

HR & Tax Alert



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Brazil and Germany: Rescission of the Double Tax Treaty to Avoid Double Taxation. Applicability of Reciprocal Treatment.

January 2006

Executive Summary

Following the discussions on the effects connected to the revocation of Decree # 76,988/76 (International Tax Treaty signed between Brazil and Germany to avoid Double Taxation), the German Ministry of Finance published on January 6, 2006 a notice which defines the chronological rules to the termination of the treaty. The Brazilian Federal Revenue and Customs Secretariat (SRF) have released the Expository Act # 72/05 aiming to accept the Tax Reciprocity Treatment from January 1, 2006.

Background

The Brazilian and German Governments entered into an International Tax Treaty in 1976 to enhance commercial relations between the two economies. However, the performance of it was frequently subject to internal discussions on the Brazilian side, which limited the potential benefits of the treaty.

As a result of such adversities and with the imposition of several taxes and contributions, the agreement was subject to a termination motion filed by the German Government from April 7, 2005 and the validity term of it was set at December 31 2005.

In principle, the tax treatment foreseen by the International Tax Treaty would no longer apply to income earned, credited or remitted to or from Germany from January 1 2006.

New Methodology for Personal Income Tax

According to the recent notice published by the German Ministry of Finance, Germany still applies the treaty exemption regarding wage tax withholding on the German salary portion for working days spent in Brazil, during the calendar year of 2006, if the expatriates maintain their German residence (i.e. expatriate who are obliged to or can voluntarily file a German income tax return for the calendar year 2006).

From 2007 onwards, a German wage tax exemption could only be applied if the special prerequisites of the "Auslandstätigkeitserlass" from October 31, 1983 are met.

Conversely, the Brazilian SRF published the Expository Act # 72/05, which provides the ability for individuals to offset tax in Brazil with respect to personal income tax effectively paid in favour of the German Government, if taxation on individuals' earnings happens to occur there.

However, the offset is only admissible under the following conditions of fact: (i) the taxable amount is the same in the two countries, (ii) the tax due in the both countries has the same nature, and (iii) the tax to be offset is not subject to reimbursements in the future.

The offset does not apply to State or City taxes.

Next Steps

The rescission of the double tax treaty between Brazil and Germany may impact on the performance of Global Mobility Programs between these two countries. As summarized below there can be an increase in the overall tax cost or potential for double tax.

Germans Working in Brazil

In principle, for the German individual who moves to Brazil, the situation in 2006 regarding German salary portion remains mostly unchanged when compared to 2005 (i.e. tax exemption in Germany and taxation in Brazil).

From 2007 onwards, if the individual does not break German residency the individual will continue to be subject to German tax. A credit will be allowed for Brazil taxes; however, companies who operate a tax reimbursement program will have increased cost due to the higher German tax rates.

Brazilians Working in Germany

From 2006 onward there will be the potential for double tax. Unless contract suspension is put in place in Brazil salary will continue to be required to be paid in Brazil and subject to withholding tax (Brazil source payment rule). Germany will not allow a credit for such taxes as the work is performed in Germany, therefore, double tax.

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