

Treaty between Brazil and Netherlands – District Court Zeeland-West Brabant Classifies Interest on Net Equity as Interest

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The Dutch District Court Zeeland-West Brabant (*Rechtbank Zeeland-West Brabant*) has recently published its decision in Case No. 23/1352 on the classification of interest on net equity under the [Brazil - Netherlands Income Tax Treaty \(1990\)](#) (the Treaty). Details of the case are as follows.

(a) Facts. The taxpayer owned 99.97% of the shares in a Brazilian company (Ltda). On 27 December 2018, the taxpayer received a net interest on equity (*Juros sobre o Capital Próprio*, JCP) of USD 19,131,109 from the Ltda. The tax inspector classified the payment as interest based on article 11(4) of the treaty and granted a tax sparing credit of 20% based on article 23(4)(b) of the Treaty. The tax inspector relied on a 2020 mutual agreement (MAP), reaffirmed in 2021, which classified interest on net equity as equity (Treaty between Brazil and Netherlands – MoF Issues Clarification on Qualification of Interest on Net Equity, Tax Sparing Credits (28 August 2020) and [Brazil and Netherlands Sign Competent Authority Agreement Classifying Interest on Net Equity as Interest \(4 April 2022\)](#)).

The MAP states that:

"JCP is a remuneration that a company organized under Brazilian law can elect to pay to its shareholders on the basis of the net equity of the company. Since JCP is calculated on the basis of the net equity of the company and paid to shareholders only in the existence of profits of the current period, accumulated earnings or profit reserves of previous periods, it could raise doubts whether it can be qualified as a dividend (Art. 10 of the Convention) or interest (Art. 11). Considering the above, the Competent Authorities wish to clarify the treatment of JCP under the Convention. The Competent Authorities have agreed that for the purpose of applying the Convention, in accordance with Brazilian tax law, JCP is considered interest within the meaning of paragraph 4 of Article 11 of the Convention."

The taxpayer appeals and argues that the payment should be taxed as a dividend under article 10(3) of the Treaty, which qualifies for a tax credit of 25% (based on article 23(4)(a) of the Treaty).

(b) Legal background. Article 10(3) of the treaty provides that the term "dividends" as used in this article means income from shares, "jouissance" shares or "jouissance" rights, mining shares, founders' shares or other rights, not being debt-claims, participating in profits, as well as income from other corporate rights which is subjected to the same tax treatment as income from shares by the laws of the State of which the company making the distribution is a resident. Article 11(4) of the treaty provides that the term "interest" as used in this article means income from government securities, bonds, or debentures,

whether or not secured by mortgage and whether or not carrying a right to participate in profits, and debt-claims of every kind as well as other income assimilated to income from money lent by the taxation law of the contracting state in which the income arises.

Article 23(4) provides that the tax paid in Brazil shall be deemed to be:

- for dividends as meant in paragraph 2 of article 10, 25% of such dividends if they are paid to a company of the Netherlands holding at least 10% of the voting capital of the Brazilian company, and 20% in all other cases; and
- for interest as meant in paragraph 2 of Article 11, 20% of such interest.

(c) Issue. The issue was whether the interest on net equity should be classified as interest or dividend.

(d) Decision. The Court initially noted that a treaty must be interpreted in good faith, adhering to the ordinary meaning of its terms within their context, and considering the treaty's object and purpose.

Thereafter, the Court observed that the interest on net equity (IoNE) is a statutory compensation paid to shareholders based on the net equity of the distributing company. A requirement for the payment of the IoNE is that there is a profit.

The Court noted that IoNE did not yet exist at the time the Treaty was concluded. The classification of IoNE as either a dividend or interest for treaty purposes remained unclear, as indicated by the subsequent signing of a MAP. As there are adequate grounds to consider IoNE as income from shares, the court determined that the payment should be categorized as a dividend. Consequently, the taxpayer is entitled to a tax sparing credit of 25%. In this context, the court asserts that any ambiguity in the Treaty text should be borne by the contracting states, and in cases of reasonable doubt, interpretations should not disadvantage the taxpayer. Consequently, the court disregarded the MAP since it was signed after the year in which the dispute arose.

For the full text of three decision no. 23/1352, see [here](#) (in Dutch only).