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Global Tax Alert

News from Americas Tax Center and Transfer Pricing

Brazil modifies transfer pricing rules

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The Brazilian tax authorities (RFB) published on 29 January 2019, Normative Instruction (NI) RFB 1.870/19, clarifying the transfer pricing rules and their application as established by NI RFB 1.312/12. NI RFB 1.870/19 is effective for calendar year 2019 and thereafter.

Transfer pricing methods for commodities (PCI and PECEX Methods)

For the application of PCI and PECEX methods, NI RFB 1.312/12 defined as a commodity all goods with NCM[1] codes:

a. Included in the list in Appendix I of NI RFB 1.312/12 and quoted in one of the publications listed in Appendix III of the same NI
b. Included in the list in Appendix I and traded on futures and commodities exchanges listed in Appendix II of NI RFB 1.312/12

Or

c. Listed as a good or right traded on the futures and commodities exchanges in Appendix II of NI 1,312/12

NI RFB 1.870/19 eliminates item "c" above, so that goods that are simply quoted in one of the commodities exchanges listed in Appendix II of NI RFB 1.312/12 are no longer considered commodities for Brazilian transfer

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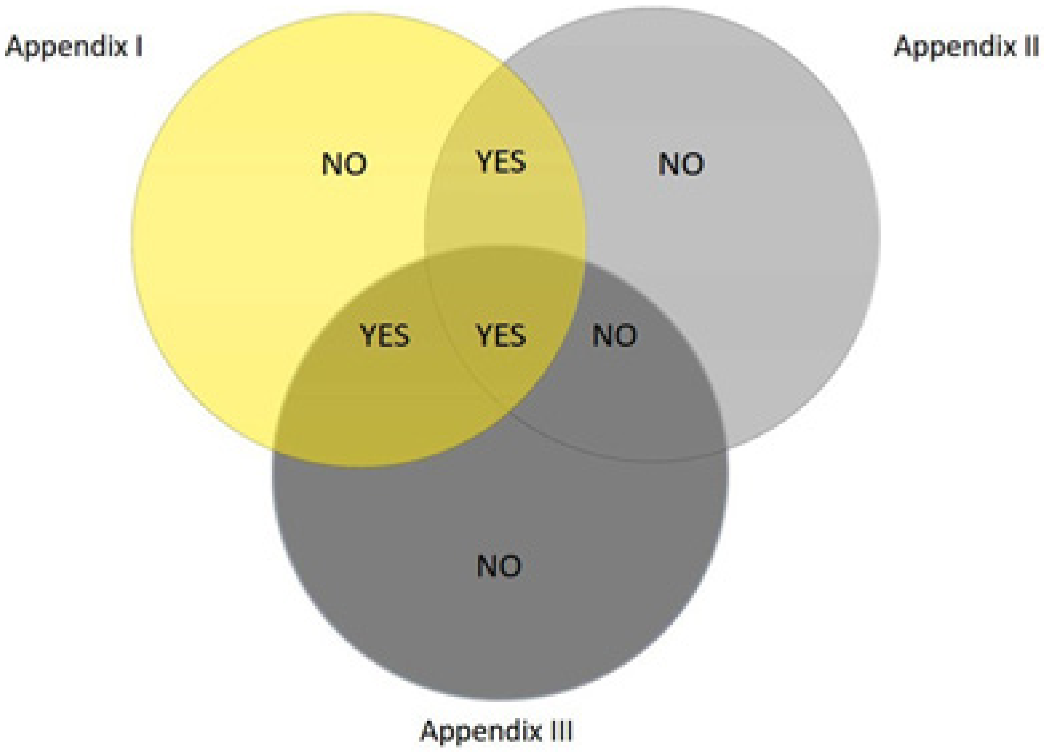
pricing purposes. In other words, NI RFB 1.870/19 establishes that goods quoted on the commodities exchanges stated in the Brazilian transfer pricing rules that do not have their NCM code listed in Appendix I are no longer considered commodities under the local transfer pricing rules.

