THE BRAZILIAN TRANSFER PRICING RULES: A NEW APPROACH TO TRANSFER PRICING?

Tatiana Falcão
Machado Associados e Consultores

A. INTRODUCTION

The Brazilian legal system is a wild hairy beast, topped with a crust so thick it takes a vast amount of time, experience and expertise to get to the bottom of the policy underlying much of the legislation. And if the piece of legislation at hand is a tax law – well let’s just say that this is any entrepreneur’s worst nightmare. Brazilian tax laws are said to be confusing and complicated, because Brazil tends to “do its own thing” when it comes to regulating cross border and international tax situations. Brazil is averse to international conventions, mainly because they tend to reduce Brazilian tax authorities’ ability to tax. That does not mean that Brazil ignores intergovernmental organizations such as the Organization for Economic Cooperation and Development (“OECD”) entirely. What it means is that it takes international tax conventions and regulations only to be an inspiration for the creation of its own international tax laws.

Brazil’s failure to follow through with international tax standards brings about several cross border tax problems, many times resulting in over taxation for taxpayers involved in the transactions. Such additional costs resulting from the Brazilian legislation’s inefficiency, bureaucracy and lack of uniformity with international standards sum up to become the “Brazilian cost” in transactions involving Brazilian suppliers, service providers or counterparts. This problem appears to be most acute upon execution of the terms of the Double Tax Conventions for the Avoidance of Double Taxation and Evasion (DTC). That is because the Brazilian Federal Revenues Service’s (and the judiciary’s ) interpretation of the DTCs it has signed with other countries, tend to favor the Brazilian Federal Revenues Service, hence resulting in excessive taxation for the taxpayer(s) involved in the transaction.

More recently, transfer pricing has also started being a concern for multinational companies operating in Brazil. For many other reasons which go beyond the scope of this text, it is virtually impossible for a foreign company to regularly establish itself in Brazil by making use of a Permanent Establishment (PE). Therefore, most of the companies wishing to establish themselves in the country do so by establishing a subsidiary. Seeing as subsidiaries are independent entities endowed with legal capacity,
they ought to obey transfer pricing provisions when transacting with their foreign related counterparts.

That interaction is in itself a conundrum, due to conflicting interaction between enforceable transfer pricing rules in (i) OECD member countries; and (ii) Brazil. The Brazilian transfer pricing regulations are unique in the world in the sense that Brazil aims to achieve the arm’s length standard by making use of a series of safe harbors and fixed formulae which are made available to the taxpayer for import and export transactions, respectively. The formulae will be further discussed under sections B.2. and B.3. below. The point being that because the Brazilian methodology approaches the arms length price objectively, through a mathematical formula, and the OECD transfer pricing regulations determine subjective approaches to achieve the arm’s length price in a transaction between related parties, sometimes the taxpayer is faced with a tough practical reality where he would need to apply one price in order to fit into the Brazilian transfer pricing standards, and another different price, in order to apply an arm’s length price which is compatible with the OECD transfer pricing regulation. Considering Brazil has never issued any rules or regulations of conciliation between the Brazilian and the OECD methodology, it is up to the taxpayer (and his or her lawyers) to “do his magic” and get by without a tax assessment.

On the other hand, the Brazilian system is unique in the sense that Brazil has been able to come up with an objective method which would allow the taxpayer to mathematically prove and determine what his transfer pricing benchmark is, without having to go through a search for comparables. This search for comparables is one of the main developing country concerns, seeing as they do not have such a wide and open market apt to produce reports on the prices practiced by competing companies commercializing comparable or similar products. Sometimes, a company might be the only producer of a specific type of product, making comparable search impracticable if not impossible.

Another criticism to the OECD proposed transfer pricing methodology that has been resolved by the Brazilian method, is the search for concurrent prices. Because developing countries’ markets tend to be concentrated with only a reduced number of players, new entrants to the market might not be able to access other companies’ product’s prices. For some companies, price strategy has a direct correlation with their competitiveness. By adopting fixed profit margins over the company’s own applied production or resale price, Brazilian tax authorities managed to develop a method which relies on the company’s/taxpayer’s own data, thereby removing the pressure from acquiring new data from the market.

