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Brazil's Approach to Transfer Pricing: A Viable Alternative to the Status Quo?

The author takes an in-depth look at Brazil's transfer pricing system, which imposes fixed margins rather than relying on comparable transactions, and asserts that it could serve as a basis for rules to be adopted by other developing countries.

BY TATIANA FALCAO

The Brazilian transfer pricing system is unique in that Brazil has developed an objective method that allows the taxpayer to mathematically determine and prove its pricing benchmark without having to go through a search for comparables. By not requiring a comparables search—which is the basis of the Organization for Economic Cooperation and Development's *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*—the Brazilian transfer pricing rules provide a viable alternative to the OECD guidelines. The search for comparables is one of the main concerns of developing countries, which do not have wide and open markets providing accessible information and reports about competing companies commercializing comparable or similar products. Sometimes, a company might be the only producer of a specific type of product, making the search for comparables impracticable if not impossible.

In addition to a search for comparables, the OECD's transfer pricing approach, unlike the Brazilian method, requires a search for concurrent prices. But because the markets in developing countries tend to be concentrated with only a reduced number of players, current participants and also new entrants to the market might not be able to access the prices of the products sold by other companies. For some companies, price strategy has a direct correlation with competitiveness. Brazilian tax authorities, by adopting fixed profit margins over the company's own applied production or resale price, managed to develop a method based on the company's own data, thereby removing the need of acquiring new data from the market.

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Brazil has developed a system providing juridical certainty. For developing countries, whose tax laws tend to be inconsistent and burdened by bureaucracy, the development of an objective method is a significant benefit, reducing the risk of an assessment by the tax authorities.

Brazil's transfer pricing rules are broader than the OECD guidelines, as the Brazilian rules apply not only to transactions by Brazilian entities with related foreign persons, but also to some foreign entities that are not related to the Brazilian entity. Most obviously, the Brazilian transfer pricing rules also apply to transactions by Brazilian entities with:

- unrelated foreign entities located in the tax haven jurisdictions listed by the Brazilian government, and
- unrelated foreign entities located in jurisdictions listed by the Brazilian government as benefiting from a "privileged tax regime."

By applying to this expanded group, the Brazilian transfer pricing rules pay special attention to the problem of Brazilian entities possibly shifting income to low-tax or no-tax jurisdictions or to other jurisdictions which provide benefits similar to those provided by tax havens. In this regard, the Brazilian transfer pricing rules are broader and more effective at combating tax evasion and intercompany profit shifting than the OECD transfer pricing guidelines.

The Brazilian transfer pricing rules could serve as a basis for transfer pricing rules to be adopted by other developing countries. Therefore, developing countries should review the Brazilian transfer pricing system.

Brazil's Legal System

The Brazilian legal system is complex and in some situations it takes effort, experience and expertise to

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understand the policy underlying much of the legislation. Brazil tends to go its own way in regulating cross-border and international tax situations. Brazil is at times somewhat averse to international conventions, mainly because they tend to limit the ability of Brazilian tax authorities to tax. That does not mean that Brazil ignores intergovernmental organizations such as the OECD entirely. What it means is that Brazil considers international tax conventions and regulations to be merely an inspiration for the formulation and interpretation of its own international tax laws.

Brazil's failure to adopt and adhere strictly to standards determined by the 34 country OECD results in some cross-border tax problems, possibly resulting in over-taxation for taxpayers involved in the transactions. Such additional costs resulting from the lack of complete conformity of Brazilian legislation with standards determined by the OECD can constitute the ''Brazilian cost'' in transactions involving Brazilian suppliers, service providers, or counterparties. This problem may occur with regard to the terms of agreements for the avoidance of double taxation and evasion. That is because the interpretation by the Brazilian Federal Revenue Service (*Secretaria da Receita Federal do Brasiland*, or RFB) and the Brazilian judiciary of the tax treaties signed by Brazil with other countries tend to favor the RFB, hence resulting in some possible double taxation for the taxpayers involved in the transaction.

