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Introduction
From the outset, Brazil’s transfer pricing rules, which took effect on 1 January 1997, have been very controversial. Contrary to the Organisation for Economic Co-operation and Development (OECD) Guidelines, US transfer pricing regulations, and the transfer pricing rules introduced by some of Brazil’s key Latin American trading partners such as Mexico and Argentina, Brazil’s transfer pricing rules do not adopt the internationally accepted arm’s-length principle. Instead, Brazil’s transfer pricing rules define maximum price ceilings for deductible expenses on inter-company import transactions and minimum gross income floors for inter-company export transactions.

The rules address imports and exports of products, services and rights charged between related parties. The rules also cover inter-company loans, and all import and export transactions between Brazilian residents (individual or legal entity) and residents in either low-tax jurisdictions (as defined in the Brazilian legislation) or jurisdictions with internal legislation that call for secrecy relating to corporate ownership, regardless of any relation.

Through the provision of safe harbours and exemptions, the rules were designed to facilitate the monitoring of inter-company transactions by the Brazilian tax authorities while they develop more profound technical skills and experience in the domain. Since the Brazilian rules do not adopt the arm’s-length principle, multinational companies with Brazilian operations have had to evaluate their potential tax exposure and develop a special transfer pricing plan to defend and optimise their overall international tax burden. From the outset, planning to avoid potential double taxation has been especially important.

In view of the substantial double taxation and documentation burdens, several international chambers of commerce and multinational companies have lobbied for changes to the current regulatory framework, in order to align Brazil’s transfer pricing rules with international standards, including the adoption of the arm’s-length principle. This effort has so far been unsuccessful.

Statutory rules
The rules require that a Brazilian company substantiate its inter-company import and export prices on an annual basis by comparing the actual transfer price with a parameter price determined under any one of the Brazilian equivalents of the OECD’s comparable uncontrolled price method (CUP method), resale price method (RPM) or cost plus method (CP method). Taxpayers are required to apply the same method, which they elect, for each product or type of transaction consistently throughout the respective fiscal year. However, taxpayers are not required to apply the same method for different products and services.
While incorporating these transaction-based methods, the drafters of the Brazilian transfer pricing rules excluded profit-based methods, such as the TNMM or PSM. This is contrary to the OECD Guidelines and the US transfer pricing regulations, as well as the transfer pricing regulations introduced in Mexico and Argentina.

Other material differences from internationally adopted transfer pricing regimes include the Brazilian transfer pricing legislation’s exclusion of a best method or most appropriate method rule; accordingly, a taxpayer may choose the respective pricing method. In addition, the Brazilian transfer pricing rules explicitly exclude inter-company royalties and technical, scientific, administrative or similar assistance fees, which remain subject to previously established deductibility limits and other specific regulations.

**Rules regarding imports of goods, services or rights**
Deductible import prices relating to the acquisition of property, services and rights from foreign-related parties should be determined under one of the following Brazilian methods:

**Comparable independent price method (PIC)**
This Brazilian equivalent to the CUP method is defined as the weighted average price for the year of identical or similar property, services, or rights obtained either in Brazil or abroad in buy/sell transactions using similar payment terms. For this purpose, only buy/sell transactions conducted by unrelated parties may be used. The use of the taxpayer’s own transactions with third parties for purposes of applying this method will be acceptable only to the extent the comparable transactions are equivalent to at least 5% of the tested transactions; if necessary, transactions carried out in the previous year can be considered to reach this percentage.

**Resale price less profit method (PRL)**
The Brazilian equivalent to the RPM is defined as the weighted average price for the year of the resale of property, services or rights minus unconditional discounts, taxes and contributions on sales, commissions and a gross profit margin determined in the tax legislation. As of 1 January 2013, a 20% gross profit margin is required for industries/sectors that are not specified in the legislation, calculated based on the percentage of the value imported over the final resale price. For the following industries/sectors a different mark-up is required:

Sectors where a 40% profit margin is required:
- Pharma chemicals and pharmaceutical products.
- Smoke products.
- Optical, photographic and cinematographic equipment and instruments.
- Machines, apparatus and equipment for dental, medical and hospital use.
- Extraction of oil and natural gas, and oil derivative products.

Sectors where a 30% profit margin is required:
- Chemical products.
- Glass and glass products.
- Pulp, paper and paper products.
- Metallurgy.
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These margins are applied in the same way for imports of products for resale or for inputs to be used in a manufacturing process. In applying the PRL, a Brazilian taxpayer may use their own prices (wholesale or retail), established with unrelated parties in the domestic market.

