Brazilian Transfer Pricing – A Practical Approach
Could this be a Model for Developing Countries?

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Application of the Transfer Pricing Legislation

- Transfer pricing rules apply for:
  - Transactions involving a corporate entity or individual residing in Brazil and a corporate entity or individual residing abroad:
    - Who are related under the terms of the Brazilian legislation; or
    - Unrelated corporate entities or individuals, with residence or domicile in:
      - A tax haven jurisdiction
      - A jurisdiction allowing corporate secrecy (ownership and/or composition);
      - A jurisdiction whose domestic legislation fails to identify the effective beneficiary of the revenue
      - Privileged tax regime jurisdictions

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Application of the Transfer Pricing Legislation

- Transfer pricing rules also apply to:
  - transactions involving a related Brazilian legal entity or individual and a foreign legal entity or individual which are mediated by a third unrelated party; and
  - Ordered import transactions (importação por encomenda).

Application of the Transfer Pricing Legislation

a) The following shall be considered to be related to a Brazilian legal entity or individual:

- It's foreign parent company;
- A foreign affiliate or branch;
- A foreign corporate entity or individual whose shareholder participation in the Brazilian entity qualifies her as a controlling or colligated entity;
- A foreign corporate entity characterized as a controlled or colligated entity;
- The foreign legal entity which is under the same corporate or administrative control, or when at least 10% of the capital of each of the companies belongs to the same corporate entity or individual;

Application of the Transfer Pricing Legislation

- The foreign corporate entity which, together with a Brazilian corporate entity or individual detains enough shares in a third person to qualify her as controller or to make her colligated;
- The foreign corporate entity or individual associated to a Brazilian entity or individual through a consortium or condominium structure;
- A foreign individual who is a relative or is related up to a third degree kinship, or is a spouse or cohabitant of any of its directors, partners, or controlling shareholders in direct or indirect participation;
- The foreign corporate entity or individual, bearing exclusivity as an agent, distributor or concessionaire for the purchase and sale of goods, services or rights abroad;
- The Brazilian corporate entity or individual, bearing exclusivity as an agent, distributor or concessionaire of a foreign company, for the purchase and sale of goods, services or rights in Brazil;

Application of the Transfer Pricing Legislation

b) Tax Havens:

- A jurisdiction which does not tax income or that taxes income at a rate which is inferior or equal to 20%;
- A jurisdiction which does not allow access to information concerning the corporate structure or ownership of the legal entities located therein;
- A jurisdiction which does not provide the identification of the effective beneficiary of the revenue attributed to a person which is a non-resident in that jurisdiction

Application of the Transfer Pricing Legislation

List of Tax Havens:

Andorra	Barbados	Cook Islands	Lebuan Islands	Marshall Islands	French Polynesia	Saint Pierre and Miquelon	Kingdom of Tonga
Anguilla	Belize	Costa Rica	Lebanon	Monaco	Qeshm Island	Saint Vincent and Grenadines	Tristan da Cunha
Antigua and Barbuda	Bermuda Islands	Djibouti	Liberia	Montserrat Islands	American Samoa	Seychelles	Turks and Caicos Island
Dutch Antilles	Brunei	Dominica	Lichtenstein	Nauru Islands	Occidental Samoa	Singapore	Republic of Vanuatu
Aruba	Campione D'Italia	Gibraltar	Macau	Niue Island	San Marino	Solomon Islands	United Emirate States
Ascension Islands	Channel Islands	Granada	Madeira Island	Norfolk Island	Saint Helena Island	St. Kitts and Nevis	American Virgin Islands
Bahamas	Cayman Islands	Hong Kong	Maldives	Panama	Santa Lucia	Swaziland	British Virgin Islands
Bahrain	Cyprus	Kiribati Islands	Isle of Man	Pitcairn Island	Saint Christoph and Nevis	Oman	

Application of the Transfer Pricing Legislation

c) Privileged tax Regimes:

– A jurisdiction which does not tax income or that taxes income at a rate which is inferior or equal to 20%;

– A jurisdiction which grants tax benefits to a corporate entity or individual:

  • Without demanding proof of the transaction's economic substance;

  • Provided the company does not exercise substantial economic activities in the country

– Does not tax foreign income/revenue, or taxes that income at a tax rate which is inferior or equal to 20%

– Does not allow access to information regarding its legal entities` corporate composition, ownership of goods, assets or rights, and/or to the economic transactions taking place in the country.

