

Brazil enacts new transfer pricing law, presents draft Normative Instruction for public consultation

July 21, 2023

In brief

The Brazilian Government issued Provisional Measure (*Medida Provisória*, or “MP”) 1152/22 on December 29, 2022, seeking alignment with the arm’s-length principle (ALP) in accordance with the OECD Transfer Pricing Guidelines. The MP was amended and ratified by the Congress, a process which was concluded on May 10. Afterwards, the MP was converted into Law 14,596, published on June 15.

As mentioned in PwC’s Tax Insight published in [January 2023](#), the MP (currently Law 14,596) generally is principles-based and delegates substantial authority to regulations to be issued by the Brazilian Federal Revenue, through Normative Instructions (*Instrução Normativa*, or “IN”). Brazil’s consolidated income tax regulations, issued as a Presidential Decree of higher authority over RFB INs, also will be reformed once the process of issuing such regulations is completed.

The draft of the first IN was made available for public consultation on July 3. The initial July 25 deadline for submitting comment is expected to be extended.

This Tax Insight presents a summary of the main changes introduced by Law 14,596, highlighting the amendments made by the Congress to MP 1152/22, as well as the main aspects related to the draft of the IN and ongoing process of drafting further regulations.

Observation: As detailed in PwC’s Tax Insight published in [March 2023](#), taxpayers can opt to apply the transfer pricing rules set forth by Law 14,596 to controlled transactions carried out in calendar year 2023 (i.e., full adoption as of January 2023). As per the draft IN, the deadline for this irrevocable option should be postponed from September 30 to November 30, 2023.

In detail

Background

The MP is a legislative instrument, issued by the President in case of relevance or urgency and, although effective as of its publication, needs to be approved by the Congress within 60 calendar days from publication, extendable by another 60 calendar days, to remain in effect.

MP 1152/22 was published in December 2022, and, after discussions at the House of Deputies and Senate, was approved on May 10 with only a few amendments, which are discussed below.

On June 15, after the Presidential signature, Law 14,596 was published introducing a new transfer pricing system (TP System) in Brazil.

Overview of key changes introduced by the new TP System (Law)

A detailed analysis of the new TP System was provided in PwC's Tax Insight published in [January 2023](#). The following is a summary of the main aspects of the new legislation:

- Introduction of the ALP in the law as the pillar of the new system using language consistent with the OECD TP Guidelines.
- Definition of related parties considering the "influence" exercised directly or indirectly by another party, which may lead to the establishment of terms and conditions in their transactions that differ from those that would be set between unrelated parties in comparable transactions, yet with a broad list of "presumptions" of influence that casts a wider net as compared to the rules of most OECD member countries.
- The TP provisions also apply to transactions carried out with any entity resident or domiciled in low-tax countries or considered beneficiary of a "privileged tax regime," both cases referencing a corporate tax rate of 17%.
- A controlled transaction comprises any commercial or financial relationship between two or more related parties, established or carried out directly or indirectly, including contracts or arrangements in any form and series of transactions, and is not limited to imports and exports of goods, services, and rights, as well as interest.
- The comparable transaction concept is consistent with international standards, as is the notion of delineation of transactions.
- The most appropriate method must be selected considering the facts and circumstances of the transactions and the availability of reliable information of comparable transactions, among other factors. There are no more fixed margins and traditional transactional methods. Comparable Independent Price (CIP) Method; Resale Price minus Profit; Cost plus Profit — as well as the profit-based methods — i.e., Transactional Net Margin Method; and Profit Split — are accepted; also, a combination of methods is allowed in order to achieve compliance with the ALP.
- The use of an interquartile range in a panel of comparables is allowed. Also, when the data collected is deemed reliable, the full range of comparables is the appropriate one.
- Spontaneous and corresponding adjustments are allowed, while primary adjustments can be imposed by the Tax authority. Primary adjustments must be to the median of the panel of comparable indicators used by the RFB. While spontaneous and primary adjustments can only be upwards, corresponding ("compensatory") adjustments can also reduce Brazilian taxable income.
- Transactions with intangibles, intragroup services, cost contribution arrangements, business restructurings, and financial transactions have specific provisions consistent with the latest version of the OECD TP Guidelines.

Amendments to the previous version of the MP

The main amendments approved by the Congress are the suppression of a broad royalty barrier and of secondary TP adjustments (deemed interests).

In the original version of the MP, royalty and technical services payments to entities located in favorable tax jurisdictions or considered beneficiary of a privileged tax regime would not be deductible. This provision was excluded, remaining only the nondeductibility in case of double nontaxation (defined in a manner equivalent to a subject-to-tax rule).

Moreover, the secondary adjustment provision was also eliminated. In the previous version, such adjustment would result from deeming primary or voluntary adjustments as a deemed loan between the related parties, remunerated at an interest rate of 12% per year.

With regard to commodities — which include the main products exported by Brazil (from mining and metals to agricultural commodities) — the CIP will be applied when reliable independent price information is available, unless it is possible to demonstrate that another method would be more appropriate considering the characteristics of the transaction. This exception warrants alignment with the ALP. In this sense:

- The functions, assets, and risks of each entity in the value chain must be considered in the analysis of the most appropriate applicable method;
- Comparability adjustments must not be made not only if they affect the reliability of the CIP method, but also to justify the adoption of other TP methods;
- The information contained in “public prices” must be used for TP purposes in the same way that it would be used by unrelated parties in comparable transactions;
- The CIP method also will be considered as the most appropriate in situations under which there are prices practiced with unrelated parties (internal comparables); and
- In extraordinary market conditions, the use of public prices will not be appropriate for TP purposes, if it leads to a result incompatible with the ALP.