Until 31 December 2012 the PRL method was calculated considering a margin of 20% applicable to products for resale, and if value was added before resale, the profit margin was increased to 60%, calculated based on the percentage of the value imported over the final sales price. The changes introduced in the transfer pricing legislation to be effective as from the tax year 2013 may be adopted by taxpayers in the tax year 2012, under the conditions determined by the tax authorities.

Production cost plus profit method (CPL)
This Brazilian equivalent of the CP method is defined as the weighted average cost incurred for the year to produce identical or similar property, services, or rights in the country where they were originally produced, increased for taxes and duties imposed by that country on exportation plus a gross profit margin of 20%, and calculated based on the obtained cost.

Production costs for application of the CPL are limited to costs of goods, services, or rights sold. Operating expenses, such as R&D, selling and administrative expenses, may not be included in the production costs of goods sold to Brazil.

Quotation price on imports method (PCI)
This new Brazilian method, introduced by Law 12715/12, must be applied to test imports of commodities that have a quote in a commodities exchange, as of 2013. Based on this method taxpayers shall compare the transaction value with the average quote of the respective commodity involved, adjusted by an average market premium, in the date of the transaction. In the case of transactions involving commodities that do not have a quote in a commodities exchange, taxpayers may choose to test the prices in import transactions based on information obtained from independent sources, provided by internationally recognised institutes involved in researches of specific sectors.

In the event that more than one method is used, except when the use of the PCI method is mandatory, the method that provides the highest value for imported products will be considered by the Brazilian tax authorities as the appropriate import price. This is intended to provide taxpayers with the flexibility to choose the method most suitable to them. The Brazilian rules require that each import transaction be tested by the parameter price determined using one of the three methods, as applicable to the type of transaction (this also applies to export transactions).

If the import sales price of a specific inter-company transaction is equal to or less than the parameter price determined by one of the methods, no adjustment is required. Alternatively, if the import sales price exceeds the determined parameter price, the taxpayer is required to adjust the calculation basis of income tax and social contribution.

The aforementioned excess must be accounted for in the retained earnings account (debit) against the asset account or against the corresponding cost or expense if the good, service or right has already been charged to the income statement.
Until 2012 one of the most controversial issues raised with regard to import transactions was the treatment of freight and insurance costs, as well as Brazilian import duty costs for purposes of applying the Brazilian transfer pricing rules. Before the changes introduced for 2013 onwards, the transfer pricing law considered freight and insurance costs and the Brazilian import duty costs borne by the Brazilian taxpayer as an integral part of import costs (i.e. the tested import price). According to the regulatory norms published in November 2002, taxpayers could compare a parameter price calculated under the CPL or PIC methods with an actual transfer price that included or excluded freight and insurance costs as well as Brazilian import duty costs borne by the Brazilian taxpayer. Meanwhile, for testing under the PRL, freight and insurance costs and Brazilian import duty costs borne by the Brazilian taxpayer should be added to the actual transfer price.

As of 2013 taxpayers are no longer required to include customs duty in the tested price as well as freight and insurance contracted with third parties, provided such third parties are not located in low tax jurisdictions or benefit from privilege tax regimes. As mentioned, the changes introduced in the transfer pricing legislation to be effective as from the tax year 2013 may be adopted by taxpayers in the tax year 2012, under the conditions determined by the tax authorities.

**Rules regarding exports of goods, services and rights**

In the case of export sales, the regulations provide a safe harbour whereby a taxpayer will be deemed to have an appropriate transfer price with respect to export sales when the average export sales price is at least 90% of the average domestic sales price of the same property, services, or intangible rights in the Brazilian market during the same period under similar payment terms. When a company does not conduct sales transactions in the Brazilian market, the determination of the average price is based on data obtained from other companies that sell identical or similar property, services, or intangible rights in the Brazilian market. When it is determined that the export sales price is less than 90% of the average sales price in the Brazilian market, the Brazilian company is required to substantiate its export transfer prices based on the parameter obtained using one of the following Brazilian methods:

**Export sales price method (PVEx)**

This Brazilian equivalent of the CUP method is defined as the weighted average of the export sales price charged by the company to other customers or other national exporters of identical or similar property, services, or rights during the same tax year using similar payment terms.