– Does not allow access to information regarding it's legal entities` corporate composition and ownership

– Does not provide enough information to identify the effective beneficiary of the income/revenues attributed to non-residents.

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Application of the Transfer Pricing Legislation

List of Privileged tax Regimes:

Uruguay	Regime applicable to the legal entities constituted under the form of Financial Institutions of Inversion (Safis) until 31 December 2010
Denmark	Regime applicable to the holding companies, not exercising substantial economic activities in the country.
The Netherlands	Regime applicable to the holding companies, not exercising substantial economic activities in the country
Iceland	Regime applicable to the legal entities constituted under the form of International Trading Companies (ITC)
Hungary	Regime applicable to the legal entities constituted under the form of Offshore KFT
United States of America	Regime applicable to state Limited Liability Companies (LLCs), owned by non residents and not subject to the federal income tax in the USA
Spain	Regime applicable to the legal entities constituted under the form of a Foreign Investment Vehicle denominated ETVE
Malta	Regime applicable to the legal entities constituted under the form of International Trading Companies (ITC) and International Holding Companies (IHC)

Application of the Transfer Pricing Legislation

Transactions which are excluded from TP control:

- Import or export (admission or remittance) of royalties and technical, scientific, administrative or similar assistance.

This means that the following transactions are not subject to control:

- Services: Remuneration for the effective rendering of services, such as business intermediation (commission or brokerage), accounting or juridical assistance, managerial and financial assistance, advertising and publicity, etc.
- Rights: Remuneration for the use of tangible goods (i.e. rent or leasing);
- Royalties: remuneration for the use of non-tangible assets, such as brands, patents, registered formulae or processes, etc.
- Technical , administrative or similar assistance: remuneration for effectively rendered services related to the use of technology. These services might involve technical work, drawings, studies and use instructions.

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Application of the Transfer Pricing Legislation

Transactions which are excluded from TP control:

Interest paid if the corresponding agreement is registered with the Central Bank of Brazil.

This means that: Active or passive interest not registered with the Brazilian Central Bank:

i. Between related parties; or

ii. Remitted to a tax haven or privileged tax regime jurisdiction

= will be subject to transfer pricing control.

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The Methods

Methodology

To determine if a transaction is compatible with the transfer pricing legislation, one has to compare the practiced price (effective price) with the comparable price/benchmark, obtained through one of the methods (preco parametro);

Practiced price: Average price applied to the transactions between the related parts

Comparable price/benchmark – price verified through the application of one of the methods established under the TP legislation. This price is reached through the analysis of (i) the average prices practiced with independent parties, or (ii) the production cost.

Methodology

The Brazilian legislation has adopted different methods, of direct and indirect comparability, to verify what would be the comparable price:

	Import Methods	**Export Methods**
Direct Comparison	PIC – Comparable Independent Prices	PVEx – Sale Price on Export
Indirect Comparison (Resale)	PRL 20 – Resale Price Minus 20% Profit ; and PRL 60 – Resale Price Minus 60% Profit , with added value in Brazil	PVA – Wholesale Sale Price at country of destination, minus profit (15%); and PVV – Retale sale price at country of destination, minus profit (30%)
Indirect Comparison (Production)	CPL – Production Cost plus Profit (20%)	CAP – Acquisition or Production cost, plus taxes and profit (15%)

Methodology

Divergence Margin:

– The requirements will be considered to have been met, when the comparable price <u>diverges by a margin of up to 5% </u>(plus or minus) from that subscribed under the import/export documentation.

Adjustments for comparability and Similarity:

- Atypical transactions will never be admitted as a comparable transaction (i.e. stock clearance, sale with government subsidy, final sale, etc);
- Transactional "bundling" is only admissible when the transactions are so closely related that evaluating them separately would be unviable if not impossible (same NCM);
- Rule: (individual) transactional approach or product approach. Basket Approach not admissible.

Methodology

Identical goods, Services or Rights:

• Adjustments are allowed only on the comparable price, and should be related to the nature of the business. Only if it is impossible to make the adjustment on the comparable price, will an adjustment on the practiced price be allowed.

• The following adjustments are allowed under the Brazilian TP legislation:

  - Payment deadline: adjustment fee applied (i.e. SELIC or LIBOR);
  - Negotiated amount: discount due to the quantities sold;
  - Guarantees: Adjustments due to product warranty, or service application;
  - Advertising and publicity: in case the recipient company bears the burden of publicity, practiced price may be higher.