Last but not least, Brazil managed to develop a system which in itself is endowed with juridical certainty. For developing countries, whose tax laws tend to be inconsistent and burdened by bureaucracy, the development of an objective methodology is therefore a plus, reducing the transaction’s overall risk of assessment.
(i) Preliminary comments:

Much like the OECD transfer pricing regulations, the Brazilian rule’s main aim is to forestall the:

i. over billing of costs and expenses derived from the acquisition or importation of goods from foreign related parties, foreign related or unrelated parties domiciled in low tax jurisdictions, or under privileged tax regimes, by disallowing deductibility of the dollar amounts that exceed the benchmarks achieved through the application of one of the legal methods made available through the Brazilian legislation, when calculating the Brazilian Corporate Income Taxes (Corporate Income Tax (“IRPJ”) and Social Contribution on Net Profits (“CSLL”));

ii. under billing of export revenues, arising from transactions with related parties, or between two unrelated parties, where one is located in a privileged tax regime, by assessing IRPJ and CSLL over the “non-billed amount,” which is the amount that would have been charged if one of the allowable transfer pricing methods had been applied; and

iii. payments of interest under agreements not registered before the Brazilian Central Bank (BACEN) executed between related parties or between unrelated parties where one is located under a privileged tax regime, and where the amounts or charges of interest: (a) exceed the benchmark reached according to the method legally set forth, or (b) are lower than the benchmark provided by the application of one of the transfer pricing methods. Excess payments are not deductible from IRPJ and CSLL tax base. In case of revenue shortage, the corresponding difference must be added back to the tax base for further assessment by the IRPJ and CSLL.

Transfer pricing adjustments may also be considered when calculating (i) depreciation/amortization/depletion expenses; and (ii) interest on equity deductions.

Brazilian legal entities must show in their Annual Income Tax Return (DIPJ):

• the existence of transactions (i) with related parties; (ii) with parties domiciled in low taxation jurisdictions; and/or (iii) carried out with entities located under a privileged tax regime;

• the method chosen to confirm compliance with the transfer pricing rules; and

• the transfer pricing adjustments made.

A.1 Arm's-Length Standard (or Alternative Standard)

The Brazilian domestic legislation describes the available methods to calculate transfer pricing adjustments.
Taxpayers are free to choose the method that results in the lowest taxation, among those described in the legislation, as long as the chosen method is used consistently per type of asset, goods, service or right.\(^1\)

The detailed description of the transfer pricing methods in the legislation and the liberty of the Brazilian taxpayer to choose the most favorable method in the case of acquisitions, imports and exports subject to transfer pricing control, make the Brazilian system one with unique characteristics, incomparable to any other existing regime.

Under the Brazilian system, there are no best method rules or any other priority order between the transfer pricing methods provided by the domestic law.\(^2\)

Differences between actual costs/expenses and the corresponding benchmark, or differences between actual revenues and the corresponding benchmark, which do not fall under the variations accepted by the law or safe harbor rules, must be added to the IRPJ and CSLL tax bases.

**B. DETERMINING THE APPROPRIATE INTERCOMPANY PRICE**

**B.1. Transactions Subject to Transfer Pricing**

Much like in the rest of the world, in Brazil the transfer pricing rules were designed to prevent Brazilian legal entities from evading taxes or shifting profits by under- or overcharging amounts:

- received from or due to a foreign related party;

- received from or due to a related or unrelated party domiciled in a low tax jurisdiction, as defined by the Brazilian legislation;

\(^1\) Article 19-B of Law 9430/96 (Law 9430), introduced by the MP 478 (currently revoked) and enforceable from 1 January 2010 to 31 May 2010, stated that the method chosen cannot be changed after the beginning of a tax audit. The same Article provided that the tax authorities could calculate the transfer pricing adjustments based on the documents available and on any method described in the legislation, if the taxpayer failed to:
  - inform in its DIPJ, before the beginning of the tax audit, the chosen transfer pricing method;
  - provide the tax authorities with documents supporting the prices practiced;
  - provide the tax authorities with the benchmark calculations; or
  - provide the tax authorities with adequate and sufficient documents to confirm the benchmark calculations made based on the chosen transfer pricing method.

Although MP 478 is no longer enforceable, and therefore the provisions it established no longer apply, the rule provides good evidence of how tax authorities are expected to act in the future, and of the types of documents the authorities are expected to demand from taxpayers.