More recently, transfer pricing has become a greater concern for multinational companies operating in Brazil, or wishing to enter the Brazilian market. For many other reasons that are beyond the scope of this article, it is difficult for a foreign company to establish itself in Brazil by use of a permanent establishment. Therefore, most of the foreign companies wishing to establish themselves in Brazil do so by forming a subsidiary. As subsidiaries are independent legal entities, they must obey transfer pricing provisions when transacting with their foreign related counterparts. When corporations establish themselves as subsidiaries—that is, wholly independent corporations—in Brazil, the Brazilian transfer pricing regulations can significantly affect the results of the trade between the subsidiaries and their parent corporations. Conflicts in applying the Brazilian transfer pricing rules might arise, especially if the parent company is located in an OECD country.

That is because Brazil aims to achieve the arm's-length standard by making use of a series of safe harbors and fixed formulas (further discussed below) that are made available to the taxpayer for import and export transactions, respectively. Because the Brazilian method approaches the arm's-length price objectively, through the use of alternative mathematical formulas, while the OECD transfer pricing regulations provide evaluative approaches to achieve the arm's-length price in a transaction between related parties, sometimes the taxpayer is faced with the tough practical reality that it would need to apply one price in order to comply with the Brazilian transfer pricing rules, and another, different price, in order comply with an arm's-length price compatible the OECD guidelines. As Brazil has never issued any rules or regulations providing for conciliation between the Brazilian and OECD approaches, it is up to the taxpayer to resolve this issue.

Purpose of Transfer Pricing Rules

Much like the OECD guidelines, the main aim of Brazilian transfer pricing rules is to forestall:

- Overbilling of costs and expenses derived from the acquisition or importation of goods from (a) related parties, (b) related or unrelated foreign parties located in low- or no-tax jurisdictions, or (c) related or unrelated foreign parties located in jurisdictions that provide to the transaction a privileged tax regime. Overbilling is forestalled by disallowing deductibility of the amounts that exceed the benchmarks achieved through the application of one of the legal methods provided by the Brazilian legislation when calculating the Brazilian corporate income tax (IRPJ) and social contribution on net profits (CSLL).
- Underbilling of export revenue arising from transactions with (a) related foreign parties, (b) related or unrelated foreign parties in low- or no-tax jurisdictions, or (c) related or unrelated foreign parties in jurisdictions providing a privileged tax regime. Underbilling is forestalled by assessing IRPJ and CSLL on the amount that would have been charged if one of the allowable transfer pricing methods had been applied.
- Payments of interest under agreements not registered before the Brazilian Central Bank with (a) a related foreign party, (b) related or unrelated parties located in low- or no-tax jurisdictions, or (c) related or unrelated foreign parties located in jurisdictions that provide a privileged tax regime and where the amounts or charges of interest exceed the benchmark reached according to the method legally set forth or fall below the benchmark provided by the application of one of the transfer pricing methods. In the case of excess payments, the excess is not deductible from the IRPJ and CSLL tax base. In the case of revenue shortage, the corresponding deficit must be added back to the tax base for further assessment of the IRPJ and CSLL.

Transfer pricing adjustments[1] also may be considered when calculating depreciation, amortization, or depletion expenses and interest on equity deductions, because these adjustments may give rise to overbilling or underbilling if the price of the product is manipulated through one of these accounting mechanisms.

Brazilian legal entities are required to show in their annual income tax return:

- the existence of transactions with foreign related parties, and with related or unrelated foreign parties located in low- or no-tax jurisdictions or jurisdictions providing privileged tax regimes for the transaction;
- the method chosen to confirm compliance with the transfer pricing rules; and
- the transfer pricing adjustments made.

Arm's-Length, Alternative Standards

Brazilian domestic legislation describes the available methods for calculating 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.[2]

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[1] For purposes of this article, a ''transfer pricing adjustment'' refers to the adjustment the taxpayer must make to the price of the product to achieve an arm's-length result as defined in Brazilian legislation.

