Transfer Pricing in Brazil

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Brazil
(views are personal)
Background & Legislation

• Brazil adopted tax law imposing worldwide income taxation 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.

• In 2012, Law n. 12,715/2012 introduced different fixed margins for different economic sectors and an specific simplified CUP Method for commodities, and other important changes.
Legislation Analysis

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

• Brazilian TP rules definition of related parties are broader than the OECD Model Convention.
Legislation Analysis

• Brazilian Transfer Pricing Regulations are not applicable to 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.
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 income tax and social contribution collection purposes (in Brazil there are two taxes on income: Income Tax and Social Contribution). Lack of compliance may result in tax penalty of 75% or 150% based on unpaid tax.

• Tax analysts say that legislation failed to explicitly adopt the arm's-length standard because, except for the comparable uncontrolled price method (CUP), all the others methods in Brazil come with their own statutorily set profit margins that vary between 15% and 40% without reference to comparable uncontrolled transactions. As a consequence, Brazil TP law does not follow OECD TP Guidelines.
Methods adopted by Brazilian TP Regulations

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

There is no preferential method (hierarchy), taxpayer may use the one that better fits (or works) to his/her operation (except for PCI and PECEx, which are mandatory for commodities), but cannot use other methods such as Profit Split and TNMM.
Methods adopted by Brazilian TP Regulations v. OECD Guidelines

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Resale method with fixed margins

• For a period of time the fixed gross profit margin for the resale price (RSP) method was 20 percent (later it was changed to 20 and 60 percent). In 2012, the law was changed by adopting different margins for certain specific sectors, keeping the 20 percent as a general prescribed margin. Accordingly the margins for the RSP method for imports are as follows:

• 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);
Resale method with fixed margins

- 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; and
- III - twenty percent for the other sectors.

For exports the margins are fifteen percent when the operation in the export country is a wholesale operation, and thirty percent when it is a retail operation (PVA and PVV methods).
Simplified CUP for commodities

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

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

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

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

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

However, it is also important to point out that the law foresees the possibility of modifying those margins through an individual request submitted by the taxpayer. A request to modify a profit margin must be accompanied by documents that prove that the margin used by the taxpayer conforms to normal practices between unrelated parties under comparable circumstances.
Predetermined margins methodology (to resale price and cost plus methods) presents remarkable strengths, which include:

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

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

1) Brazilian taxpayers which have a net profit originating from export sales to related parties (before taxes on income: IRPJ and CSLL), taking into consideration the taxable year and the previous two years, of at least 10% over such sales will not have to make export TP adjustments (other restrictions apply).

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 (this SH is not valid for commodities).

**Important**: rules set forth in items 1 and 2, are not applicable for sales to related parties established in low tax or non-cooperative jurisdictions, as defined by Brazilian TP Regulations, and when the prices of the goods and rights are available in organized markets through mercantile and futures exchange (mandatory PECEX).
Final Remarks

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

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

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