**Resale price methods**

The Brazilian versions of the RPM for export transactions are defined as the weighted average price of identical or similar property, services, or rights in the country of destination under similar payment terms reduced by the taxes included in the price imposed by that country and one of the following:

- A profit margin of 15%, calculated by reference to the wholesale price in the country of destination (wholesale price in country of destination less profit method, or PVA).
- A profit margin of 30%, calculated by reference to the retail price in the country of destination (retail price in country of destination less profit method, or PVV).
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**Purchase or production cost-plus taxes and profit method (CAP)**
This Brazilian equivalent of the CP method is defined as the weighted average cost of acquisition or production of exported property, services, or rights increased for taxes and duties imposed by Brazil, plus a profit margin of 15%, calculated based on the sum of the costs, taxes and duties.

**Quotation Price on Exports method (PCEX)**
This new Brazilian method, introduced by Law 12715/12, must be applied to test exports of commodities that have a quote in a commodities exchange, as of 2013. Based on this method taxpayers shall compare the transaction value with the average quote of the respective commodity involved, adjusted by an average market premium, in the date of the transaction. In the case of transactions involving commodities that do not have a quote in a commodities exchange, taxpayers may choose to test the prices in export transactions based on information obtained from independent sources, provided by internationally recognised institutes involved in researches of specific sectors as well as by Brazilian regulatory agencies. Taxpayers must apply this method to test commodities quoted in the exchange market, even if their average export sales price are at least 90% of the average domestic sales price of the same goods.

In the event that the export sales price of a specific inter-company transaction is equal to or more than the transfer price determined by one of these methods, no adjustment is required. On the other hand, if the export sales price of a specific inter-company export transaction is less than the determined transfer price, the taxpayer is required to make an adjustment to the calculation bases of income tax and social contribution.

**Rules regarding interest on debt paid to a foreign-related person**

**Rules applicable until 31 December 2012**
The statutory rules provide that interest on related party loans that are duly registered with the Brazilian Central Bank will not be subject to transfer pricing adjustments. However, interest paid on a loan issued to a related person that is not registered with the Brazilian Central Bank will be deductible only to the extent that the interest rate equals the LIBOR dollar rate for six-month loans plus 3% per year (adjusted to the contract period). The actual amount of the interest paid on the loan in excess of this limitation will not be deductible for income tax and social contribution purposes.

The rules do not provide a reallocation rule, which would treat the foreign lender as having received less interest income for withholding tax purposes. Because the foreign lender actually received the full amount of the interest in cash, the foreign lender will still be required to pay withholding tax at the rate of 15% on the full amount paid, including the excess interest.

Similarly, loans extended by a Brazilian company to a foreign-related-party that are not registered with the Brazilian Central Bank must charge interest at least equal to the LIBOR dollar rate for six-month loans plus 3%.

**Rules applicable as of 1 January 2013**
As of 1 January 2013 interest on related party loans, even if resulting from agreements duly registered with the Brazilian Central Bank, will be deductible only up to the amount that does not exceed the rate determined based on the following rules, plus a spread to be determined by the Ministry of Finance based on an average market spread:
• In case of transaction in US dollars subject to fixed interest rate: rate of Brazilian sovereign bonds issued in US dollars in foreign markets.
• In case of transaction in Brazilian reais subject to fixed interest rate: rate of Brazilian sovereign bonds issued in Brazilian reais in foreign markets.
• In all other cases: London Interbank Offered Rate – LIBOR for the period of six months.

In the case of transactions in Brazilian reais, subject to floating interest rate, the Ministry of Finance can determine a different base rate.

For transactions covered in item III above in currencies for which there is no specific Libor rate disclosed the LIBOR for US Dollar deposits must be considered.

The deductibility limit must be verified on the contract date, and it will apply during the full contract term. For this purpose, the renewal and the renegotiation of contracts will be treated as the signing of a new contract.

**Rules regarding royalties and technical assistance**
The statutory rules expressly exclude royalties and technical, scientific, administrative or similar assistance remittances from the scope of the transfer pricing legislation. Accordingly, provisions of the Brazilian income-tax law established before the Brazilian transfer pricing rules went into effect still regulate the remittances and deductibility of inter-company payments for royalties and technical assistance fees.

According to this preceding legislation, royalties for the use of patents, trademarks and know-how, as well as remuneration for technical, scientific, administrative or other assistance paid by a Brazilian entity to a foreign-related party are only deductible up to a fixed percentage limit set by the Brazilian Ministry of Finance. The percentage limit depends on the type of underlying royalty, product or industry involved (the maximum is 5% of related revenues, 1% in the case of trademarks).

Additionally, royalties and technical assistance fees are only deductible if the underlying contracts signed between the related parties have been approved by the National Institute of Industrial Property (INPI) and registered with the Brazilian Central Bank after 31 December 1991. Royalty payments that do not comply with these regulations and restrictions are not deductible for income tax.

