Transfer Pricing in Brazil and further implications

Marcos Aurélio Pereira Valadão

Brazil

(views are personal)

PRESENTATION PLAN

- **Brazilian approach to Transfer Pricing and how it differs from OECD´s**
- **Brazilian approach to Transfer Pricing and worldwide unitary taxation**
- **Brazilian approach to Transfer Pricing and correlative adjustments and domestic legislation**

Background & Legislation

- **Brazil adopted tax law imposing worldwide income taxation in 1995 (Federal Law n. 9.249/1995).**
- **Transfer Pricing law was enacted in 1996, and entered into force in Jan. 1, 1997 (Federal Law n. 9,430/96). It was modified by other laws.**
- **In 2012, Law n. 12,715/2012 introduced different fixed margins for different economic sectors and an specific simplified CUP Method for commodities, among other important modifications.**

Legislation Analysis

- **Transactions examined under Brazilian Transfer Pricing Regulations include:**
- **(1) imports and exports of goods, services, and rights with related parties;**
- **(2) payments or credits for interest paid or received on loans with related parties.**

- **Brazilian TP rules definition of related parties are broader than the OECD Model Convention.**

Legislation Analysis

- Brazilian Transfer Pricing Regulations are not applicable to payments (imports) of royalties, technical assistance, and scientific and administrative fees (when it represents payments for technology transfer). These expenses are subject to restrictions, and they have limited deduction. They are also subject to withholding tax. The limited deductions replace TP regulations application, and in some cases it would lead to a similar result (tax base) derived from the second.

Legislation Analysis

- In general, Brazilian legislation seeks to adopt the arm's length principle.

- Tax experts say that legislation failed to explicitly adopt the arm's-length standard due the use of fixed margins (between 15% and 40%) for Resale Price and Cost Plus methods. Which means that for this two methods, Brazil TP law does not follow OECD TP Guidelines. In addition, Brazilian methodology applies an specific method for commodities, where the arm's length price is deemed to be the quotation at recognized mercantile exchanges.

Methods adopted by Brazilian TP Regulations

- There are two sets of methods for goods, services an rights (in general):
  - For import transactions:
    - Comparable Uncontrolled Price Method (PIC)/(PCI) **(CUP)**
    - Resale Price Method (20% gross profit margin or other specific margins for specific economic sectors) (PRL) **(RPM)**
    - Cost Plus Method (20% mark up margin) (CPL) **(Cost Plus)**
  - For export transactions.
    - Comparable Uncontrolled Price Method (PVEx)/(PECEX) **(CUP)**
    - Wholesale Price in the Country of Destination Less Profit Method (15% gross profit margin) (PVA) **(RPM)**
    - Retail Price in the Country of Destination Less Profit Method (30% gross profit margin) (PVV) **(RPM)**
    - Cost Plus Method (15% mark up margin) (CAP) **(Cost Plus)**

There is no preferential method (hierarchy), taxpayer may use the one that better fits (or works) to his/her operation (except for PCI and PECEX, which are mandatory for commodities), but cannot use other methods such as Profit Split and TNMM (transactional methods).

Methods adopted by Brazilian TP Regulations v. OECD Guidelines

BRAZIL	OECD
•PIC /PCI– PVEx/PECEX	*Comparable Uncontrolled Price (CUP)*
•PRL – PVA/PVV	*Resale Price Method (RPM)*
•CPL – CAP	*Cost Plus Method*
• *N/A*	*Transactional Net Margin Method (TNMM)*
•*N/A*	*Profit Split Method*

On fixed margins

Compulsory profit and mark up margins are determined by Law, depending on the Transfer Pricing Method, and they differ for inbound and outbound transactions. The law grants the Ministry of Finance the authority to change these margins. The profit margins are not dependent on comparable, uncontrolled transactions.

However, it is also important to point out that the law foresees the possibility of modifying those margins through an individual request submitted by the taxpayer. A request to modify a profit margin must be accompanied by documentation that prove that the margin used by the taxpayer conforms to normal practices between unrelated parties under comparable circumstances.