\(^2\) The best method rule replaced the system whereby the United States transfer pricing regulations contained a prescribed order of methods. The best method rule determines that although there is no specific priority as to the transfer pricing methods available to the taxpayer, the taxpayer must apply the transfer pricing method that provides the ‘most reliable measure of an arm's length result’. The best method rule implies that if another of the available methods is subsequently shown to produce a more reliable measure of an arm's-length result than the one chosen by the taxpayer, this other method must be used. The application of the best method rule obliges the taxpayer to maintain ‘contemporaneous documentation’ supporting the method. It also allows taxpayers to make all pertinent documentation available to the Internal Revenues Service within thirty days, upon its request. Argentina currently also applies the best method rule.
• derived from transactions with related or unrelated parties carried out under a privileged tax regime, as defined by the Brazilian legislation.

As long as one of the requirements above is met, Brazilian transfer pricing rules apply to:

• costs/expenses related to the acquisition and/or import of assets, goods, services or rights;
• revenues from exports of goods, services or rights;
• interest expenses and revenues.

However, the transfer pricing rules do not apply to:

• domestic transactions, which fall under the scope of the disguised distribution of profit rules; and
• royalties and the remuneration for the transfer of technological know-how.

The transactions carried out between related parties include not only those carried out between the Brazilian legal entity and (i) its branches; (ii) its headquarters; (iii) its controlled companies; (iv) its controlling shareholders (individual or legal entities); (v) companies under common corporate or common management control; and (vi) its managers; and/or (vii) relatives by blood or marriage, up to the third degree, spouses, or significant others, of the managers or of the controlling shareholders, but also the transactions with:

• the Brazilian legal entity's foreign affiliated companies as defined by Article 243, paragraphs 1 and 2 of Law 6404/76 — Brazilian Corporation Law (LSA);
• companies that participate with the Brazilian legal entity in a joint enterprise, under a 'consortium' or 'condominium', as defined by the Brazilian law;
• foreign legal entities that grant to the Brazilian legal entity (as their agent, distributor or dealer), exclusive rights to buy or sell assets/goods/services/rights;
• foreign agents, distributors or dealers of the Brazilian legal entity, to whom the latter has granted exclusive rights to buy or sell assets/goods/services/rights; and
• foreign companies, when the same individual or legal entity holds an equity stake of at least 10% in both the foreign company and the Brazilian legal entity.

Brazilian transfer pricing rules also apply to the transactions carried out between a Brazilian company and a related foreign party by means of an interposed person. The concept of a related party under the Brazilian legislation therefore goes beyond what is determined to be a related party under the OECD transfer pricing regulations, to the extent that the Brazilian rules also assume a relation when the parties are blood related

---

3 The tax authorities’ understanding is that the application of the transfer pricing rules does not depend on the actual admission of the assets, goods, services or rights into Brazil.
4 See, fn 3, above.
5 Law 9430 releases Brazilian legal entities from complying with transfer pricing rules when remitting royalties or paying for technological know-how derived from abroad.
6 According to LSA, a company is affiliated to another if the investor has a significant influence in the management of the company invested in, without controlling. The Brazilian legislation assumes that there is influence if the investor holds 20% or more of the voting capital of the invested company.
(a relative or kin down to the third degree, spouse or cohabitant), and when they act through an exclusive agent, distributor or dealer.\footnote{According to article 23 of Law 9430/96, the entities considered to be related to Brazilian companies, in excess of the definition contained in the OECD Transfer Pricing Guidelines are: (i) the non-resident individual who is a relative or kin down to the third degree, spouse or cohabitant of any of its directors or officers or of its direct or indirect controlling partner or shareholder; (ii) the non-resident individual or legal entity that is its exclusive agent, distributor or dealer for the purchase and sale of goods, services or rights; and (iii) the non-resident individual or legal entity whose exclusive agent, distributor or dealer for the purchase and sale of goods, services or rights is the legal entity domiciled in Brazil.}

This means that there might be occasions where a company will have to undergo transfer pricing rules specifically for Brazilian tax purposes. This should not generate any conflicts internationally, for those will be the cases where the OECD guideline rules will not apply, leaving it for the Brazilian legislator alone to control the price of the transaction. It is interesting to see that in some cases, Brazilian transfer pricing rules can be even more stringent than the OECD standard rules, which are mostly forwarded and applied by the developed world.

