

Date: 17 October 2008

Brazil's Transfer Pricing Differences Create Challenges for Corporations

by Lisa M. Nadal, *Worldwide Tax Daily*

PricewaterhouseCoopers practitioners in an October 16 webcast addressed the challenges caused by Brazil's transfer pricing regime as well as new developments, including a new definition of tax havens and changes in the accounting rules.

The Brazilian transfer pricing requirements pose challenges for multinational corporations because Brazil does not adhere to the OECD guidelines or to the arm's-length standard, a PricewaterhouseCoopers practitioner said October 16.

Cristina Medeiros, partner and Brazil leader, transfer pricing, PwC Brazil, spoke during a webcast hosted by PwC on October 16. Practitioners discussed recent changes in the Brazilian transfer pricing rules and how multinational corporations can adjust to the developments.

Medeiros explained that because of the differences in the Brazilian transfer pricing regime compared with the rest of the world, multinational corporations have to address their Brazilian transfer pricing documentation separately from their global transfer pricing documentation to reduce the risk of a transfer pricing assessment in Brazil and double taxation. Also, Brazil does not have advance pricing agreements, so taxpayers cannot be certain that their methods will be accepted, she noted.

It's critical to have robust annual transfer pricing documentation in Brazil, Medeiros said. A Brazilian transfer pricing report should include an inventory of intercompany transactions; the method selected, and detailed information on the assumptions considered; the computation of the average annual information for both benchmark prices and import and export transactions; and a reconciliation of the computation information with the books and records.

Juan Carlos Ferreiro, partner and South America leader, transfer pricing, PwC Argentina, agreed with Medeiros, saying that because Brazil does not follow the OECD guidelines or the arm's-length standard, international corporations face a risk of double taxation when they have intercompany transactions in Brazil.

Ferreiro said that despite the differences, taxpayers may be able to harmonize some of the transfer pricing methods to comply with both Brazil and other countries. He explained that doing a coordinated analysis, which he called a "Brazilian profit alignment", is useful to reduce double tax, costs, and documentation efforts. "The analysis for this type of work should begin with a strong functional analysis," he said, adding that it is also important to gather very detailed financial information.

New Laws

Nelio Weiss, partner in charge, South America, international tax structuring, PwC Brazil, discussed the introduction of Law 11,727/2008, enacted on October 23. That law introduced an expanded definition of low-tax jurisdictions as it applies to Brazil's transfer pricing rules. (For prior coverage, see Doc 2008-14429 [PDF] or 2008 WTD 127-4.)

Weiss explained that until now, Brazil's concept of tax haven has been a jurisdiction with an income tax rate of 20 percent or lower. The new law expands this concept to add features related to secrecy, Weiss said, noting that countries with regimes that allow investors to maintain secret information related to ownership of shares and to beneficiaries of earnings will now be covered by the Brazilian definition of tax haven.

It is interesting that some European countries may now fall under the new tax haven definition, Weiss said. The definition will apply not only to countries but also to states and provinces within a country—even if the country as a whole is not deemed to be a tax haven—if the state or province has rules that fit the new definition of tax haven. However, countries that have tax treaties with Brazil will not be considered tax havens under the expanded definition, he added.

The new law is set to be effective on January 1, 2009, Weiss said, though it remains to be seen which countries will be on the new blacklist. The Brazilian tax authority is expected to publish the new list by the end of the year.

Weiss also discussed Law 11638, which changed some aspects of the Corporations Act and seeks to bring Brazil's generally accepted accounting principles closer to international accounting standards. Weiss said the changes will have important tax consequences.

As part of the new law, some large privately held companies will be required to have independent audits performed on their financial statements, Weiss said. The new law also requires that receivables and liabilities must be adjusted to present value, Weiss said, noting that this can have a significant impact on income statements and tax results.

Weiss noted that the law states that accounting adjustments made exclusively to harmonize the new accounting rules may not be used as the basis for levying taxes or have other tax effects. However, a provisory measure is expected to be issued soon that may limit the neutrality of the new law to a period of two years, he said.

Audit Developments

Medeiros said a new automated procedure for transfer pricing audits, called "AUDIN," is expected to be in place as of November 2008. The new approach will require some taxpayers that are audited to electronically transmit information to the tax authorities. AUDIN "is expected to increase the efficiency of tax authorities, and more notices relating to transfer pricing adjustments are expected," Medeiros said.

Medeiros also discussed the main issues challenged by the tax authorities in Brazil: failure to present transfer pricing documentation because no method was chosen; failure to properly provide backup documentation for the method chosen; and deficiencies related to a company's books not matching its transfer pricing documentation. She added that in Brazil, audit targets are selected by sectors and that recently the main sectors selected for audit have been the pharmaceutical, automotive, and electronics industries.