Consequently, while royalty and technical assistance payments are not subject to transfer pricing rules, they are subject to rules that impose fixed parameters that are not in accordance with the arm’s-length principle, except for royalties for the use of a copyright (e.g. software licences), which are not subject to the rate limitations mentioned above and, in most cases, are paid at much higher rates. Such remittances are subject to Brazil’s transfer pricing rules for import transactions.

The Brazilian transfer pricing regulations make no mention of royalty and technical assistance payments received by a Brazilian taxpayer from a foreign-related party. Hence, such foreign-source revenues should be subject to Brazil’s transfer pricing rules for export transactions.

**Definition of related persons**
Brazil’s transfer pricing rules provide a much broader definition of related parties than do internationally accepted transfer pricing principles. As described in the following
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section, the regulations go so far as to characterise foreign persons as being related when both are located in low-tax jurisdictions, whether or not a relationship exists between them. The statutory list of related persons illustrates that the transfer pricing regulations clearly target foreign-related parties since none of the listed relationships would result in a Brazilian company being considered as related to another Brazilian company. Consequently, the transfer pricing rules do not apply to two Brazilian sister companies, leaving the possibility for multinationals to conduct inter-company transfers between their Brazilian subsidiaries on non-arm’s-length terms. Inter-company transactions in a purely domestic context are covered by the disguised dividend distribution rules described below, which are less rigorous.

Under the statutory rules, a foreign company and a Brazilian company may be considered to be related if the foreign company owns as little as 10% of the Brazilian company, or when the same person owns at least 10% of the capital of each.

Additionally, regardless of any underlying relationship, the Brazilian definition of related parties considers a foreign person to be related to a Brazilian company if, in the case of export transactions, the foreign person operates as an exclusive agent of the Brazilian company or, in the case of import transactions, the Brazilian company operates as an exclusive agent of the foreign person. This broad definition was specifically designed to control potential price manipulations between third parties in an exclusive commercial relationship. For these purposes, exclusivity is evidenced by a formal written contract, or in the absence of one, by the practice of commercial operations relating to a specific product, service or right that are carried out exclusively between the two companies or exclusively via the intermediation of one of them. An exclusive distributor or dealer is considered to be the individual or legal entity with exclusive rights in one region or throughout the entire country.

Companies located in low-tax jurisdictions or beneficiaries of privileged tax regime
Under the regulations, the transfer pricing rules apply to transactions conducted with a foreign resident, even if unrelated, that is domiciled in a country that does not tax income or that taxes income at a rate of less than 20%, or in a jurisdiction with internal legislation allowing secrecy in regard to corporate ownership. For these purposes, the tax legislation of the referred country applicable to individuals or legal entities will be considered, depending on the nature of the party with which the operation was carried out. The transfer pricing provisions also apply to transactions performed in a privileged tax regime, between individuals or legal entities resident or domiciled in Brazil and any individuals or legal entities, even if not related, resident or domiciled abroad. These rules create some practical compliance issues because they require Brazilian companies to inform the tax authorities regarding transactions conducted with companies in tax havens even though the parties are completely unrelated and the transactions were contracted at arm’s length.

In an effort to facilitate compliance by taxpayers, the Brazilian tax authorities have issued a list of jurisdictions that they consider to be tax havens or without disclosure of corporate ownership. This list currently includes the following jurisdictions: American Samoa, Andorra, Anguilla, Antigua and Barbuda, Dutch Antilles, Aruba, Ascencion Islands, Bahamas, Bahrain, Barbados, Belize, Bermuda, Brunei, Campione D’Italia, Singapore, Cyprus, Costa Rica, Djibouti, Dominica, French Polynesia, Gibraltar, Granada, Cayman Islands, Cook Islands, Island of Madeira (Portugal), Isle of Man, Pitcairn Islands, Qeshm Island, Channel Islands (Jersey, Guernsey, Alderney, Sark),
Hong Kong, Kiribati, Marshall Islands, Samoa Islands, Solomon Islands, St Helena Island, Turks and Caicos Islands, British Virgin Islands, US Virgin Islands, Labuan, Lebanon, Liberia, Liechtenstein, Macau, Maldives, Mauritius, Monaco, Monserrat, Nauru, Nieuw, Norfolk, Oman, Panama, Saint Kitts and Nevis, Saint Lucia, Saint Pierre and Miquelon, Saint Vincent and Grenadines, San Marino, Seychelles, Swaziland, Switzerland, Tonga, Tristan da Cunha, Vanuatu and United Arab Emirates. The list of privileged tax regimes includes: Sociedad Anonima Financiera de Inversion (SAFI) incorporated under Uruguayan law until December 2010, holding companies incorporated under Danish law and under Dutch law that do not have substantial economic activity, international trading companies (ITC) incorporated under Icelandic law, offshore (KFT) companies incorporated under Hungarian law, LLCs incorporated under US state law (in which the equity interest is held by non-residents and which are not subject to US federal income tax), Entidad de Tenencia de Valores Extranjeros (ETVEs) incorporated under Spanish law and ITCs and international holding companies (IHC) incorporated under Maltese law.

