Transfer Pricing Brazilian Case

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Background & Legislation

- **Brazil adopted tax law imposing worldwide income taxation for juridical persons in 1995. The change in the law that allowed the taxation on a worldwide basis was made by means of the Federal Law n. 9.249, Dec. 29, 1995, that entered into force in Jan. 1, 1996.**

- **Transfer Pricing law was enacted in 1996, and entered into force in Jan. 1, 1997 (Federal Law n. 9,430/96). Federal Law 9,430/96 was modified by Law n. 10,451/ 2002, and by Federal Law n. 11,196/2005, which introduced a modification to adjust exchange rate appreciation of the Real against foreign currency.**

Background & Legislation

- **In 2012, the law was changed to be more "comparables"-based by adopting different margins for certain specific sectors, but in general maintained 20 percent as a prescribed margin for the resale price method, among other modifications introduced by Provisional Measure n. 563/2012 (some of this changes will enter into force only in January first, 2013).**

<u>This presentation is based on the Law 9.430 as amended (including Provisional Measure n. 563/2012)</u>

- **Brazilian regulations for transfer pricing must follow enacted law. It may be an Administrative Rule ("*Portaria*") issued by the Minister of Finance or by the Federal Revenue Secretary, or an Normative Rule ("*Instrução Normativa RFB*"), that are detailed regulations (rullings).**

Background & Legislation

- **Current transfer pricing rules are detailed in Normative Instruction SRF No. 243, issued in November 11, 2002, as amended.**
- **Regulations to accept adjustments in mark up margins were established by the Ministry of Finance through Administrative Rule Number 222, issued in Sept., 2008 (previously under Portaria MF no. 95, de 1997). There are other Regulations dealing with adjustments to exchange rate appreciation.**
- **Law and regulations are available at: www.receita.fazenda.gov.br/Legislacao/LegisAssunto/PrecosTransf.htm (Texts in Portuguese)**

Legislation Analysis

- **In general, Brazilian legislation seeks to adopt the arm's length principle. If this principle is not observed, the law authorizes tax authorities to reallocate income for tax assessment purposes. Lack of compliance may result in tax penalty of 75% or 150% based on unpaid tax.**
- **Aside from the comparable uncontrolled price method, which is simillar to OECD Guidelines, all the others methods in Brazil come with their own statutorily set of profit margins that vary between 15% and 40% without the need to use a comparable uncontrolled transaction. This feature makes Brazilian legislation simpler.**

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.**
- **Related parties are juridical persons (legal entities) or individuals that have common interests (branch, controlled companies, participation holders, exclusive distribution rights owners, etc), in accordance to a set of rules established by tax legislation.**

Legislation Analysis

- **Under TP Regulations, related parties are the Brazilian entity and:**
- **1 – the parent company when it is domiciled in a foreign country;**
- **2 - a foreign branch or subsidiary of the Brazilian entity**
- **3 – a non-resident individual or legal entity, domiciled abroad, when it holds at least 10 % of the shares or control of the Brazilian company;**
- **4- a legal entity domiciled abroad in which the Brazilian company holds at least a 10 % participation or is a controlled company;**
- **5 – a foreign company that are under common corporate or administrative control, or when at least 10 % of the shares of each belongs to a common shareholder;**
- **6 - a non-resident individual or legal entity, domiciled abroad that jointly hold at least a 10 % participation or control a third legal entity;**

Legislation Analysis

- 7 - an individual or legal entity resident abroad that are associated in any form of condominium, consortium or co-ownership in any enterprise, in accordance with Brazilian Law definition;

- 8 - a non-resident individual who is a relative to the third degree of kinship, or is the spouse (legally or by common law) of any director or directly or indirectly controlling partner or shareholder;

- 9 - an individual or legal entity resident abroad, that acts as exclusive agent and distributor (or private concessionaire) for purchase and sale of goods, services and rights;

- 10 - an individual or legal entity resident abroad, to whom the legal entity in Brazil acts as exclusive agent and distributor (or private concessionaire) for purchase and sale of goods, services and rights.

- This rule also applies to Brazilian individuals, when applicable.

- **It is clear that Brazilian TP rules to define related parties are broader than the Model Convention and TP Guidelines from the OECD.**

Legislation Analysis

- **Transactions examined under Brazilian Transfer Pricing Regulations also includes…**
- **Operations performed by individuals and legal entities in Brazil with any individual or legal entity, residing or domiciled in a country that do not tax income or that tax income up to a maximum rate of 20 percent, regardless of whether the latter is a related part, are examined under the Brazilian Transfer Pricing Regulations.**
- **This rule also applies to countries that offers secrecy to the ownership structure of legal entities.**
- **Normative Instruction No. 1.037, issued in June 4, 2010, as amended, brings a list of jurisdictions that fulfill the conditions as the definition of low tax or non transparent jurisdictions.**

Legislation Analysis

- Brazilian Transfer Pricing Regulations are not applicable to royalty payments, technical assistance, and scientific and administrative fees (when it represents payments for technology transfer). These expenses are subject to restrictions, and have limited deduction. They are also subject to withholding tax. These limited deductions replace TP regulations application, and in some cases would lead to a analogous result derived from it.
- It is also a deviation from OECD Model, where royalties and technical assistance, and scientific and administrative fees are subject to transfers price regulations.