The diagram below summarizes the application of the new NI:

Diagram 1: Goods considered as commodities for Brazilian transfer pricing rules according to NI 1.870/19



To apply the PCI and PECEX methods, NI RFB 1.870/19 clarifies that taxpayers must perform a transfer pricing analysis on a transaction basis, instead of comparing average prices by product, which is what taxpayers do with other traditional methods (e.g., the resale minus profit method – PRL and the cost-plus method – CAP). This approach follows the tax authorities' understanding published on Private Ruling No. 17, of 12 December 2018.

Also, NI RFB 1.870/19 does not allow taxpayers to group all the transactions that occurred on the same day to calculate a single actual intercompany price to be tested by the PCI and PECEX methods.

Divergence margin

Considered a benefit for taxpayers, the local legislation allows the use of a divergence margin for all transfer pricing methods. Under NI RFB 1.312, this margin was satisfactory when the weighted average benchmark price differed from the actual price up to 5%.[2] The interpretation on using the actual price as a reference for the percentage calculation of the margin was confirmed by Private Ruling No. 17 of December 2018. According to NI RFB 1.870/19, this interpretation still applies for transactions that occurred on or before 31 December 2018.

Beginning on 1 January 2019, however, NI RFB 1.870/19 establishes that taxpayers must use the weighted average benchmark price as the denominator to calculate the divergence margin. This modification is illustrated below:

Formula 1: Divergence margin on imports:

$$\text{Divergence margin until 31/12/18} = \frac{\text{Actual price – Benchmark price}}{\text{Actual price}}$$

$$\text{Divergence margin after 1/1/19} = \frac{\text{Actual price – Benchmark price}}{\text{Benchmark price}}$$

Formula 2: Divergence margin on exports:

$$\text{Divergence margin until 31/12/18} = \frac{\text{Benchmark price – Actual price}}{\text{Actual price}}$$

$$\text{Divergence margin after 1/1/19} = \frac{\text{Benchmark price – Actual price}}{\text{Benchmark price}}$$

Common provisions for import transactions

NI RFB 1.870/19 made two significant changes to the provisions applicable to import transactions. The benchmark prices calculated under the comparable independent prices (PIC) and the cost of production plus profit (CPL) methods must be calculated exclusively in the calendar year in which the good, service or right was imported. The resale minus profit (PRL) benchmark price calculation, on the other hand, must be performed in the calendar year in which the imported good, service or right was sold (or affected the profit and loss of the company for any reason).

Additionally, NI RFB 1.870/19 requires the excess costs recorded, which is obtained through the comparison between actual prices on imports and benchmark prices calculated by one of the transfer pricing methods for imports (PIC, PRL or CPL), to be added to the corporate income tax and social contribution tax bases in the calendar year in which the imported good, service or right was sold.

These two modifications, which were added, respectively, to Section 3 of Article 4 and Section 1 of Article 5 of NI RFB 1.312/12, make it clear that taxpayers need to have exact control over their inventory records to make it easier for them to identify (i) imported quantities, (ii) the year in which the transactions occurred, (iii) when the imported item was sold, and (iv) the transfer pricing methods applied. Such control becomes even more important given that differences may exist between the timing of the calculation of the parameter prices and the effective taxable adjustments.

Taxpayers that use the PRL method may have an easier time establishing control over their inventory records because that is the method usually adopted to test the costs on intercompany imports, and because the parameter prices must be calculated when the imported item is sold. However, taxpayers that use the PIC or CPL methods, or taxpayers that change their transfer pricing method from one year to the next, may need to give their inventory records more attention, as parameter prices may need to be calculated in a period different from that in which the good is disposed of.

Taxpayers must keep the excess costs calculated in a calendar year, through the application of the PIC or CPL method, in a separate control for cases in which there is a remaining inventory balance at the end of the calendar year.

Comparable independent prices method (PIC)

NI RFB 1.312/12 clarified the analysis regarding the relationship of the parties involved in a transaction to which the PIC method applies using external comparable information.