Pursuant to Article 24 of Law 9430/96 (Law 9430) — as amended by Article 3 of Law 10451/02 and Article 22 of Law 11727/08 — low taxation jurisdictions are those whose legislation:

- does not allow the access to information about the shareholding structure of the legal entities involved, their ownership, or the identification of the beneficial owner of income earned by non-residents; and/or
- does not tax income or taxes the income at maximum rates which are lower than 20\%, considering: (i) the tax legislation applicable to individuals or legal entities, according to the qualification of the person with whom the relevant transaction is performed; and (ii) the segregated taxation of income derived from work and from capital.

\textbf{IN SRF 1037/2010 (IN 1037)} enumerated the jurisdictions considered to be of low tax\footnote{According to IN SRF 11037 the following jurisdictions fall under the concept of low taxation jurisdictions: Andorra; Anguilla; Antigua and Barbuda; Netherlands Antilles; Aruba; Ascension Island; Bahamas; Bahrain; Barbados; Belize; Bermuda Island; Brunei; Campione D’Italia; Channel Islands (Alderney, Guernsey, Jersey and Sark); Cayman Islands; Cyprus; Singapore; Cook Islands; Costa Rica; Djibouti; Dominica; United Arab Emirates; Gibraltar; Granada; Hong Kong; Kiribati; Labuan; Lebanon; Liberia; Liechtenstein; Macao; Madeira Island; Maldives; Man Island; Marshall Islands; Mauritius; Monaco; Montserrat Islands; Nauru; Niue Island; Norfolk Island; Panama; Pitcairn Island; French Polynesia; Qeshm Island; American Samoa; West Samoa; San Marino; Saint Helen Islands; Saint Lucia; Saint Kitts and Nevis Federation; Saint Peter and Saint Miguel Islands; Saint Vincent and Grenadines; Seychelles; Solomon Islands; Swaziland; Switzerland; Sultanate of Oman; Tonga; Tristan da Cunha Islands; Turks and Caicos; Vanuatu; British Virgin Islands; and US Virgin Islands. It should be noted that Switzerland used to also be in the list of tax havens, but was excluded due to the Swiss government’s request. Executive Declaratory Act 11, of 24 June 2010 was issued removing Switzerland from the list for further analysis by the Brazilian government. Switzerland is therefore currently excluded, until further analysis of its request.} and has been considered as an all inclusive list of such cases. IN 1037 also introduced a list of privileged tax regimes, hence resolving the uncertainty brought about by article 30 of Law 11941/09, which conceptualized the privileged tax regime institute, but did not identify any of the countries which would fit into that category.
Pursuant to Article 24-A of Law 9430, resulting from Article 23 of Law 11727/08, as amended by Article 30 of Law 11941/09, privileged tax regimes are those that meet one or more of the following requirements:

- do not tax income, or tax income at a maximum rate which is lower than 20%;
- provide tax advantages to non-residents (individual or legal entities) conditioned upon non-performance of substantial economic activities in the relevant jurisdiction, or without requiring performance of substantial economic activities in that jurisdiction;
- do not tax income earned outside its territory, or taxes such income at a maximum rate which is lower than 20%; and/or
- do not allow access to information about the shareholding structure of legal entities, ownership of assets and rights or economic transactions performed.

The concept of privileged tax regime is broad and its analysis gives room to a certain level of subjectivity. Until now, the RFB has not clarified the scope of this concept, although it has narrowed the scope of application of the institute, by identifying the countries and the regimes it considers to be of a privileged nature. In practical terms, the introduction of two different lists, one of low tax jurisdictions and another of privileged tax regimes, follows the OECD standard to the extent that Brazil has shown to have opted to have a black list (low tax jurisdictions) and a grey list (privileged tax regimes).

The penalty for the commercialization of goods, services or rights with a black list country is threefold: (i) the application of an increased Withholding Income Tax (elevated from 15%, the standard, to 25%); (ii) application of transfer pricing control to remittances made to one of the listed country, regardless of whether the receiving entity is a related entity; and (iii) application of the Brazilian thin capitalization rules. Grey list countries, on the other hand, are only penalized by two forms of control, namely, transfer pricing and thin capitalization (as per items (i) and (ii) above). Remittances made to grey list countries are subject to the regular Withholding Income Tax rate of 15%.