Currently, the inclusion of Switzerland, Dutch holding companies, and Spanish companies incorporated as ‘Entidades de Valores Extranjeros’ or ‘ETVEs’ is suspended as a result of a request made to the Brazilian government by those countries, until their inclusion is further evaluated by the Brazilian authorities.

**Other regulations**

**Contemporaneous documentation requirements**

Many taxpayers initially failed to appreciate the complexities created by the Brazilian transfer pricing rules and their practical application to particular circumstances. The general impression held by many companies was that the fixed-income margins established by the Brazilian rules made it easier to comply with the rules and eliminated the need for detailed economic studies and supporting documentation. In practice, however, the application of the rules has shown that they are more complicated than they might appear. The amount of information necessary to comply with the rules was underestimated because the regulations did not provide any contemporaneous documentation requirements.

This changed in August 1999, when the Brazilian tax authorities issued information requirements concerning transfer pricing as part of the manual for filing the annual income-tax return (*Declaração de Informações Econômico-Fiscais da Pessoa Jurídica*, or DIPJ). These documentation requirements, which include five information forms (*Fichas*) in the tax return for disclosure of transactions conducted with foreign-related parties, greatly increased the transfer pricing compliance burden. These forms oblige taxpayers filing their annual tax returns to provide detailed disclosure regarding their inter-company import and export transactions, the method applied to test the inter-company price for the 49 largest import and export transactions, and the amount of any adjustments to income resulting from the application of the method to a specific transaction during the fiscal year in question.

For most companies, the elements needed to comply with the information requirements imposed by the information returns and a possible transfer pricing audit should be available through analytical information or the accounting system. However, many companies have yet to develop the systems that can provide the information needed to comply with these requirements as well as for purposes of determining the best transfer pricing methodology. Companies need to develop the necessary
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information-reporting systems and controls that can provide reliable accounting information regarding all transactions conducted with foreign parties to both facilitate compliance with the Brazilian transfer pricing rules and to properly defend on audit.

**Divergence margin**

For inter-company import and export transactions, even if the actually practised transfer price is above the determined transfer price (for import transactions) or below the determined transfer price (for export transactions), no adjustment will be required as long as the actual import transfer price does not exceed the determined transfer price by more than 5% (i.e. as long as the actual export transfer price is not below the calculated transfer price by more than 5%).

The divergence margin accepted between the parameter price obtained through the use of PCI and PCEX methods and the tested price is 3%.

**Relief of proof rule for inter-company export transactions**

In addition to the statutory 90% safe harbour rule for inter-company export transactions, there is a secondary compliance rule (herein referred to as the ‘relief of proof rule) whereby a taxpayer may be relieved of the obligation to substantiate the export sales price to foreign-related persons using one of the statutory methods if it can demonstrate either of the following:

- Net income derived from inter-company export sales, taking into account the average for the calculation period and the two preceding years, excluding companies in low-tax jurisdictions and transactions for which the taxpayer is permitted to use different fixed margins, is at least 5% of the revenue from such sales. As of 2013 this relief of proof can be adopted only in case the net exports to related parties do not exceed 20% of the total net exports, and in case the net income from exports is at least 10% of the revenues from such sales.
- Net revenues from exports do not exceed 5% of the taxpayer's total net revenues in the corresponding fiscal year.

If a taxpayer can satisfy the relief of proof rule, the taxpayer may prove that the export sales prices charged to related foreign persons are adequate for Brazilian tax purposes using only the export documents related to those transactions.

The relief of proof rules does not apply to export transactions carried out with companies located in low-tax jurisdictions or beneficiaries of privileged tax regime, and they do not apply to exports subject to the mandatory adoption of the PCEX method.