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Methodology

- Quality control, administration, hygiene conditions and service standard: if cost borne by foreign company, then price of transacted good may be higher;
- Intermediation cost, in purchase and sale transactions, practiced by non-related companies;
- Re-conditioning of goods: adjustments with respect to cost difference in the materials purchased in the re-conditioning if goods;
- Transport and Insurance;
- Credit risks (only admissible for export transactions): Must be based on average assumption of total losses incurred in the previous calendar year.

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Methodology

–Similarity Adjustment:

•Two or more goods will be considered similar (in use conditions or the destination to which they serve) in case they simultaneously:

a) Have the same nature and species;

b) May be mutually substitutable, in the function to which they are destined;

c) Have equivalent specifications

- In case the products are considered to be similar, other adjustments (apart from those listed before) will also be admissible:
- Price adjustments due to the physical nature and content of the goods;
- Price adjustments relating to the production of the good or rendering of the service, or constitution of the right;

•Price adjustments due to the models subject to comparison

Methodology

Need to identify:

- Differences between models;
- Technical Specifications;
- Components of each product (and how they differ);
- Accessories, parts and pieces of each of the models compared.

If products are “bulked” because they share the same NCM: Similarity adjustment will be allowed.

Under Import transactions: similarity adjustments allowed under PIC and CPL methods

Under export transactions: similarity adjustments admissible for all methods except CAP.

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Import of Goods, Services or Rights

How to determine the comparable price:

1. Taxpayer should make an option for the best method, that is, the one allowing the greatest amount of deduction to the taxpayer.
2. The method should be applied consistently per good, service or right, during all of the tax period (cannot mix and match methods for one same good);
3. Comparable prices (practiced with unrelated parties) should be multiplied by the quantities transacted in the operation;
4. The results verified should be added and divided by the total quantity, hence determining the average pro-rata price.
5. The average pro-rata price will be then compared to the cost price by the taxpayer, making use of one of the methods PIC, PRL 20 or PRL 60, CPL.

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Import of Goods, Services or Rights

When is an adjustment necessary?

Main (non-accounting) Rule:

Practiced Price › Comparable Price = adjustment

Practiced Price ‹ Comparable Price = no adjustment

The excess practiced price would be added to the assessment base of the Income Tax (IRPJ) and Social Contribution on Net Profits (CSLL) and subjected to taxation.

In 2002, a new rule was introduced providing for an option to make an accounting adjustment.

The Import Methods

1. Comparable Independent Price Method (PIC)

2. Resale Price Minus Profit Method (profit Margins 20% and 60%) (PRL)

3. Production Cost Plus Profit (CPL)

The Import Methods

1. Comparable Independent Price Method (PIC):

The comparable price (or benchmark) results from the weighted arithmetic average of:

(i) The price of the goods, services and rights

(ii) verified in Brazil or abroad

(ii) between unrelated parties (only - related party data not admissible)

(iii) In purchase or sale transactions,

(iv) of the same or similar assets, goods, services or rights (functional analysis)

(v) under similar payment conditions.

Similar to OECD Comparable Uncontrolled Price Method (CUP)

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The Import Methods

This means that the comparable price (benchmark) should be verified through the weighted arithmetic average price of the similar or identical goods, services or rights:

(i) Sold by the same exporting company, to a resident or non-resident unrelated person;

(ii) Acquired by the same importing company, from a resident or non-resident unrelated person; and

(iii) In a purchase or sale transaction occurring between resident or non-resident unrelated companies.

The Import Methods

2. Resale Price Minus Profit Method:

Weighted Arithmetic Average of the resale price of the goods, services or rights, reduced by:

(i) The unconditional discounts granted;

(ii) The taxes and contributions levied on the sale;

(iii) The paid brokerage and commission fees;

(iv) The profit margin of:

1. 20%, for the resale of goods, services or rights;
2. 60% for the import of goods, services or rights to be applied in a production process

The Import Methods

Example: What if a company imports a merchandise lot from a related non-resident company, of which part of the lot is destined to be industrialized and part is destined to be resold as spare parts?

Legislation provides that taxpayer would be entitled to the most beneficial method, therefore, it is understood taxpayer would be allowed to chose the method which brings him most advantages (PRL 20 or PRL 60).

i.e. A imports 100 stirring wheels from a non-resident related company, 80 of which will be applied in the production of new vehicles and 20 units will be directly resold as spare parts. In case part of the 20 units destined for direct resale are resold within that period, PRL 20 may be used for all 100 imported units.