B.2. Transfer Pricing Methods for Acquisitions and Imports

9 The following regimes qualify as privileged tax regimes: the regime applicable to holding companies set out in the legislation of Luxembourg; the regime applicable to the Sociedad Anonima Financiera de Inversion (SAFI) set out in the legislation of Uruguay until December 31, 2010; the regime applicable to holding companies set out in the legislation of Denmark, in case they do not carry substantial activity; the regime applicable to the International Trading Company (ITC) set out in the legislation of Iceland; the regime applicable to the Offshore KFT set out in the legislation of Hungary; the regime applicable in American States to Limited Liability Companies (LLCs) formed of non-residents and not subject to federal income tax, set out in the legislation of United States of America; the regime applicable to the Entidad de Tenencia de Valores Extranjeros (ETVE) set out in the legislation of Spain; and the regime applicable to the International Trading Company (ITC) and the International Holding Company (IHC) set out in the legislation of Malta. IN 1037 used to also foresee in the list the regime applicable to holding companies set out in the legislation of the Netherlands, if they do not carry out any substantial activity. However, following the edition of IN 1045/10 (IN 1045) the inclusion of Netherlands was questioned by the Dutch government, and hence excluded from the list. According to Executive Declaratory Act 10, of 24 June 2010, the effects deriving from the Netherlands inclusion are suspended until further analysis. For the time being, therefore, the Netherlands is not considered to be a privileged tax regime.
As of 2011, four methods may be used to calculate transfer pricing adjustments in acquisitions and imports of assets, goods, services or rights:

- Comparable Independent Prices (PIC);
- Resale Price Less 20% Profit (PRL 20 - for goods imported and resold without undergoing any industrial process in Brazil);
- Resale Price Less 60% Profit (PRL 60 - for imported goods which undergo further industrialization in Brazil);
- Production Cost Plus Profit (CPL).

If the benchmark reached by the application of one of such methods (the most favorable method at the option of the taxpayer, as long as such option is validly made before a tax inspection) is greater than the acquisition/import prices subject to transfer pricing control, no adjustment is required when calculating the IRPJ and the CSLL.

On the other hand, if the benchmark is lower than said acquisition/import prices and this difference exceeds the variations accepted by the legislation, such difference must be added to the IRPJ and CSLL tax bases.

Below is a brief description of the benchmark calculations for imports, based on the methods commented in this section.

**PIC.** PIC Basically corresponds to the OECD’s Comparable Uncontrolled Price Method (CUP). The benchmark results from the weighted arithmetic average of purchases and sales, between unrelated parties, in Brazil or in other countries, of the same or similar assets, goods, services, or rights, under similar payment conditions.

The following transactions may be used when calculating the PIC benchmark:

- same or similar assets, goods, services, or rights sold by the same foreign related party to unrelated legal entities, with or without domicile in Brazil;
- same or similar assets, goods, services, or rights purchased by the same Brazilian company from an unrelated legal entity, with or without domicile in Brazil, and/or
- same or similar assets, goods, services, or rights purchased or sold between unrelated legal entities, with or without domicile in Brazil.

Comparable prices must be adjusted in order to equalize different conditions; much like the OECD determines one to promote a functional analysis when determining comparability. The difference in the Brazilian case, is that the Brazilian rule determines exactly what factors may be taken into account in order to determine comparability and similarity. The Brazilian adjustments are hence detailed in Article 9 of IN SRF 243/02 (IN SRF 243) and comprise payment terms, quantities sold, guarantees offered, marketing/advertisement obligations, costs with quality standards and quality control, packaging costs, brokerage fees due to unrelated parties, freight and insurance for identical assets, goods, services or rights. Article 10 of IN SRF 243 provides that, in case the assets, goods, services or rights are similar, in addition to the adjustments
above, the prices must be adjusted for differences in the physical characteristics and content of the comparable items, considering their production and development costs exclusively in relation to the differences found. Other adjustments will not be accepted under the Brazilian legislation.

The Brazilian rule on comparability makes sense to the extent that the Brazilian law’s objective is to transform the OECD’s subjective approach to transfer pricing, into a very objective and mathematical approach for companies transitioning from Brazil. The aim is to grant juridical certainty to those transactions, to the extent that the formula will be responsible for an exact result, which will determine the exact range in which a Brazilian entity’s price may be fixed.