NI RFB 1.870/19 clarifies that, when using the PIC method, taxpayers may use as a comparable transaction the purchase and sales transactions with third parties performed by any company of the same group and located in any jurisdiction, as long as the third party is not located in a country considered as a tax haven or privileged tax jurisdiction.

Resale minus profit method (PRL)

Modification of the actual price calculation when applying the PRL method

The PRL method was always the subject of discussion among Brazilian taxpayers. One of the most controversial issues was the actual price calculation when applying the PRL method. NI RFB 1.870/19 clarifies that the weighted average actual price will be composed of the purchases made during the calculation period under analysis and the beginning inventory balances of that period, with the values and quantities of the remaining inventory balance at the end of the calendar year deducted.

In line with Private Ruling No. 17, of 12 December 2018, NI RFB 1.870/19 requires the inclusion of freight and insurance values in the cost of goods imported and, as a result, in the actual price calculation, whenever freight and insurance values are included in the Incoterm (*International Commercial Terms*) used for the import transaction.

Thus, for import transactions carried out with Incoterms that make the exporter responsible for freight and insurance, because freight and insurance are part of the purchase price, taxpayers must include the freight and insurance values when computing the cost of the good, service or right imported.

Modifications of the benchmark price calculation when applying the PRL method

In accordance with Law No. 9.430/96, as amended by Law No. 12.715/12, and as confirmed by Private Ruling No. 17, of 12 December 2018, only domestic market sales must be taken into account when calculating the PRL method benchmark price. In other words, taxpayers must not include sales to third parties located abroad (foreign market) in the PRL method calculation.

As determined by Section 1-A of Article 12 of NI RFB 1.312/12, the benchmark price calculated through the PRL method must be exclusively based on sales transactions with third parties in the domestic market if the same imported good, service or right is included in both: (i) domestic market sales and (ii) foreign market sales. However, the benchmark price must be used to test the import costs of all items sold in the calendar year under analysis, regardless of the destination market.

For a better understanding, consider the example below:

Table 1: PRL method calculation according to NI 1.870/19

REF	Description	Value
A	Average import cost (actual price)	110
B	PRL method computed with domestic market sales only	100
C = A - B	Unitary transfer pricing adjustment	10
REF	Description	Quantity
D	Quantity sold on the domestic market	100
E	Quantity sold on the foreign market	150
F = D + E	Total quantity	250
G = C * F	Total transfer pricing adjustment	2.500

NI RFB 1.870/19 also confirmed the methodology for calculating fixed profit margins under the PRL method. As defined by the norm, the different PRL profit margins apply according to the economic activity sector of the company. Under NI RFB 1.312/12, the PRL profit margins were calculated by taking into consideration the participation (percentage) of the imported good on the net sales revenue. The net revenue was defined by NI RFB 1.312 as the sales revenue decreased by unconditional discounts, taxes and contributions on sales, commissions and brokerage fees paid. Section 13 of Article 12 of NI RFB 1.312, however, contradictorily stated that the fixed profit margin percentage must be applied over the gross sales revenue, according to the sales invoice, decreased only by the unconditional discounts.

NI RFB 1.870/19 eliminates Section 13 of Article 12 of NI RFB 1.312 and adopts the procedure already widely used by local taxpayers, which is the calculation of the fixed profit margin based on the net sales revenue.

While NI RFB 1.870 is welcome as it clarifies some items in the Brazilian transfer pricing regulations that have caused some controversy, it also increases the level of difficulty for complying with the control of import transaction benchmark prices. The changes to the calculation of the divergent margin may also affect a number of taxpayers. Companies doing business in Brazil should, therefore, reassess their transfer pricing position and determine whether any actions are needed going forward.

Endnotes

1. *Nomenclatura Comum do Mercosul* – Mercosul harmonized codes for goods, used to identify them on trades. Mercosul is a treaty that created the South Common Market made up of Brazil, Argentina, Paraguay and Uruguay. Bolivia, Colombia, Chile, Ecuador and Peru are associate member states.
2. 3% for commodities.

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