The Import Methods

PRL 20 Example:

Recap:

Weighted arithmetic average of the resale price (A) of the goods, services or rights, reduced by:

1. The unconditional discounts granted (B);
2. The taxes and contributions levied on the sale (C);
3. The paid brokerage and commission fees (D);
4. The profit margin of 20%, for the resale of goods, services or rights (E);

The Import Methods

PRL 20 Example:

A	Average Resale Price	200
B	Unconditional Discounts	(5)
C = A x 20%	Taxes and Contribution on Sales (20%)	(40)
D = A x 8%	Comissions (8%)	(16)
E = (A – B) x 20%	Profit Margin = 195 x 20%	(39)
F = A – B – C – D - E	Comparable Price - PRL	100

Assuming price practiced on Import was $ 20

Practiced Price (20) ‹ Comparable Price (Benchmark = 100)

No Adjustment to be made.

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The Import Methods

PRL 60 Example:

Recap:

Weighted arithmetic average of the resale price (A) of the goods, services or rights, reduced by:

1. The unconditional discounts granted (B);
2. The taxes and contributions levied on the sale (C);
3. The paid brokerage and commission fees (D);
4. The aggregated value through the production process in the country;
5. The profit margin of 60% for the import of goods, services or rights to be applied in a production process (H);

The Import Methods

PRL 60 Example:

Assuming the aggregated value in Brazil = 80

I – Net sale Price: weighted arithmetic average of the sale price of the manufactured goods, minus unconditional discounts, taxes and contributions on sale and the commission and brokerage fees sold.

A	Average Resale Price	200
B	Unconditional Discounts	(5)
C = A x 20%	Taxes and Contribution on Sales (20%)	(40)
D = A x 8%	Comissions (8%)	(16)
E = A – B – C – D	Net Price	139

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PRL 60 Example:

Assuming the aggregated value in Brazil = 80

II – Participation Percentage of the goods, services or rights imported in the total cost of the good manufactured in the country: percentage relation between the price of the imported good, service or right and the total cost of the produced good, calculated according to the company's cost chart.

Cost of Imported good	20	20%
Other costs (aggregated value)	80	80%
Total cost	100	100%

The Import Methods

PRL 60 Example:

III – Proportionate Sale Price (participation of the imported goods, services or rights in the final sale price of the manufactured good): application of the participation percentage of the good, service or right (as in item II of previous slide), over the net sale price, calculated as per item I.

E	Net price	139
F	Participation percentage of imported good	20%
G = E x F	**Proportionate sale Price**	**27.80**

The Import Methods

PRL 60 Example:

IV – Profit Margin: Application of the 60% margin over the “participation of the imported good, service or right over the sale price of the manufactured good,” calculated in accordance with item III.

G	Proportionate sale Price	27.80
H = G x 60%	**Profit Margin = 27.80 x 60%**	**16.68**

The Import Methods

PRL 60 Example:

V – Comparable Price: Difference between the “participation of the imported good, service or right over the sale price of the manufactured good,” calculated in accordance with item III, and the profit margin of 60%, calculated in accordance with item IV.

G	Proportionate sale Price	27.80
H	Profit margin	16.68
I = G - H	**Comparable Price**	**11.12**

Import Price: $ 20

Practiced Price (20) › Comparable Price (11.12)

Adjustment amount: $ 8.88

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The Import Methods

3. Production Cost Plus Profit (CPL):

The comparable price under this method is determined by assessing the average cost of the production of similar or identical goods, services or rights, in the country where they were originally produced, and add:

i. A profit margin of 20%, before the assessment of taxes and levies;

ii. Taxes and levies assessed by the foreign country

Production costs should be discriminated per component, value and respective suppliers.

The Import Methods

The following may be considered to integer the cost:

i. The acquisition cost of raw materials, intermediary products and packaging material;
ii. The cost of any other goods, services or rights applied on production;
iii. The cost of the personnel applied on production;
iv. Cost of rent, maintenance and repair;
v. Depreciation, amortization and exhaustion charges;
vi. Reasonable costs associated to breaks and losses.

No other cost will be admissible.

A similarity assessment is admissible under this method.