The PRL methodology corresponds to the OECD’s Resale Price Method and in Brazil, is applied at two distinct versions: (i) PRL with a profit margin of 20%, for goods, assets, services or rights imported into Brazil exclusively for resale purposes, without undergoing any further industrialization in the country; or (ii) PRL with a profit margin of 60% for the goods, assets, services or rights imported into Brazil which are destined to undergo further industrialization in the country or be added to an existing production line.

PRL 20. The benchmark results from the weighted arithmetic average of the resale price of the imported assets, goods, services or rights, in transactions with non-related parties, reduced by (i) unconditional discounts that do not depend on future events/conditions, as shown on the relevant invoice; (ii) indirect taxes included in the sales price (e.g., Tax on Circulation of Goods and Services (“ICMS”), Tax on Services (“ISS”), and Contributions to Finance Social Security (“PIS and COFINS”)); (iii) brokerage fees and sales commissions; and (iv) the 20% profit margin on the resale price less the unconditional discounts above.

The PRL 20 applies to assets, goods, services or rights imported for resale (i.e., which are not used in the Brazilian company's production process).

PRL 60. The benchmark shall result from the weighted arithmetic average resale price of the assets, goods, services or rights resold to unrelated parties, produced with the use of the imported items minus (i) unconditional discounts (as defined above); (ii) taxes included in the sales price (as explained above); (iii) brokerage fees and sales commissions; and (iv) the 60% profit margin on the resale price less the unconditional discounts, taxes, brokerage fees and sales commissions above and the value added in Brazil to the assets, goods, rights and services acquired/imported by the reseller.

The PRL 60 applies to imported assets, goods, services or rights used in the taxpayer's production process.

IN SRF 243 provides further clarification about the calculation of the benchmark in accordance with this method, but there are disputes regarding the interpretation of the law conveyed therein.

CPL. CPL corresponds to the OECD’s Cost Plus Method. The Brazilian benchmark is calculated by taking the weighted average of the production cost of the imported
assets, goods, services, or rights (in the country where they were originally manufactured) and adding a profit margin of 20% over the cost, plus the taxes levied upon exportation (charged by the manufacturing country).

In addition to direct costs, costs of any goods, services or rights used or consumed in the manufacturing process, reasonable process losses, depreciation, and lease and maintenance expenses related to the production process may be taken into account when calculating the benchmark under this method, as determined by IN SRF 243 (controversies arise as to whether other costs not mentioned in IN SRF 243 can be considered in the calculation of the benchmark according to this method).

The benchmark may also be calculated by taking into consideration the production cost of similar assets, goods, services, or rights, adjusted as provided by the legislation (please refer to the comments on adjustments for similar items described under the PIC method).

B.3. Transfer Pricing Methods for Exports

I - The Use of Safe Harbors

According to the Brazilian tribunals, “although Brazil is not an OECD member, it strives to comply with the arm’s length principle by adopting specific closed methods with predefined margins,” and by adopting certain safe harbors. On the other hand, the OECD has already manifested itself favorably to the use of safe harbors, by saying that the use of safe harbors could “significantly ease compliance by (...) sparing the taxpayer the search for comparables, thus saving time and resources which would otherwise be devoted to determining transfer prices.”

Based on the above, the Brazilian tax administration chose to adopt a hybrid system when it comes to the application of transfer pricing rules for exports. Brazil only gives up the need to search for comparables in case the company meets one of the safe harbor provisions. In case it does not met any of the safe harbor provisions, it may have to search for comparables, depending on the transfer pricing method it chooses to apply on export transactions.

(i) General Safe Harbour Rule: Exclusion from Transfer Pricing

The first exclusionary transfer pricing rule applies both to import and export transactions. It is a general rule of non-application of transfer pricing provisions, to certain kinds of transactions. Law 9430 states that the transfer pricing rules are not applicable to:

- imports of royalties and technical, scientific and administrative or similar assistance (the same rule has been extended to exports of royalties and exports of the same services, according to IN SRF 243); and

---

12 As per paragraph 4.100 of the OECD Transfer Pricing Guidelines.
interest paid if the corresponding agreement is registered with the Central Bank (BACEN). Please note that interest deriving from loans not registered with the Central Bank, will be subject to transfer pricing control.

The safe harbor therefore merely removes certain types of remittances from transfer pricing control.

(ii) Safe Harbors for Exports

Under the second safe harbor rule, which is specific for exports, transfer pricing rules will only apply to exports if the average export price is inferior to 90% of the average price of the same or similar good, service, or right sold in the Brazilian market to unrelated parties, during the same period and under similar payment conditions. For the applicability of such rule, only transactions involving independent parties can be considered.