**Exchange adjustment**

In an attempt to minimise the effect of the appreciation of local currency vis-à-vis the US dollar and the euro, the Brazilian authorities issued ordinances and normative instructions at the end of 2005, 2006, 2007 2008, 2010 and 2011, which amended the Brazilian transfer pricing legislation for export transactions only. Per these amendments, Brazilian exporting companies were allowed to increase their export revenues for calendar years 2005, 2006, 2007, 2008, 2010 and 2011 (for transfer pricing calculation purposes only), using the ratio of 1.35, 1.29, 1.28, 1.20, 1.09 and 1.11, respectively. For 2009 and 2012, no exchange adjustment was allowed. This exceptional measure only applied for those years, and for the statutory 90% safe harbour, 5% net income relief of proof and CAP method.
Cost-contribution arrangements

No statutory or other regulations on cost-contribution arrangements have been enacted at this point. Accordingly, deductibility of expenses deriving from cost-contribution arrangements is subject to Brazil’s general rules on deductibility, which require deductible expenses to be (1) actually incurred, (2) ordinary and necessary for the transactions or business activities of the Brazilian entity, and (3) properly documented.

Based on our experience, Brazilian tax authorities will assume that related charges merely represent an allocation of costs made by the foreign company. Consequently, they will disallow deductibility for income tax and social contribution on net income unless the Brazilian taxpayer can prove that it actually received an identifiable benefit from each of the charged services specified in any corresponding contracts. Sufficient support documentation is crucial to substantiate any claims that expenses are ordinary and necessary, especially in the case of international inter-company cost-contribution arrangements.

In past decisions, the Brazilian tax authorities and local courts have repeatedly ruled against the deductibility of expenses deriving from cost-contribution arrangements due to the lack of proof that services and related benefits had actually been received by the Brazilian entity. In addition, in past decisions Brazilian tax authorities have ruled against the deductibility of R&D expenses incurred by a foreign-related party and allocated as part of the production cost base in the calculation of the CPL for inter-company import transactions.

With the exception of cost-contribution arrangements involving technical and scientific assistance with a transfer of technology, which are treated the same as royalties (please see above), resulting inter-company charges will have to comply with Brazil’s transfer pricing regulations, in order to be fully deductible. Due to the nature of the transaction, the CPL is the most commonly adopted method.

Back-to-back transactions

Back-to-back transactions are subject to TP rules. For this purpose, it should be considered as back-to-back transactions those in which the product is purchased from a foreign party and sold to another foreign party, and at least one of them is treated as a related party for Brazilian transfer pricing purposes, without the transit of goods in Brazil.

Legal cases

A significant issue under dispute between taxpayers and the tax authorities relates to the mechanics for calculating the PRL 60%. Normative Instruction (IN) 243 issued in 2002, which replaced IN 38, introduced significant changes to the calculation of the PRL method, creating a controversy regarding whether it expanded the scope beyond what the law intended. As a result of this controversy, most companies ignored the IN 243 provisions related to the PRL 60% calculation, which would yield much higher taxable income than the mechanics of IN 32. The Brazilian tax authorities have begun issuing large tax assessments based on IN 243.

The Taxpayers’ Council decided in a few cases against the taxpayers, and recently there was a decision in favour of taxpayers. Also, a Federal Regional Court (that it is not yet a final instance of this legal dispute) decided against a taxpayer, in an overturn of
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the same Court’s position from a few months back. In any event, the final decision on this dispute will only be known when it reaches the Superior Courts. As of 2013 the mechanics for calculating PRL 60% according to IN 243 provisions was included in Law 12,715, but with profit margins of 20%, 30% or 40% according to each industry/sector (please see comments above). This change in the tax law will end the dispute regarding this matter as of calendar year 2013.

**Burden of proof**
The taxpayer is obliged to satisfy the burden of proof that it has complied with the transfer pricing regulations as of the date the annual corporate income-tax return is filed. However, the fact that the Brazilian rules allow taxpayers to choose from several methods for each type of transaction provides properly prepared taxpayers an advantage over the tax authorities. Proper and timely preparation enables taxpayers to collect the necessary information and choose the most appropriate method in advance. The rules also state that the tax authorities can disregard information when considered unsuitable or inconsistent. Assuming the methodology is applied and documented correctly, taxpayers can satisfy the burden of proof and push the burden back to the tax authorities. This also applies when a taxpayer can satisfy the relief of proof rule for inter-company export transactions.

**Tax audit procedures**
Audits are the Brazilian tax authorities’ main enforcement tool with regard to transfer pricing. Transfer pricing may be reviewed as part of a comprehensive tax audit or through a specific transfer pricing audit.