[2] It should be noted that Article 19-B of Law 9430/96 (Law 9430), introduced by Provisional Measure (MP) 478 (later revoked) and enforceable from Jan. 1, 2010, to May 31, 2010, stated that the method chosen cannot be changed after the be-

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Under Brazilian legislation, which contains a detailed description of the methods, the taxpayer may choose the most favorable method in the case of acquisitions, imports, and exports subject to transfer pricing control.

Brazilian law contains no best method rule, nor does it impose a hierarchy of methods.[3]

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

Determining the Intercompany Price

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. As noted, the rules apply not only to transactions by Brazilian entities with foreign related persons, but also to some foreign entities that are not related to the Brazilian entity if they are located in tax havens or privileged tax regimes. The rules also apply to entities that might not commonly be considered related, as described below, when exclusive rights are granted or in the case of 10 percent common ownership.

When one of those conditions is met, the rules apply to:

- costs or expenses related to the acquisition or import of assets, goods, services or rights (with the understanding that the application of the transfer pricing rules does not depend on the actual admission of the assets, goods, services or rights into Brazil);
- revenues from exports of goods, services or rights; and
- interest expenses and revenues.

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.[4]

Transactions carried out between related parties include those carried out between the Brazilian legal entity and its branches, headquarters, controlled companies, controlling shareholders (individual or legal entities), companies with which the Brazilian entity is under common corporate or common management control, its managers or relatives by blood or marriage up to the third degree, and spouses or significant others of the managers or of the controlling shareholders.

Related-party transactions also include those 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);[5]
- companies that participate with the Brazilian legal entity in a joint enterprise, under a consortium or condominium, as defined by 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, or 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, or rights; and
- foreign companies, when the same individual or legal entity holds an equity stake of at least 10 percent 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. More specifically, 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 guidelines, are:

- the nonresident 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;
- the nonresident individual or legal entity that is its exclusive agent, distributor, or dealer for the purchase and sale of goods, services, or rights; and
- the nonresident 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.

There may be occasions when a company will be subject to transfer pricing rules specifically for Brazilian tax purposes. In these cases the OECD guidelines will not apply, leaving 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.

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ginning 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 (a) disclose on its tax return, before the beginning of the tax audit, the chosen transfer pricing method, (b) provide the tax authorities with documents supporting the prices used, (c) provide the tax authorities with the benchmark calculations, or (d) 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.

[3] The best method rule in the United States replaced a hierarchy under which the comparable uncontrolled price method was given priority. Under the best method rule, 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 subsequently is shown to produce a more reliable measure 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 Revenue Service within 30 days, upon its request. Argentina currently also applies the best method rule.

[4] Law 9430 exempts Brazilian legal entities from complying with transfer pricing rules when remitting royalties or paying for technological know-how derived from abroad.

[5] 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 significant influence if the investor holds 20 percent or more of the voting capital of the invested company.

The term ''low-tax jurisdiction'' is defined[6] as those jurisdictions 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 nonresidents; or
- does not tax income or taxes the income at maximum rates lower than 20 percent, 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.

The jurisdictions considered to be of low tax or no tax are specifically listed in the legislation.[7] The list is considered all-inclusive.[8]

A list of ''privileged tax regimes'' was introduced in the Federal Revenues Service (SRF) Normative Instruction (IN) 103710 (IN 1037), hence resolving the uncertainty brought about by Article 30 of Law 11941/09, which introduced the concept of the privileged fiscal regime, but did not identify any of the countries that would fit into that category.

Privileged tax regimes are those meeting one or more of the following requirements:[9]

- failing to tax income, or taxing income at a maximum rate lower than 20 percent;
- providing tax advantages to nonresidents (individual or legal entities) conditioned upon nonperformance of substantial economic activities in the relevant jurisdiction, or not requiring performance of substantial economic activities in that jurisdiction;
- failing to tax income earned outside their territories or taxing such income at a maximum rate lower than 20 percent; or
- failing to 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 leaves room for a certain level of subjectivity. Until now, the RFB has not clarified the scope of this concept, although it has narrowed the scope of its application by identifying the countries and the regimes it considers to be of a privileged nature.[10]

In practical terms, the introduction of two different lists—one for low- or no-tax jurisdictions and another for privileged tax regimes—follows the OECD standard to the extent that Brazil has opted to list low- and no-tax jurisdictions separately from privileged tax regimes.