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The Export Transactions

Safe Harbours:

- No TP control if:

1. Price practiced on the sale of goods service and rights in related party transactions is superior to 90% of the price practiced between unrelated parties in similar or identical transactions in the Brazilian Market,
2. Conquering new markets
3. Proves 5% net profit in export revenues to related parties taking into account the current tax year average and the two preceding years.
4. Proves that total net export revenue (including export to tax havens and privileged tax regimes) does not exceed 5% of the overall net revenue during the same period

The Safe Harbours

Safe Harbour n. 1:

Export revenues shall **only** be subject to Transfer Pricing control in case:

i. the average export price of each type of good, service or right
ii. is inferior to 90% of the average price practiced in the Brazilian market
iii. on the sale of the same goods, services or rights
iv. during the same period and under similar payment conditions.

A contrariu sensu TP rules do not apply in case the average price of the exported good, service or right is equal or superior to 90% of the average practiced under the Brazilian market, provided similar conditions are met.

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The Safe Harbours

Safe Harbour n. 1:

In case the exporting company does not habitually conclude sales in the Brazilian internal market, the comparable average price will be based on the transactions performed by other companies selling goods services or rights in the Brazilian market, under similar or identical conditions.

–Price Adjustments: Sales to the Brazilian internal market:

- Average Price shall be liquid of:
  - unconditional discounts
  - ICMS, ISS, COFINS, PIS/PASEP and other taxes levied on the sale price; and
  - Transport and insurance costs, borne by the seller.

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The Safe Harbours

Safe Harbour n. 1:

–Price Adjustments: Export Transactions:

- Average Price shall be liquid of:
  - Transport and insurance costs, borne by the seller.

Prices shall be adjusted so as to minimize the effects provoked by the different business conditions, physical nature and content of the good, as per “Brazilian functional analysis.”

The Safe Harbours

Safe Harbour n. 1:

–Average Price practiced on export and comparable price (benchmark): Methodology

To achieve the transactional average price:

Multiply the prices practiced by the quantities exported in each transaction = Result A

To achieve the Weighted arithmetic average:

Add the average prices (above) obtained in each of the transactions and divide them by the total number of transactions.

Safe Harbour n. 1: Example

Brazwear is owned by a Spanish company

Brazwear produces and sells clothes in Brazil and abroad

In 2008, Brazwear opened a branch in Italy with 100% ownership

All of Brazwear's sales to the Brazilian internal market are made to independent distributors, who bear transport and insurance cost

Brazwear does not provide discounts

Taxes levied on sales in 2009 totaled USD 6,000,000

On export to unrelated entities, Brazwear paid transport and insurance in the total amount of USD 300,000

Transport and insurance related to the sales made to the Italian branch were valued in USD 100,000

Safe Harbour n. 1: Example

Type of Sale	Price in USD	Quantity	Unitary Price
Internal Market	30,000,000	150,000	200
Export to unrelated entity	15,000,000	100,000	150
Export to related entity	5,000,000	31,250	160
Total	50,000,000	281,250	

1. Adjust the sale price for the internal market:

Total Sale:		30,000,000
(-) unconditional discounts:	n/a	
(-) tax on sales:		(6,000,000)
(-) Transport and Insurance:	n/a	
= Net Price:		24,000,000

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The Safe Harbours

Safe Harbour n. 1: Example

2. Calculate the Weighed Arithmetic Average sale price for the internal market:

Net Price:	24,000,000
(÷) Quantity:	150,000
= Average Price:	160

3. Adjust sale price to related companies and calculate weighed arithmetic average:

Export to Related entity:	5,000,000
(-) transport and insurance:	(100,000)
= Net Export price	4,900,000
(÷) Quantity	31,250
= Average Price to related co.	156,80

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Safe Harbour n. 1: Example

4. Compare the domestic market’s benchmark (comparable price) with the average export price to a related party:

Internal Market Price:	160
90% limit	144
Average Price to a related party:	156,80

Practiced Price (156,80) › 90% Price practiced in the internal market (144)

Therefore: Not subject to assessment (tax administration cannot arbiter the price)

The Safe Harbours

Safe Harbour n. 2 : Conquering of New Markets

A company will be allowed to export goods services and rights to a related entity at a price which is lower than 90% of the price practiced in the Brazilian domestic market, as long as:

i. The exported goods services or rights have never before been commercialized by the exporting company, or by any other company related to it, in the country of destination;
ii. The goods, services or rights are sold to the final consumer at a lower price than that applied by competing companies in the penetrating market;
iii. The penetration plan contains a specific export plan which has been previously approved by the Tax general Coordination (COSIT);
iv. The export plan demonstrated that the related party in the country of destination will not profit from these transactions;
v. In case the company foresees a loss in Brazil, the export plan should demonstrate how much time will be needed to recover those losses in Brazil;
vi. The export transaction is not to a tax haven or secrecy jurisdictions (legislation is unclear with respect to privileged tax regime).