Strengths of fixed margins methodology

Predetermined margins methodology (to resale price and cost plus methods) presents remarkable strengths, which include:

- it dismisses the availability of specific comparables;
- it does not distort competition among enterprises in an specific country, since they are subject to the same tax burden, and they are not benefitted with asymmetry of information;

Strengths of fixed margins methodology

- it is adequate to countries with scarcity of human resources and technical knowledge of specific transfer price issues;
- it is easy to be implemented by tax authorities and taxpayers;
- it stabilizes the expectations for juridical and economic areas;
- the system ensures equal conditions of competition between companies;
- low cost system to companies and tax administration;
- emphasis on practicality

Simplified CUP for commodities

Price under Quotation Method for Imports (PCI), and Price Under Quotation Method for Exports (PECEX) are variations of the traditional CUP Method. These specific methods were recently added by Law n. 12,715/2012 to substitute the traditional CUP method, for imports (PCI) and exports (PECEX), when the prices of the goods and rights are available in organized markets through mercantile and futures exchange. In this case it is mandatory. The aim is to avoid discussions on prices when there is a defined market that sets the price globally. This price is deemed to be the arm´s lenght price. The law defined the Price under Quotation Method for Imports (PCI) Price under Quotation Method for Exports (PECEX) as the average daily price of goods or rights subject to public prices in commodities futures and internationally recognized exchange markets.

Simplified CUP for commodities

Price under Quotation Method for Imports (PCI), and Price Under Quotation Method for Exports (PECEX) are simplified variations of the traditional CUP Method.

This simplified CUP method is very useful, saving time on the search for comparable transactions when there is a defined and stable organized market that globally sets the price for certain type of goods.

The law allows for price adjustments such as market premium and transportations costs, and the use of international recognized databases.

Brazilian approach to Transfer Pricing and Worldwide Unitary Taxation

1) The impact of the adoption of worldwide unitary taxation, through formulary apportionment, towards the Brazilian methodology is almost impossible to foresee.

2) It seems that worldwide unitary taxation would not be compatible with the Brazilian methodology in the general sense, because albeit Brazil applies fixed margins (which apparently is similar to a formulary approach), the Brazilian methodology is indeed a simplification of traditional transaction methods, and the worldwide unitary taxation are more like a transactional profit split method.

Brazilian approach to Transfer Pricing and Worldwide Unitary Taxation

3) Brazil does not adopt transactional profit methods. This type of methodology can be considered a starting point to a worldwide unitary taxation approach (formulary apportionment), on an activity-by-activity basis. One can conceive a sort of a multilateral APA for applying it. However, this type of methodology would not be applicable in Brazil under the current circumstances, for the same reasons Brazil does not adopt "profit methods".

Brazilian approach to Transfer Pricing and Worldwide Unitary Taxation

4) It is worth to stress again that the Brazilian TP legislation does not apply to royalties and know how transfers in imports, which are an important part of the discussions on transfer pricing. This rules also apply to either related and unrelated transactions. Actually, a move toward Worldwide Unitary Taxation, could impact taxation of non-MNEs with international transactions. It is predictable that it would imply an extensive change in Brazilian income tax law.

Brazilian approach to Transfer Pricing and and correlative adjustments and domestic legislation

When it comes do correlative adjustments, which depends on tax treaties, Brazilian tax legislation presents two particular aspects:

- **None of the 29 Brazilian DTAs in force allow for correlative adjustments, because they do not bring the paragraph two of the art. 9º of the Model Conventions.**

- **It is not a consensus, but it is generally accepted that internal law only (without a DTA) would not allow tax administration to negotiate increases and decreases of the tax base for income tax, especially in regards to the strict legality that governs the application of tax law in Brazil.**

Final Remarks

Despite of the fact that lots of the details of the Brazilian TP laws and regulations were omitted here (these details give room to some adjustments for specific situations), Brazilian methodology is far simpler than the OCED Transfer Pricing Guidelines. It is worth mentioning that the recent UN Manual on Transfer Pricing for Developing Countries brings four country practices (Brazil, China, India and South Africa), which may be very useful.

One can be sure that the use of traditional transaction methods with fixed margins, which is the Brazilian methodology main feature, due to its simplicity and practicality, is a feasible alternative to developing and less developed countries to deal with the important issue of transfer pricing.

Brazilian Law and regulations are available at: www.receita.fazenda.gov.br/Legislacao/LegisAssunto/PrecosTransf.htm (Texts in Portuguese)

Thank you!

Obrigado!