Legislation Analysis

- Brazilian Transfer Pricing Regulations also apply to transactions performed by unrelated parties, depending on the conditions of the operation. It also applies to transactions performed through an "interposed person", which is a third party that is not directly associated to the related parties, but is engaged in business (international transactions of the same nature) connecting the two related parties. It acts as "conduit company". Actually, it is an anti-tax-avoidance rule.
- Brazilian taxpayers must inform in their annual tax return for juridical person (DIPJ) if there is any kind of relationship with related individuals or legal entities, resident or domiciled abroad.

Methods adopted by Brazilian TP Regulations

- There are two set of methods for goods, services an rights (in general):
  - For import transactions:
    - Comparable Uncontrolled Price Method (PIC **+ PCI**) **(CUP)**
    - Resale Price Method (general 20% gross profit margin) (PRL) **(RPM)**

      + Other margins for specific sectors (see next slide).
    - 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% margin) (PVA) **(RPM)**
    - Retail Price in the Country of Destination Less Profit Method (30% margin) (PVV) **(RPM)**
    - Cost Plus Method (15% profit margin) (CAP) **(Cost Plus)**

    There is no preferable method, taxpayer may use the one that better fits (or works) to his/her operation, but cannot use other methods such as Profit Split and TNMM.

Fixed Margins for the Resale Price Method

I - **forty per cent**, for the following sectors:

a) pharmaceutical chemicals and pharmaceuticals;

b) tobacco products;

c) equipment and optical instruments, photographic and cinematographic;

d) machinery, apparatus and equipment for use in dental, medical and hospital;

e) petroleum, and natural gas (mining industry), and

f) petroleum products (derived from oil refineries and alike);

II - **thirty percent for the sectors of:**

a) chemicals (other than pharmaceutical chemicals and pharmaceuticals);

b) glass and glass products;

c) pulp, paper and paper products; and

d) metallurgy.

Additional Explanation for PCI e PECEX methods

PCI and PECEX methods were recently added by Provisional Measure 563/2012. They 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. The law defined the methods as follows:

Price under Quotation Method for Imports - PCI is defined as the average daily price of goods or rights subject to public prices in commodities futures and internationally recognized exchange markets.

Price under Quotation Method for Exports- PECEX is defined as the average daily price of goods or rights subject to public prices in commodities futures and internationally recognized exchange markets.

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.

Methods adopted by Brazilian TP Regulations v. OECD Recommendations

BRAZIL	**OECD**
IMP - EXPORT	
PIC, PCI – PVEx, PECEX	*Comp. Uncontrolled Price (CUP)*
PRL – PVA/PVV	*Resale Price Method (RPM)*
CPL – CAP	*Cost Plus Method*
N/A	*Transac.Net Margin Met. (TNMM)*
N/A	*Profit Split Method*
	OTHER
N/A	*Formulary Apportionment*

Methods adopted by Brazilian TP regulations

- There are special rules for financial operations.

  The interest paid or credited to the a related person, when due to the loan agreement, will only be deductible for purposes of determining taxable income to the amount not exceeding the calculated value based on the rate London Interbank Offered Rate - LIBOR for deposits in U.S. dollars for six months plus a margin percentage as spread, to be set annually by the Minister of Finance based on market average rate.

Methods adopted by Brazilian TP regulations

- Compulsory profit margins are set between 15 and 40 percent, depending on the Transfer Pricing Method, the economic sector, and they differ for inbound and outbound transactions. The law specifies minimum and maximum profit margins and grants the Ministry of Finance the authority to change these margins; that is, the profit margins are statutorily set in the Transfer Pricing regulations and 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 by an act of the Minister of Finance through an individual request submitted by the taxpayer. A request to modify a profit margin must be accompanied by documents that prove that the margin used by the taxpayer conforms to normal practices between unrelated parties under comparable circumstances.

Safe Harbor in Brazilian TP regulations (examples)

1) Brazilian taxpayers which have a net profit originating from export sales to related parties (before taxes on income), taking into consideration the taxable year and the previous two years, of at least 5% over such sales will not have to make export TP adjustments.

2) Brazilian taxpayers are not subject to transfer pricing in exports when it is shown that net export revenues is equal to or less than 5% of its total net revenues.

3) For exports, Brazilian taxpayers are not subject to transfer pricing regulations if the average sales price in international controlled transactions is equal to or higher than 90% of the average sales price in uncontrolled transactions with unrelated parties in the Brazilian market.

Safe Harbor in Brazilian TP regulations

4) Market conquest special rules. Operations targeted to conquest market for Brazilian goods and services, when previously adapted to certain conditions are not submitted to TP regulations.

5) A 5% gap between prices assumed as uncontrolled prices (parameter price), in transactions between related parties, and the import and export prices in transaction documents is acceptable.

Important: rules set forth in items 1, 2 and 4 are not valid for sales to related parties established in low tax or non transparent jurisdictions, as defined by Brazilian TP Regulations.

Current important Issue

- **Intangibles**

- Transactions with intangibles are subject to Brazilian TP regulations. However, a set of operations are excluded: royalty payments, technical assistance, and scientific and administrative fees (when it represents payments for technology transfer – which is intangible property).

- There is not a set of rules appropriated to cover intangibles. Actually, most of the intangible transactions are classified as a royalty transactions, thus not under TP regulations.

Kiitos!

Obrigado!

Gracias!

Danke!

Thank you!