The penalty for the commercialization of goods, services, or rights with a jurisdiction on the list of low-tax and no-tax jurisdictions is threefold:

- withholding tax is increased from the standard 15 percent to 25 percent;
- remittances made to one of the listed jurisdictions is deemed to meet the definition of transfer pricing control regardless of whether the receiving entity is a related entity; and
- Brazilian thin capitalization rules are applied.

The list of jurisdictions with a privileged tax regime, on the other hand, are penalized only by two forms of control—namely, transfer pricing and thin capitalization. Remittances made to jurisdictions with privileged fiscal regimes are subject to the regular withholding income tax rate of 15 percent.

Methods for Acquisitions, Imports

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 percent profit (PRL 20, for goods imported and resold without undergoing any industrial process in Brazil);
- resale price less 60 percent profit (PRL 60, for imported goods which undergo further industrialization in Brazil); and
- production cost plus profit (CPL).

If the benchmark reached by the application of one of these methods (the most favorable method at the option of the taxpayer, provided that such option is validly made before a tax inspection) is greater than the acquisition or import prices subject to transfer pricing con-

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[6] See Article 24 of Law 9430/96 (Law 9430), as amended by Article 3 of Law 10451/02 and Article 22 of Law 11727/08.

[7] They include Andorra, Anguilla, Antigua and Barbuda, the Netherlands Antilles, Aruba, Ascension Island, the Bahamas, Bahrain, Barbados, Belize, Bermuda Island, Brunei, Campione D'Italia, the Channel Islands (Alderney, Guernsey, Jersey, and Sark), the Cayman Islands, Cyprus, Singapore, the Cook Islands, Costa Rica, Djibouti, Dominica, the United Arab Emirates, Gibraltar, Granada, Hong Kong, Kiribati, Labuan, Lebanon, Liberia, Liechtenstein, Macao, Madeira Island, the Maldives, Man Island, the Marshall Islands, Mauritius, Monaco, the Montserrat Islands, Nauru, Niue Island, Norfolk Island, Oman, Panama, Pitcairn Island, French Polynesia, Qeshm Island, American Samoa, West Samoa, San Marino, the Saint Helen Islands, Saint Lucia, the Saint Kitts and Nevis Federation, the Saint Peter and Saint Miguel Islands, Saint Vincent and the Grenadines, the Seychelles, the Solomon Islands, Swaziland, Tonga, the Tristan da Cunha Islands, the Turks and Caicos Islands, Vanuatu, the British Virgin Islands, and the U.S. Virgin Islands.

[8] Federal Revenues Service (SRF) Normative Instruction (IN) 1037/2010 (IN 1037).

It should be noted that Switzerland formerly was included in the list of tax havens, but was removed at the Swiss government's request by Executive Declaratory Act 11 of June 24, 2010, which called for excluding the country from the list of tax havens pending further analysis by the Brazilian government.

[9] See Article 24-A of Law 9430, resulting from Article 23 of Law 11727/08, as amended by Article 30 of Law 11941/09.

[10] Tax regimes currently qualifying as privileged in Brazil include Luxembourg's holding company regime; Uruguay's the regime applying to *sociedad anonima financiera de inversion* (SAFI) until Dec. 31, 2010; the Danish regime applicable to holding companies that do not carry substantial activity; Iceland's regime applying to international trading companies (ITCs); Hungary's regime applying to *korlátolt felelosségu társaság* (KFT); the regime set out in U.S. legislation applying to limited liability companies (LLCs) formed of nonresidents and not subject to federal income tax; the Spanish regime applying to *entidad de tenencia de valores extranjeros* (ETVEs); and the Malta regime applying to ITCs and international holding companies (IHCs).

IN 1037 also used to list as privileged the Netherlands' regime for holding companies that do not carry out any substantial activity. However, following the edition of IN 1045/10 (IN 1045), the inclusion of the Netherlands was questioned by the Dutch government, and hence excluded from the list. According to Executive Declaratory Act 10 of June 24, 2010, the effects deriving from the Netherlands' inclusion are suspended until further analysis. For the time being, therefore, the Netherlands is not considered a privileged tax regime.