The Safe Harbours

Safe Harbour n. 3 : Net Profit Safe Harbour

If the export transactions to a related company represent at least 5% of the overall net profits verified in all export transactions, taking into account the annual average of the present tax period and the past two assessment periods, then the taxpayer may provide proof of the process practiced during the year by using only the documents related to the transaction itself.

i. The Net profit has to be verified before income tax and social contribution deductions;

ii. Common costs and expenses should be pro-rated proportionately to the net profits

iii. Because the method takes into account the triennial average (current year and last two years), it has become common to use the weighed arithmetic average for the three years.

iv. In this case, there should be a corresponding exchange rate adjustment

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The Safe Harbours

Example 1 – without exchange rate adjustment:

Description	Total	Related Entity	%
Gross Revenue	105,500	10,500	
(-) deductions	(16,000)	0	
= Net Revenue	89,500	10,500	11.73%
(-) Cost of Good Sold	(44,500)	(8,900)	
= Gross Profit	45,000	1,600	
(-) Common Expenses	(31,500)	(3,695)	11.73%
Net Profit	13,500	(2,095)	< 5%

Under this hypo, the company's export transactions are at a loss, and therefore it is subject to TP control.

Example 2 – with exchange rate adjustment for revenues:

Taking into account the triennial average – would have to account for exchange rate correcting factor IN 605/2005: In 2005, the factor was of 1.35%

Description	Total	Related Entity	Related Entity x 1.35%	%
Gross Revenue	105,500	10,500	14,175	
(-) deductions	(16,000)	0	0	
= Net Revenue	89,500	10,500	14,175	11.73%
(-) Cost of Good Sold	(44,500)	(8,900)	(8,900)	
= Gross Profit	45,000	1,600	5,275	
(-) Common Expenses	(31,500)	(3,695)	(3,695)	11.73%
Net Profit	**13,500**	**(2,095)**	**1,580**	**11.15%**

Note: costs were not adjusted to account for exchange rate

Only related entity's gross revenue adjusted

Related entity : Total revenue ratio is kept constant

The Safe Harbours

Example 3 – with exchange rate adjustment for revenues and expenses:

Description	Total	Related Entity	Related Entity x 1.35%	%
Gross Revenue	105,500	10,500	14,175	
(-) deductions	(16,000)	0	0	
= Net Revenue	89,500	10,500	14,175	15.84%
(-) Cost of Good Sold	(44,500)	(8,900)	(8,900)	
= Gross Profit	45,000	1,600	5,275	
(-) Common Expenses	(31,500)	(3,695)	(4,989)	15.84%
Net Profit	13,500	(2,095)	286	< 5 % (2.02%)

Note: Ratio with respect to the adjusted exchange rate

If revenues and expenses were to be corrected, company would have to undergo TP control

Net profit (286) is less than 5% of the net export price (14,175)

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The Safe Harbours

Safe Harbour 4: Net Revenue

An entity will not have to provide any other documentation (except for the documents used in the export transactions themselves), in case:

i. Its net export revenue for the year (to related and unrelated entities and individuals);
ii. Does not exceed 5% of the total net revenue for the same period;

The yearly export revenue computation shall also include sales revenues to corporate entities or individuals located in tax haven jurisdictions

Net Revenue: Example

Revenues from internal market	5,100,000
Export Revenues to Tax Havens	50,000
Export Revenues to related entities	150,000
Export Revenues to Unrelated entities	200,000
Total Gross Revenue	5,500,000

= 400,000

Description	Total	Export	%
Gross Revenue	5,500,000	400,000	
(-) Deductions	(1,020,000)	0	
Net revenue	**4,480,000**	**400,000**	**9%**

The 5% net export revenue limit should take into account all export transactions: with tax havens, related and unrelated entities.

In this hypo: Entity subject to TP control, for exceeded 5% limit.

BUT: Entity will always be subject to TP control when there are transactions with tax haven jurisdictions.