**The audit procedure**
The audit procedure occurs annually, except in some cases such as suspicion of fraud. As part of the audit process, the regulations require a Brazilian taxpayer to provide the transfer pricing calculation used to test inter-company transactions conducted with foreign-related parties, along with supporting documentation. Since the taxpayer is obliged to satisfy the burden of proof that it has complied with the transfer pricing regulations as of the date the tax return is filed, it is important for taxpayers to have their support and calculations prepared at that time. If the taxpayer fails to provide complete information regarding the methodologies and the supporting documentation, the regulations grant the tax inspector the authority to make a transfer pricing adjustment based on available financial information by applying one of the applicable methods. As from calendar year 2012, taxpayers can only change the method adopted before the start of the audit procedure, unless the tax authorities disqualify the existing documentation; in this case, taxpayers will have 30 days to present a new calculation based on another method and the corresponding support documentation.

As part of the audit process, the tax inspectors typically request that the methods used by the taxpayer be reconciled with the accounting books and records. The tax inspector also requests any significant accounting information used to independently confirm the calculations performed by the company. The information requested by the tax inspector may be quite burdensome and may require the company to provide confidential data regarding the production cost per product, the prices charged in the domestic market, and the prices charged to foreign-related and independent parties.

As previously mentioned, companies need to develop the necessary information-reporting systems and controls that can provide reliable accounting information.
regarding all transactions conducted with foreign-related parties in advance to properly defend on audit.

**Assessments and penalties**

In making an assessment if taxpayers are not able to present a new calculation and its support documentation in 30 days after the first one has been disqualified, the tax inspector is not required to use the most favourable method available. Consequently, the inspector will most likely use the method that is most easily applied under the circumstances and assess income tax and social contribution at the maximum combined rate of 34%. The objective of an assessment would not necessarily result in the true arm’s-length result but would be based on an objective price determined by the regulations.

In the case of exports, tax inspectors would most likely use the CAP, because they could rely on the Brazilian cost accounting information of the taxpayer. In the case of imports, the tax inspector may have independent data collected from customs authorities, using import prices set by other importers for comparable products, based on the customs valuation rules, or use the PRL.

If the Brazilian tax authorities were to conclude that there is a deficiency and make an income adjustment, penalties may be imposed at the rate of 75% of the assessed tax deficiency. The rate may be reduced by 50% of the penalty imposed if the taxpayer agrees to pay the assessed tax deficiency within 30 days without contesting the assessment. In some cases when the taxpayer fails to provide the required information, the penalty rate may be increased to 112.5% of the tax liability. In addition, interest would be imposed on the amount of the tax deficiency from the date the tax would have been due if it had been properly recognised. In this instance, the interest rate used is the federal rate established by the Brazilian Central Bank known as SELIC.

**Resources available to the tax authorities**

The Brazilian tax authorities have created a group of agents specialised in transfer pricing audits. In addition, all tax agencies have a special area dedicated to the investigation and development of audits that conduct studies and form databases that can be used to compare prices and profit margins across industries and to identify questionable companies for audit. The electronic contemporaneous documentation filing requirements (DIPJ) for transfer pricing purposes facilitate the creation of such comprehensive databases. Since taxpayers are required to report in the DIPJ the average annual transfer prices for the 49 largest inter-company import and export transactions, the Brazilian tax authorities will be able to test these prices using the prices of similar products traded by other companies. In addition, as mentioned earlier, the tax inspector may also use data collected from the customs authorities’ electronic Integrated System for International Trade (Sistema Integrado de Comércio Exterior, or SISCOMEX), as well from Integrated System of Foreign Service Trade (Sistema Integrado de Comércio Exterior de Serviços, Intangíveis e outras operações que produzam variações no patrimônio, or SISCOSERV).

**Liaison with customs authorities**

In principle, it should not be possible to have different import values for customs and transfer pricing purposes. However, in determining import sales prices, the transfer pricing rules and customs valuation rules are not the same. It is quite common to find that the customs and transfer pricing rules result in different import prices. In practice,
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many multinational companies find themselves having to use an import sales price for customs’ purposes, which is higher than the price determined by the transfer pricing rules. As a result, these companies pay higher customs’ duties and, at the same time, make a downward adjustment to the price for transfer pricing purposes.

**Limitation of double taxation and competent authority proceedings**

Should the Brazilian tax authorities adjust transfer prices, it is possible that the same income could be taxed twice, once in Brazil and once in the foreign country. Multinational companies conducting transactions with their Brazilian affiliates through countries that do not have double-tax agreements with Brazil, such as the US and the UK, cannot pursue competent authority relief as a means of preventing double taxation arising from an income adjustment. Conversely, multinational companies conducting transactions with their Brazilian affiliates through countries that have double-tax agreements with Brazil may appeal for relief under the competent authority provisions of Brazil’s tax treaties. However, few taxpayers have tested this recourse, and none successfully. This is because Brazilian transfer pricing rules were enacted after the various tax treaties had been signed, so the reasons for evoking competent authority relief on transfer pricing grounds did not yet exist.

