UN Committee of Experts on International Cooperation in Tax Matters, supra n. 31, para. 41.

Ibid., paras 39–51.

Ibid., para. 51.
Chand & Vilaseca, supra n. 43, s. 4 (b).

National Foreign Trade Council, supra n. 41.

BR: Law No. 12,973/14, Art. 78.


International Monetary Fund, supra n. 40.

Dourado, supra n. 50, at 6.


Ferreira, supra n. 15, at 258.