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The Safe Harbours

Common Rules to Net Profit and Net Revenue safe harbours:

The Safe harbours on net profits and net revenues will not apply when the sales are made to a related or unrelated entity located in a tax haven jurisdiction, or a jurisdiction which opposes secrecy towards tax information.

The legislation does not make any reference to privileged tax regimes.

Under the previous example: If the entity’s net export revenue for the year had been inferior to 5% of the total net revenues, it would have been free from providing TP control towards related party transactions, but not towards the transactions to tax haven jurisdictions.

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The Export Methods

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The Export Methods - Common Rules

Weighed Arithmetic Average = The average price will be obtained by multiplying the prices practiced by the quantities negotiated in each transaction. The individual results will be added up and divided by the total quantity.

In case more than one method is applicable to the same transaction, the taxpayer may chose the one which will grant him the lowest taxable amount.

The choice for a method may be made autonomously by the taxpayer, without the need to communicate it to the tax administration

The chosen method must be applied consistently, per service, good or right, during all of the taxable year.

Comparability adjustments (for similar and identical products) are admissible (due to physical nature of the product, business conditions, etc).

The Export Methods - Common Rules

Similar goods services and rights – besides the adjustments allowed, prices may also be adjusted due to: (i) differences in physical nature; and (ii) content.

In case it is impossible to identify transactions occurring during the same assessment period, prices may be compared with past or future transactions, provided the necessary currency valuation and exchange rate adjustments are made.

In case it is verified that the export sale price is inferior to 90% of the average price practiced in the Brazilian market (safe harbour 1), the export sale revenues will be determined by taking into reference the price verified by applying one of the export methods:

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The Export Methods

1. Export Sales Price (PVEx) Method

2. Wholesale Price in Country of Destination Less Profit (PVA)

3. Retail Price in Country of Destination Less Profit (PVV)

4. Purchase or Production Cost plus Taxes and Profit (CAP)

The Export Methods- PVEx

1. Export Sales Price (PVEx) Method:

Benchmark = arithmetic average of the sales price applied by the company itself on export transactions, to unrelated clients or to other unrelated (Brazilian) exporting company.

The method applies to the sale of similar or identical goods, services or rights.

Only sales concluded with unrelated parties may be used for benchmark calculation under this method.

The Export Methods - PVA

2. Wholesale Price in Country of Destination Less Profit (PVA):

Benchmark = weighed arithmetic average of the sales price of similar or identical **goods,** practiced in the **wholesale** market of the country of destination, reduced by:

i. The taxes already included in the price and charged in the country of destination; and

ii. Profit margin of **15%** on the **wholesale** price (gross price)

The excludable taxes included in the price by the country of destination, are those considered to be similar to the Brazilian ICMS, ISS, COFINS and PIS/PASEP.

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The Export Methods - PVV

3. Retail Price in Country of Destination Less Profit (PVV):

Benchmark = weighed arithmetic average of the sales price of similar or identical **goods,** practiced in the **retail** market of the country of destination, reduced by:

i. The taxes already included in the price and charged in the country of destination; and
ii. Profit margin of **30%** on the **retail** price (gross price)

The excludable taxes included in the price by the country of destination, are those considered to be similar to the Brazilian ICMS, ISS, COFINS and PIS/PASEP.

The Export Methods - CAP

4. Purchase or Production Cost plus Taxes and Profit (CAP):

Benchmark = weighed arithmetic average of the acquisition or production cost of exported goods, services or rights, increased by:

i. The taxes and contributions levied in Brazil; and
ii. Profit margin of 15% on the cost of the item, already increased by the taxes

- Transport and insurance costs are to be included in the acquisition or production cost under this method.
- Taxes credited back to the exporter upon export shall be excluded from the acquisition and/or production costs.
- This method may also be applied in case the company exports through a third party or an exporting company.
- The exporting company’s profit margin cannot be added on to the acquisition or production cost

Potential Modifications to the Transfer Pricing System

Provisional Measure 563/2012 (MP 563/12)

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MP 563/12

Main modifications:

1. Changes to the PIC Method

2. Substantial changes to the PRL Method (and abolition of the dual PRL20 and PRL60 Methods)

3. Introduction of two new methods, for the import and export of commodities:
    i. Listed Price for Imports Method (PCI – Método do preço sob cotação na importação)
    ii. Listed Price for Export Method (PECEX – Método do preço sob cotação para exportação)

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MP 563/12

1. Changes to the Comparable Independent Price Method (PIC)

Under the current definition:

The comparable price (or benchmark) results from the weighted arithmetic average of:

(i) The price of the goods, services and rights (ii) verified in Brazil or abroad (iii) between unrelated parties (iv) in purchase or sale transactions, (v) of identical similar assets, goods, services or rights (functional analysis) (vi) under similar payment conditions.