**Advance pricing agreements (APAs)**

While Brazil’s transfer pricing rules do not expressly refer to the institution of APAs, the statutory rules offer some leeway for the negotiation of an advance ruling from the tax authorities, stating that a taxpayer’s transfer prices are appropriate, even though they do not meet the fixed profit margins contained in the statute. The regulations specifically state that taxpayers may file ruling requests to alter the fixed profit margins for either industry sectors or individual taxpayers. Careful planning and substantial documentation will be necessary to justify lower margins to the Brazilian tax authorities.

To date, however, the few companies that filed ruling requests with the Brazilian tax authorities have not succeeded in obtaining different margins.

**OECD issues**

As with many other countries, Brazil is still in the early stages of developing its transfer pricing policies. Brazil’s transfer pricing regime has been criticised abroad for its failure to abide by international transfer pricing principles. The Brazilian transfer pricing rules focus not on the identification of the true arm’s-length price or profit but on objective methods for determining what the ‘appropriate’ transfer price should be for Brazilian tax purposes. The regulations themselves do not mention the arm’s-length principle, and the rules do not expressly require that related parties conduct their operations in the same manner as independent parties.

Brazil is not an OECD member country. However, in the preamble to the tax bill that introduced the transfer pricing rules, the Brazilian government stated that the new rules conformed to the rules adopted by OECD member countries. In a ruling, the Brazilian tax authorities reaffirmed their opinion that Brazil’s transfer pricing regulations are in line with the arm’s-length principle as established in Article 9 of the OECD Model Tax Convention. Although these pronouncements appear to be an endorsement of the arm’s-length principle as the norm for evaluating the results achieved by multinational enterprises in their international inter-company
transactions, the regulations do not provide the same level of explicit guidance and flexibility provided by the OECD Guidelines.

The fixed percentage margin rules, which have the appearance of safe harbours, are designed to facilitate administration and compliance and not necessarily to foster a fair and flexible system seeking maximum compatibility with the arm’s-length principle. The Brazilian rules prescribe methodologies for computing arm’s-length prices that are different from the methodologies approved by the US regulations and the OECD Guidelines and apply to transactions between certain unrelated parties. In other areas, such as technology transfers and cost-contribution arrangements, Brazil has failed altogether to establish transfer pricing rules.

The question is whether non-Brazilian OECD-compliant methods may be applied by taxpayers in valid situations when the three Brazilian transaction-based methods cannot be applied for practical reasons (for example, lack of applicability in general or lack of reliable information). In the case of transactions conducted with related parties in treaty countries, there is a strong basis supporting the conclusion that the treaties, which are based on the OECD model treaty and supersede Brazilian domestic laws, should allow a Brazilian company to apply profit-based methods accepted by the OECD.

In practice, however, the Brazilian tax authorities have demonstrated that they clearly do not agree with this interpretation, especially when it comes to methodologies not provided in the Brazilian transfer pricing regulations. In transfer pricing audits, the Brazilian tax authorities have repeatedly rejected economic studies prepared in line with the arm’s-length principle under observance of the OECD Guidelines as acceptable documentation. It can be assumed that the Brazilian tax authorities do not want to set a precedent that would allow multinational companies to bypass the rigid Brazilian documentation methods in favour of more flexible OECD approaches. Defending the use of OECD methodologies may eventually be resolved in the courts, although such a resolution would involve a lengthy and costly legal process.

**Disguised dividend distributions**

Brazil’s income tax law lists seven types of related party transactions (domestic and international) that are deemed to give rise to disguised distributions of dividends. In summary, such disguised distributions of dividends encompass all transactions between a Brazilian legal entity and its individual or corporate administrator(s) and/or controlling partner(s) or shareholder(s), which are negotiated at terms more favourable than fair market value. In the concrete case of related party financing transactions, these rules have a certain analogy to thin capitalisation rules or practices. Amounts characterised as disguised dividends are added to the taxable income of the legal entity deemed to have performed such a disguised distribution. This rule does not apply when the taxpayer can substantiate that the terms of the related party transactions were at fair market value. However, as previously mentioned, compliance with these disguised dividend distribution rules is less rigorously enforced than compliance with the transfer pricing rules, which focus exclusively on international inter-company transactions.