From the Brazilian final sales price, ICMS, ISS, PIS and COFINS, and unconditional discounts shall be deducted. Export prices shall also be free of freight and insurance costs borne by the seller.

(iii) Safe Harbors for Entering New Markets

Likewise, exports involving related parties with the purpose of entering new markets are not subject to transfer pricing adjustments, as provided by the law. However, this rule does not apply to exports to low taxation jurisdictions or privileged tax regimes.

Such exports can be done at average prices lower than 90% of the prices applied in Brazil for the same assets, goods, services of rights, as long as:

- the assets, goods, services or rights have not, in the past, been traded in the country of destination, by the exporting company or any other company related to it in the world;
- the assets, goods, services or rights are traded to consumers for a price that is lower than the price of any identical or similar good, service or right traded in the country of destination;
- the transactions are part of an export plan, previously approved by the Federal Revenues Service;
- the export plan demonstrates that the related company in the country of destination will not accrue profits in relation to the relevant transactions and provides for a deadline for the Brazilian company to recover losses borne in the same transactions, if any.

The export plan must also describe:

- the name of the related company that will be in charge of distributing the assets, goods, services or rights in the country of destination;
- the quantity of each asset, goods, service or right to be exported as part of the plan to enter the new market;
- the form of distribution of the relevant assets, goods, services or rights in the
country of destination and local companies in charge of such distribution;
- the percentage margin agreed upon with the foreign distributors;
- the term for execution of the export plan (including starting and termination
dates), which must not exceed twelve months; and
- a budget for the promotional and advertisement expenses in the country of
destination.

(iv) Variation Margins

In addition to the foregoing, IN SRF 243 foresees a second safe harbor, releasing
Brazilian legal entities from calculating transfer pricing adjustments as per one of the
methods described in the legislation, if they demonstrate that (these exceptions do not
apply to exports to low taxation jurisdictions):

- their net export revenues (including exports to parties domiciled in low tax
jurisdictions) in the calendar year do not exceed 5% of the total net revenues of
the same period; or
- their net profits from exports to related parties, before CSLL and IRPJ provision,
are equivalent to, at least, 5% of the total revenues accrued in such transactions,
considering the annual average for the current tax base period and for the two
preceding years.

The latter calculations must be supported by profit and loss statements, evidencing
the results achieved during the reference period, and making a distinction between the
revenues, cost and expenses related to transactions performed between related and
unrelated parties. Common costs and expenses must be shared taking into account the
proportion of the net revenue of exports to related parties vis-à-vis the total net
revenues, unless the costs and expenses are properly individualized.

The safe harbors provided by IN SRF 243 do not apply to transactions with
companies residing in low tax jurisdictions (disputes may arise regarding their
application to transactions carried out under privileged tax regimes) and do not prevent
the Brazilian tax authorities from investigating the relevant prices and assessing the tax
whenever the applicability of those exceptions is deemed inadequate.

II – Methods applicable to Export Transactions

If the taxpayer does not benefit from any safe harbor, any one of the following four
methods can be used to calculate the benchmark for exports:

- Export Sales Price (PVEX);
- Wholesale Price in Country of Destination Less Profit (PVA);
- Retail Price in Country of Destination Less Profit (PVV); and
- Purchasing or Production Cost Plus Taxes and Profit (CAP).

Comparable prices must be adjusted to equalize different conditions as described in
IN SRF 243.
If the benchmark obtained by one of the above methods (most favorable at the option of the taxpayer, if the option is validly made before a tax audit) is lower than actual export prices subject to transfer pricing control, no adjustment shall be required when calculating IRPJ and CSLL. On the other hand, if the benchmark is higher than the export price and this difference exceeds the threshold imposed by the legislation, the positive difference must be added to IRPJ and CSLL tax bases.

**PVEX.** The benchmark is achieved by finding the arithmetic average of the prices charged on export transactions to unrelated parties, or the arithmetic average of the export price of the same or similar asset/goods/service/right applied by any given Brazilian company to a non-related party. The transactions considered in the benchmark calculation shall relate to the same reference period and must be carried out under similar payment conditions.