Under the new definition provided by MP 863/12:

The comparable price (or benchmark) results from the weighted arithmetic average of:

(i) The price of the goods, services and rights (ii) verified in Brazil or abroad (iii) in purchase and sale transactions (iv) **carried through by the taxpayer himself, or by third parties**, (v) of identical or similar assets, goods, services or rights (functional analysis) (vi) under similar payment conditions.

MP 563/12

This means that parties using PIC will be able to use third party transactions when ascertaining the benchmark.

The transactions used in the benchmark computation should represent at least 5% of the import price of the transactions subject to transfer pricing control (this has been referred to as a "relevance test")

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MP 563/12

2. Changes to the Resale Price Minus Profit Method (PRL)

Only the name of the method remains the same – the definition changes substantially:

New definition: Weighted Arithmetic Average of the sale price (ii) in the country (Brazil) (iii) of the imported goods, services or rights (iv) under similar payment conditions, (v) under the following methodology:

a. Net sales price: Weighted arithmetic average of the sale price of the manufactured good, service or right, excluding unconditional discounts, taxes, contributions levied on the sale, and the paid commissions and brokerage fees.

b. Percentage participation of the imported good, service or right on the total cost of the good, service or right sold – percentage rate between the weighted average cost of the imported good, service or right, and the total weighted average cost of the good, service or right sold (in the Brazilian market), calculated according to the company's "cost" accounting records

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c. Participation of the imported goods, services or rights, in the sales price of the good, services or rights sold (in Brazil) – application of the participation percentage of the imported good, service or right on the total cost, as per item "b," over the net sales price calculated as per item "a."

d. Profit Margin – application of the profit margins (described below) according to the economic sector to which the corporate entity subject to transfer pricing control belongs, over the amount found under item "c" (for participation of the imported goods, services or rights, in the sales price of the goods, services or rights sold in Brazil):

(i) 40% profit margin for:

- Manufacturing of Pharma-chemicals and Pharmaceuticals;
- Manufacturing of Tobacco products;
- Manufacturing of optical, photographic and cinematographic instruments and equipments;
- Trading of machinery, devices and equipments for medical, dental or hospital use;
- Extraction of oil and natural gas; and
- Manufacturing of oil bi-products.

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MP 563/12

(ii) 30% profit margin for:

- Manufacturing of Chemicals;
- Manufacturing of glass and glass bi-products;
- Manufacturing of paper, cellulose and paper bi-products ; and
- Metallurgy;

(iii) All the remaining business sectors are to apply a general profit margin of 20%.

e. Comparable price/benchmark – the difference between the amounts found under item “c” (participation of the imported good, service or right in the sales price of the sold good, service or right) and item “d” (profit margin)

If the person subject to TP control carries out more than one business activity, the profit margin applied under the new PRL method should correspond to that applicable to the business for which the good was imported.

If the imported good is then resold to be used in a different economic segment, or is used to produce one or more products, the final benchmark will be the arithmetic average of all the results obtained by applying the PRL method to each of the transactions.

MP 563/12

3. Listed Price for Imports Method (PCI) and Listed Price for Export Method (PECEX)

PCI and PECEX are applicable only to the import and export of commodities which are listed in international markets

Definition: Average daily quote of goods and rights subject to public listing in internationally recognized trading and futures markets

The price of the good imported or exported by the entity subject to transfer pricing control will be compared to the quoted price of the good in an internationally recognized trading or futures market, and adjusted positively or negatively according to the market's average premium, on the date of the transaction, in case of imports to or exports from:

i. related parties;

ii. entities resident or domiciled in low tax jurisdiction;

iii. corporate entities or individuals taking advantage of privileged tax regimes.

MP 563/12

Rules exclusively applicable to the PECEX Method:

i. If no quote is available for a given product, the last known quote applies;

ii. The 90% safe harbour rule is not applicable for listed commodities, subject to the PECEX methodology

4. Validity and applicability of MP 563/12:

The new Transfer Pricing rules are only to come to force on 1.1.2013

The new TP rules may be applied during the tax year of 2012 at the election of the taxpayer

MP 563/12 is valid until 25.7.2012

Thank you!

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