

Brazil issues guidance for early adoption of the arm's-length principle

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In brief

On December 29, 2022, the Provisional Measure (MP) 1152/22 was published by the Brazilian Government, seeking alignment with the arm's-length principle (ALP) in accordance with the OECD Transfer Pricing Guidelines. The MP must be ratified by the Congress and converted into ordinary law within 60 days from the date of its publication (discounting Congressional recess, the initial deadline is in April 2023). Such term may be extended for another 60 days (i.e., in June 2023).

Brazil's new transfer pricing (TP) system would be mandatory for taxpayers starting January 1, 2024. However, taxpayers may opt into the new rules with retroactive effect starting January 1, 2023. This option is regulated by Normative Instruction (IN) 2132/23, issued by the Federal Revenue of Brazil (*Receita Federal do Brasil* (RFB)) and published on February 24, 2023.

The IN/RFB 2132/23 also provides further guidance relating to TP adjustments and royalties for calendar year 2023.

Action item: The deadline for formalization of the early adoption for 2023, if elected, must be made during the period September 1-30, 2023. As such, taxpayers considering early adoption should begin evaluating its potential impact so they are prepared to make a final decision in September 2023.

In detail

Background

MP 1152/22 aligns with the OECD and the RFB joint final report, regarding the necessary changes to the Brazilian TP rules as one of the mandatory requirements for Brazil's accession to the OECD (see PwC's Tax Insights published in [May 2022](#) and [January 2023](#) for more details).

MP 1152/22 authorizes the RFB to establish and regulate the conditions for taxpayers' option to anticipate the new TP rules for calendar year 2023 ('early adoption'). Therefore, IN/RFB 2132 details the timeline and procedures to be observed in such a case.

In addition to the criteria for the early adoption in 2023, IN/RFB 2132 also determines the effects and procedures related to TP adjustments in 2023, as well as the deductibility conditions for royalties.

Criteria for adoption in 2023

The option for taxpayers to apply the transfer pricing rules set forth by MP 1152/22 to controlled transactions carried out in calendar year 2023 will be irreversible. **Note:** The option will imply, as of January 1, 2023, compliance with all the provisions of MP 1152/22 (full adoption of the new TP methodology, including the royalties deductibility regulations).

The option must be formalized within the period September 1-30, 2023, through: (1) a digital process requested in the Tax Authorities Virtual Service Center Portal (Portal e-CAC); and (2) by attaching the option term as per the Model determined in the appendix of the IN/RFB 2132.

In the case of new legal entities resulting from a merger or spin-off in the period from September to December of calendar year 2023, the option must be formalized in the first month of activity. Conversely, in case of liquidation of a legal entity in the period from January to August of calendar year 2023, the option must be formalized in the month of liquidation.

TP adjustments to the IRPJ and CSLL calculation bases

As mentioned in PwC's [January 2023 Tax Insight](#), the MP 1152/22 listed the types of adjustments allowed or imposed, solely for the purposes of corporate income taxes (IRPJ and CSLL).

The taxpayer-initiated adjustments must be performed in order to increase corporate income tax (CIT) basis (or decrease tax losses) due to noncompliance with the ALP. These adjustments are referred to as "spontaneous" (made directly to the CIT calculation basis on December 31, 2023) or "compensatory" (made by the end of calendar year 2023). Secondary adjustments will be imposed by the tax authority in the event of noncompliance with such provisions (i.e., a yearly interest rate of 12%, as determined by MP 1152/22).

Note: Only compensatory adjustments carried out according to the conditions and within the terms established by the RFB can reduce Brazilian corporate taxes or increase tax losses. The "compensatory" adjustment does not depend on any prior authorization of the RFB. Nevertheless, it must comply with the following requirements:

- Be registered in the bookkeeping of the legal entity domiciled in the country and of the other parties of the controlled transaction;
- Be based on the issuance of debit note, credit note, or any fiscal and commercial documentation to support the nature and amount of the adjustment; and
- Be ratified through declaration of the legal representative of the other parties of the controlled transaction, stating that the adjustment was performed in the same amount as done by the Brazilian legal entity.

The compensatory adjustment could be reviewed upon a tax inspection.

The spontaneous or compensatory adjustments will **not** automatically imply any adjustments in calculating the basis of other taxes, including those levied on the importation of goods and services, which must be determined in compliance with the applicable legislation.

Royalties

For taxpayers that opt to elect to apply the new TP rules for 2023, the specific deductibility rules with mandatory defined thresholds no longer will apply. Instead, a new limitation was established determining that payments of royalties to entities located in countries with favored taxation or considered a beneficiary of a privileged tax regime will be fully nondeductible, as well as payments to related entities that result in double non-taxation.

The following cases of expenses with royalties, technical, scientific, administrative, or similar assistance are considered to result in double non-taxation on transactions with related parties when:

- (1) The same amount is treated as a deductible expense for another related party;
- (2) The amount deducted in Brazil is not treated as taxable income for the foreign beneficiary in accordance with the legislation of its jurisdiction; or
- (3) The amounts are intended to finance, directly or indirectly, deductible expenses for related departments, which imply in the hypotheses referred to in items 1 or 2, above.

Observations

Brazil's MP 1152/22 appears likely to be approved by the National Congress, inasmuch as it is viewed as an improvement in the Brazilian business environment for foreign investors and eliminates disparities that may lead to double non-taxation. A detailed Normative Instruction with guidance (practical details) on the application of the new methodology is expected to be issued after the conversion of the MP into law.

The IN/RFB 2132/23 indicates that the process of changing to the ALP approach is moving forward. Also, taxpayers interested in early adoption would not be forced into an irreversible election by Q1 with uncertain results — considering that the law itself still might change — while the legislative process unfolds, ending in April or extending until June — and that a much longer (set of) regulations is yet to be issued.

Another positive aspect is that taxpayers can freely make a downward “compensatory” (corresponding) adjustment, since IN/RFB 2132/23 emphasizes that there will be no pre-filing or interference or pre-approval by the RFB. However, it does reference as evidence of documentation for such adjustment “credit and debit notes” which actually represent transactional adjustments — albeit motivated by TP — rather than corresponding TP adjustments (to the tax basis only). IN/RFB 2132/23 also mentions other evidence not necessarily inherent to transactional price adjustments.

If read and interpreted appropriately, the reference to transactional price adjustments should not be seen as limiting. The reference to debit notes, however, may create uncertainty as to application of the rule, since agents or reviewers might mistake transactional adjustments for TP adjustments and disallow the latter.

Furthermore, the IN/RFB 2132/23 clarifies that TP adjustments will not trigger adjustments to the bases of other taxes and duties, including those applicable to importation of goods (e.g., customs duties) and services (e.g., withholding taxes and others).

Let's talk

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

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