Brazil limits related-party interest deductions

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In brief

The Brazilian Ministry of Finance recently issued important guidance (Ordinance 427/13) regarding the deductibility and income recognition of interest in debt funding arrangements with foreign related parties and parties resident in tax havens or privileged tax regimes.

US multinational corporations (MNCs) should consider these new rules carefully when entering into loan agreements with Brazilian counterparties.

In detail

At the end of 2012, the Brazilian government issued Law 12766/12, which introduced changes to the deductibility and income recognition of interest in related-party loan arrangements. Under the previous rules, the deductibility of interest paid to foreign related parties was not limited if the loans were registered with the Brazilian Central Bank (BACEN). For loans not registered with BACEN, interest deductibility was limited to the LIBOR dollar rate for six-month loans plus a three-percent spread.

Under the new law, loans with related parties -- or with parties resident in tax havens or privileged tax regimes -- will be subject to the Brazilian transfer pricing rules for purposes of corporate income tax deductibility and income recognition, even if the loans are registered with BACEN. The new law sets out the formula for determining the arm's-length interest rates for companies to apply when accruing interest income or interest deductions on related-party loans. The new rates are based on the market rate of sovereign bonds and on the six-month LIBOR rate. The law also provides that an additional spread — to be set by the Ministry of Finance —is to be added to the interest rate.

On August 2, the Brazilian Ministry of Finance published Ordinance No. 427/13, which sets the additional spread at 3.5% for interest expenses of Brazilian companies on loans with foreign related parties signed on or after January 1, 2013.

The ordinance also sets the additional spread for interest income accrued by Brazilian entities on foreign related-party loans at 2.5% for agreements signed on or after August 2, 2013. For loan agreements entered into from January 1, 2013, through August 1, 2013, the additional spread has been set at zero.

In general, for fixed-rate US Dollar-denominated debt, the benchmark rate is the market rate for US Dollar-denominated Brazilian sovereign bonds. For fixed-rate Brazilian Real-denominated debt, the benchmark rate is the market rate for Real-denominated Brazilian sovereign bonds. For floating-rate debt, the benchmark rate is six-month LIBOR.

The takeaway

The spread rate definition for interest payments on related party loans is an important change for US MNCs doing business in Brazil. US MNCs should consider these new rules carefully when entering into loan agreements with Brazilian counterparties.

Let's talk

For a deeper discussion, please contact:

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