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trol, no adjustment is required when calculating the corporate income tax and social contribution on net profits.

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

The benchmark calculations for imports, based on the methods discussed in this section, is briefly described below.

PIC

PIC basically corresponds to the OECD's comparable uncontrolled price (CUP) method. 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:

- the 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;
- the 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; or
- the 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, similar to the OECD requirement to provide a functional analysis to support a comparability determination. The difference in the Brazilian case is that the Brazilian rule determines exactly what factors may be taken into account in determining comparability and similarity.

The Brazilian adjustments are detailed in Article 9 of IN SRF 243/02 (IN SRF 243) and comprise payment terms, quantities sold, guarantees offered, marketing or advertising 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 objective of the Brazilian law is to transform the OECD's evaluative approach to transfer pricing into a highly objective and mathematical approach for companies doing business from Brazil. The aim is to provide juridical certainty for 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.

PRL Methods

The PRL methods correspond to the OECD's resale price method and in Brazil are applied with two distinct profit margins:

- 20 percent for goods, assets, services, or rights imported into Brazil exclusively for resale purposes and not undergoing any further industrialization in the country; or
- 60 percent for goods, assets, services, or rights imported into Brazil and destined to undergo further industrialization in the country or to be added to an existing production line.

The 20 percent benchmark results from the weighted arithmetic average of the resale price of the imported assets, goods, services, or rights in transactions with unrelated parties, reduced by:

- unconditional discounts that do not depend on future events or conditions, as shown on the relevant invoice;
- indirect taxes included in the sales price (such as taxes on the circulation of goods and services, taxes on services, and contributions to finance social security);
- brokerage fees and sales commissions; and
- the 20 percent profit margin on the resale price less the unconditional discounts above.

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

The 60 percent benchmark results 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:

- unconditional discounts (as defined above);
- taxes included in the sales price (as explained above);
- brokerage fees and sales commissions; and
- the 60 percent 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 or 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 percent 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 also may be calculated by taking into consideration the production cost of similar assets, goods, services, or rights, adjusted as provided by the

legislation (see the comments on adjusting for similar items under the PIC method).

Methods for Exports

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.[11] The OECD generally has opposed the use of safe harbors, stating in paragraph 4.125 of the transfer pricing guidelines that "the use of safe harbors is not recommended." However, the organization in March 2011 announced that it was considering an update to its guidance on safe harbors and asked for comments on this effort.[12]

The Brazilian tax administration chose to adopt a hybrid system in applying transfer pricing rules for exports. Under this system, a company need not search for comparables if it meets one of the safe harbor provisions. If it meets none of those provisions, it may have to search for comparables depending on the method it chooses to apply on export transactions.

General Safe Harbor Rule: Exclusion from Transfer Pricing

The first exclusionary transfer pricing rule applies both to import and export transactions. Law 9430 states that the transfer pricing rules do not apply 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
- interest paid if the corresponding agreement is registered with the Central Bank.

Interest on loans not registered with the Central Bank will be subject to the transfer pricing control provisions.

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

Safe Harbors for Exports

Under the second safe harbor rule, which is specific to exports, transfer pricing rules will apply to exports only if the average export price is less than 90 percent 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. The rule applies only to transactions involving independent parties.

Tax on the circulation of goods and services, services, contributions to finance social security, and unconditional discounts are deducted from the final sales price. Export prices also will be free of freight and insurance costs borne by the seller.

Safe Harbors for Entering New Markets

Likewise, when the exporter is attempting to enter a new market, the related-party transactions are not subject to transfer pricing adjustments, as provided by the law. However, this rule does not apply for exports to low-tax jurisdictions or privileged tax regimes.

For an exporter attempting to enter a new market, the transaction can be executed at average prices lower than 90 percent of the prices applied in Brazil for the same assets, goods, services, or rights, provided that:

- 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 RFB; and
- 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 also must provide:

- 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 12 months; and
- a budget for the promotional and advertisement expenses in the country of destination.