**PVA.** The benchmark shall result from the weighted arithmetic average of wholesale prices of the same or similar asset/goods\(^{13}\) in the country of destination, subject to similar payment conditions, reduced by:

- taxes charged by that country on the sales price (similar to PIS/COFINS, ICMS and ISS); and
- a 15% profit margin on the gross wholesale price.

**PVV.** The benchmark shall result from the weighted arithmetic average of the retail price of the same or similar asset/goods\(^{14}\) in the importing country, provided that asset/good is subject to similar payment conditions, less:

- taxes charged by that country on the sales price (similar to PIS/COFINS, ICMS and ISS); and
- a 30% profit margin on the gross retail price.

**CAP.** The benchmark shall result from the arithmetic weighted average of the purchase or production costs associated with the exported assets, goods, services, or rights plus Brazilian taxes and the application of a 15% profit margin over the total amount.

### B.4. Common Rules on Imports and Exports

Below are some of the definitions carried by the transfer pricing legislation, for purposes of benchmark definition. These might guard some or no correlation with the OECD suggested definition under the transfer pricing guidelines.

**Similar products.** Similar products are those that concurrently (i) have the same characteristics and application; (ii) have equivalent specifications; and (iii) can be mutually exchanged, in view of their intended purpose.

---

\(^{13}\) The legislation is unclear about the application of PVA to rights and services, although it seems that the application of the method in these cases is very difficult if not impracticable.

\(^{14}\) The legislation is unclear about the application of PVV to rights and services, although it seems that the application of this method in these cases is very difficult if not impracticable.
Variation margins. No transfer pricing adjustment is required in case the price achieved by the taxpayer varies from the benchmark in an amount equal or equivalent to 5%.

Prices excluded for comparison purposes. Specially reduced prices (during sale season) or other unusual prices cannot be used when calculating the benchmark.

Accepted documents. In addition to documents usually required for purchase and sale, reports and publications issued by official entities, governmental agencies, surveys made by reputable companies/institutions, stock exchange quotations, etc. can be used to support transfer pricing calculations.

Amendments to legal profit margins. Articles 19-A and 20 of Law 9430 allow the Finance Minister to change the fixed profit margins used to calculate transfer pricing benchmarks (i) per sector or economic activity; and (ii) under special circumstances. Articles 32 to 34 of IN SRF 243 further clarifies that these changes can be made ex officio or at the request of interested parties.

Tax audits. Brazilian legal entities must inform in their DIPJ the transfer pricing method chosen and provide the tax authorities with all the necessary documents to support their transfer pricing calculation.

Article 19-B of Law 9430 provides that tax authorities may calculate the benchmarks based on the documents available and apply any other transfer pricing method described in the legislation if the taxpayer fails to:

- inform the chosen method to calculate their transfer pricing adjustments, before the beginning of a tax audit;
- provide the tax authorities with the benchmark calculations based on the chosen method; or
- supply the tax authorities with adequate and sufficient documentation to support said calculations.

C. CONCLUSION:

The Brazilian transfer pricing methodology is not safe from criticism. The proposed methodology has complexities which could have been solved by the legislator had he taken his time to think about the system more thoroughly. However, it is a good methodology to the extent that it allows companies to reach a transfer pricing benchmark without having to resort to external, inaccessible and unobtainable data. Perhaps now that it has become trendy to make the case for developing countries because of their expansionist capacity and their economic potential, it would be the time to think at a national (Brazilian) level and at an international level, of conversion rules to make the Brazilian system compatible with the international, OECD transfer pricing guidelines-based system.
Were that to be the case, the Brazilian system could be further developed by international regulators such as the OECD or the United Nations international taxation department, in order to be taught to other developing countries which have not been able to implement transfer pricing regulations yet due to lack of resources, lack of qualified personnel, or merely due to lack of a thorough knowledge of the international regulation on the subject.

Alternatively, the Brazilian system could be marketed as a stepping stone. An initial, simpler and more objective approach for developing countries to get acquainted with the transfer pricing regulations and build domestic capacity on the subject. A country would then have the option to merge into the international OECD based transfer pricing system once it had acquired enough knowledge and know-how in dealing with transfer pricing issues.

Regardless of the approach taken in dealing with transfer pricing issues, the Brazilian system is definitely not one to be discarded. It offers an option, for countries in need of knowledge and experience in dealing with transfer pricing issues. One alternative transfer pricing approach might just be better than having no approach at all.