Observation: The law maintained the mandatory effective date of the new system as from January 1, 2024, despite efforts by taxpayers to postpone the term to 2025. The early adoption option, making the new retroactive effective as from January 1, 2023 for taxpayers who opt into the new system in September, is also maintained. The law is extensive yet it delegates substantial authority to the RFB regulations being drafted, and it does incorporate rules that are interpreted by different OECD member countries in different ways — hence, taxpayers have expressed concern over the timeline for early adoption or for the new system becoming mandatory in the absence of draft regulations being published, covering all articles of the new law.

Main aspects addressed in the first draft IN regulations

The first IN drafted and released by the RFB covers only the “general provisions” of the new law, not addressing key items that concern taxpayers (such as intangibles and the new “benefit test” for services imports), which the RFB declared its intention to regulate through other – multiple – regulations being drafted. Those will be covered in further public consultations later in 2023 and into 2024. The first draft IN nonetheless seeks to alleviate this concern by making express reference to the OECD TP Guidelines as a “subsidiary” (secondary) source of interpretation of the Brazilian TP Law, directly applicable when not in conflict with the law (i.e., while the OECD Guidelines do not change materially) or with RFB regulations (hence the relevance of all INs yet to be issued). This general rule nonetheless is helpful as it does approximate the Brazilian rules to an ambulatory or dynamic approach to the application of the TP Guidelines.

Observations on key aspects to be considered include:

- The deadline for the early adoption of the new rules for calendar year 2023 would be postponed from September 30 to November 30.

- As per suggestions publicly made by PwC, corresponding (“compensatory”) adjustments — which can be downward and as per the letter of the law are to be made in the same calendar year during which the original transaction takes place — now could be done until the Tax Return submission (i.e., Fiscal Year close relating to the prior calendar year, the same during which the original transaction takes place), as long as the taxpayer provisions the adjustment at the close of the calendar year in question.
- The Master File and the Local File would be formally introduced, and are broadly aligned with OECD models. However, there are specific mandatory sections that diverge from common practices of OECD member countries, making the Brazilian documentation requirement more burdensome for taxpayers; e.g., in the Master File, the taxpayer must disclose the profits/losses and income tax paid by each entity of the group in the last three periods.
- There would be no exemptions or thresholds from the Master File and/or Local File requirements. These reports must be submitted in the same deadline of the tax return — July of the following year — except for the first two years (2023, optional, and 2024), under which the deadline would be the end of the following year.
- Documents (not only the reports) in foreign language must be accompanied by its translation into Portuguese (and Tax Authorities may request the version translated by a Public Translator), which is inconsistent with statements made publicly by RFB officials prior to the public consultation.
- It is expected that a “TP Return” will be included in the Tax Return.
- A Safe Harbor rule for low value adding services is proposed (albeit subject to a benefit test yet to be addressed by detailed guidance). Consistent with the OECD Guidelines, the Safe Harbor rule established a minimum 5% markup in case of exports of low value adding services, and a maximum 5% markup in case of imports. It is expected that broader Safe Harbor rules are being designed, in tandem with the work of the Inclusive Framework on Pillar One Amounts A and B.
- The use of internal and external comparables, as well as foreign comparables is reaffirmed as acceptable; nonetheless, a non-exhaustive list of “examples” of comparability adjustments (subject to the facts and circumstances of the transaction and analysis) is included in the draft with items such as “country risk” and “net back” adjustments.
- The use of non-contemporaneous comparables, in case of absence of contemporaneous ones, would be allowed, but there is no guidance on the period that could be considered.
- The IN reaffirms that the tested part could be the less complex of the transaction, regardless of where it is domiciled.
- According to the draft of the IN, the new rules should apply to all contracts that have impacts on the Corporate Income Tax and Social Contribution Tax (IRPJ and CSLL) computation bases as of their initial adoption, regardless of the date of the contract (therefore, including those entered into force before the new rules are effective).
- The IN reaffirms that the new rules specifically apply to the determination of the tax base of IRPJ and CSLL corporate taxes only, not directly causing adjustments to other tax bases (not even for income withholding taxes). However, this rule, which is fully consistent with the letter of the TP law, does not prevent the authorities from using the TP files as foundations of fact based on which audits of other taxes and levies (such as customs duties, withholding income taxes, and other remittance taxes) could be initiated.

Further guidance should be issued to cover (1) commodities; (2) intangibles (including Brazil’s interpretation of the DEMPE standard); (3) intragroup services (and the new benefit test); (4) cost contribution arrangements; (5) business restructuring; (6) financial transactions; (7) advanced pricing agreement (APA); and (8) additional measures of simplification.

Next steps

The RFB will evaluate the comments and suggestions to the draft of the IN. The initial July 25 deadline for submitting comment is expected to be extended. The final version of this first IN is expected to be issued by August. Also, further guidance through new INs are expected to address topics that were not included in this first regulation.

Let's talk

For a deeper discussion of how Brazil's new transfer pricing rules might affect your business, please contact:

Transfer Pricing – Brazil

Romero J.S. Tavares, PhD, *São Paulo*
+55 11 94176 1136
romero.tavares@pwc.com

Michela Chin, *São Paulo*
+55 11 98426 2260
michela.chin@pwc.com

Daniel Perin, *São Paulo*
+55 11 99300 9440
daniel.perin@pwc.com

Transfer Pricing Global and US Leaders

Horacio Peña, *New York*
Global Transfer Pricing Leader
+1 917 478 5817
horacio.pena@pwc.com

Paige Hill, *New York*
US Transfer Pricing Leader
+1 917 923 8412
paige.hill@pwc.com

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