Variation Margins

In addition to the foregoing, IN SRF 243 foresees two de minimis exceptions,[13] exempting Brazilian legal entities from calculating transfer pricing adjustments under one of the methods described in the legislation if they demonstrate that:

- their net export revenues (including exports to parties domiciled in low-tax jurisdictions) in the calendar year do not exceed 5 percent of the total net revenues of the same period; or
- their net profits from exports to related parties before the provision of corporate income tax and social contribution on net profits are equivalent to at least 5 percent 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 in relation to the total net revenues, unless the costs and expenses are properly individualized.

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[11] Taxpayer's Council, First Chamber, Porto Alegre, Decision Ac. 101-94.859-136791, Feb. 23, 2005.

[12] See 19 *Transfer Pricing Report* 1102, 3/10/11.

[13] These exceptions do not apply to exports to low- or no-tax jurisdictions.

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While the safe harbors provided by IN SRF 243 do not apply to transactions with companies residing in low-tax jurisdictions, the question of whether they apply to transactions carried out under privileged tax regimes is not settled. The safe harbors do not prevent the Brazilian tax authorities from investigating the relevant prices and assessing the tax whenever the applicability of those exceptions is deemed incorrect.

Non-Safe-Harbor Methods for Exports

If the taxpayer does not benefit from any safe harbor or exception, 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); or
- 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 corporate income tax and social contribution on net profits. 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 the tax bases.

PVEX

The benchmark under PVEX 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, or right applied by any given Brazilian company to an unrelated party. The transactions considered in the benchmark calculation must relate to the same reference period and must be carried out under similar payment conditions.

PVA

The PVA benchmark results from the weighted arithmetic average of wholesale prices of the same or similar assets or goods[14] in the country of destination, subject to similar payment conditions, reduced by:

- taxes charged by that country on the sales price (similar to the tax on circulation of goods and services, services, and contributions to finance social security); and
- a 15 percent profit margin on the gross wholesale price.

PVV

The PVV benchmark results from the weighted arithmetic average of the retail price of the same or similar assets or goods[15] in the importing country, provided that asset or good is subject to similar payment conditions, less:

- taxes charged by that country on the sales price (similar to the tax on circulation of goods and services, services, and contributions to finance social security); and
- a 30 percent profit margin on the gross retail price.

CAP

The CAP benchmark results 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 percent profit margin over the total amount.

Common Rules on Imports and Exports

Below are some of the definitions found in the transfer pricing legislation that apply for purposes of the benchmark definition. These may have some or no correlation to the suggested definitions in the OECD 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.
- *Variation margins*. No transfer pricing adjustment is required when the price achieved by the taxpayer varies from the benchmark in an amount equal to 5 percent.
- *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, and other such items can be used to support transfer pricing calculations.
- *Amendments to legal profit margins*. The Brazilian transfer pricing system raises issues of profit margin accuracy for different sectors, and the need to facilitate changes of 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 32-34 of IN SRF 243 further clarify that these changes can be made ex officio or at the request of interested parties.
- *Tax audits*. Brazilian legal entities must disclose the transfer pricing method chosen on their tax returns and must provide the tax authorities with all the necessary documents to support their transfer pricing calculation.

The tax authorities (under Law 9430, Article 19-B) may calculate the benchmarks based on the documents

[14] 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.

[15] As with PVA, 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.

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.

Conclusion

The Brazilian transfer pricing system allows companies to determine a transfer pricing benchmark without having to resort to external and sometimes unobtainable data—one advantage over the OECD transfer pricing rules. Now that developing countries have become significantly more important because of their economic capacity and their economic potential, the OECD could consider modifying its transfer pricing guidelines to accept Brazil's system as an alternative for other developing countries that have not yet been able to implement the OECD's more complex transfer pricing guidelines due to a of lack of resources, qualified personnel, or comparables.

As a second alternative, 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. Developing countries then could decide, on a more definitive basis, which transfer pricing system they want to adopt.

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