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# Global Tax Alert

News from Americas Tax Center  
and Transfer Pricing

## Brazil and OECD present study on alignment of Brazil's transfer pricing rules with OECD guidelines

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In an event hosted in Brazil by the National Confederation of Industry (*Confederação Nacional da Indústria*, or CNI) on 11 July 2019, Brazil's Federal Revenue Department (*Receita Federal do Brasil*, or RFB) and the Organisation for Economic Co-operation and Development (OECD) presented the outcome of a study related to the probable alignment of Brazilian transfer pricing rules with the OECD guidelines. The project was funded by the British Government through the United Kingdom Foreign and Commonwealth Office.

The project was launched in February 2018 with the goal of evaluating Brazil's tax environment, focusing on the administrative and legal aspects of transfer pricing. It also examined the similarities and differences between the Brazilian transfer pricing rules and the OECD's guidelines.

The group involved in the project consisted of professional representatives from multinational enterprise groups headquartered both in Brazil and abroad, as well as RFB and OECD officials.

The project was conducted in three stages:

1. Preliminary analysis of the legal and administrative framework of Brazil's transfer pricing rules
2. Assessment of the strengths and weaknesses of Brazil's existing transfer pricing rules and administrative practices
3. Exploration of options for aligning Brazil's transfer pricing rules with the OECD's transfer pricing standard

## Stage 1: Preliminary analysis of the legal and administrative framework of Brazil's transfer pricing rules

The group conducted a general overview of Brazil's transfer pricing system. It considered the origins of the transfer pricing system, the interaction of the system with the arm's-length principle, and Brazil's position on OECD legal instruments and guidelines.

The group then prepared a draft report, outlining the differences between the Brazilian and OECD transfer pricing approaches, as well as the main policy issues related to Brazil's alignment with the OECD guidelines.

## Stage 2: Assessment of the strengths and weaknesses of Brazil's existing transfer pricing rules and administrative practices

During this stage, the group analyzed the strengths and weaknesses of the Brazilian transfer pricing legislation and the tax administrative practices associated with transfer pricing.

The first step of the analysis highlighted the Brazilian practices that differed from the OECD transfer pricing standard.

The second step of the analysis evaluated the effectiveness of Brazil's existing transfer pricing rules and practices, considering the OECD's transfer pricing policy objectives. Specifically, the group assessed how the Brazilian rules interact with the objectives of the OECD transfer pricing guidelines, including how Brazil protects against base erosion and profit shifting (BEPS) and double taxation. The group

also considered how easy it was: (1) to administer Brazil's transfer pricing rules; (2) for taxpayers to comply with those rules; and (3) for taxpayers to gain tax certainty.

As part of stage 2, the group collected data from stakeholders through questionnaires that were answered by 47 enterprises. This information allowed the group to conclude that some of the differences between Brazil's transfer pricing rules and the OECD's guidelines could result in double taxation and a significant reduction of Brazil's tax revenue. The group noted that Brazil's transfer pricing rules:

- ▶ Lack an arm's-length principle
- ▶ Adopt fixed margins for the sales and cost-based methods
- ▶ Disregard the profit-based methods, such as the profit split method (PSM) and the transactional net margin method (TNMM)
- ▶ Lack the most appropriate method rule
- ▶ Limit comparability adjustments by not considering relevant issues, such as transactions involving commodities
- ▶ Lack specific rules for transactions related to intangibles and services
- ▶ Lack a legal provision to adopt tax rulings and advance pricing agreements (APA)
- ▶ Do not apply a profit allocation to permanent establishments
- ▶ Have weak safe harbor rules (e.g., the rules could potentially allow a taxpayer to underprice local transactions to generate more profits from export transactions, large and small companies can apply the same safe harbor tests)

Appendix I, Assessment of Effectiveness, is a comparative table with the main conclusions found by the OECD in this project. Appendix I was prepared based on the comments provided by the OECD officers in the presentation at the National Confederation of Industry event.

### Appendix I – Assessment of Effectiveness

	Primary Objectives		Secondary Objectives			
Themes:	Preventing risks of tax erosion	Preventing double taxation	Ease of tax administration	Ease of tax compliance	Tax Certainty	
					Domestic	International
Absence of restatement of the arm's length principle in the Brazilian legislation	No	No	Maybe	Maybe	No	No
Fixed margins approach	No	No	Yes	Yes	Yes	No
<b>Scope of the application of transfer pricing rules:</b>						
- Broader personal scope	Yes	No	No	No	Yes	No
- Narrower material scope	Yes	No	Yes	Yes	Yes	No

	Primary Objectives		Secondary Objectives			
Themes:	Preventing risks of tax erosion	Preventing double taxation	Ease of tax administration	Ease of tax compliance	Tax Certainty	
					Domestic	International
Absence of transactional profit methods	No	No	Maybe	Maybe	Yes	No
The application of “other methods” is not allowed	No	No	Yes	Maybe	Yes	No
Freedom to chose the method	No	No	Yes	Yes	Yes	No
Absence of a complete comparability analysis / process of performing a comparability analysis	No	No	Yes	Yes	Yes	No
Restrict use of comparable	No	No	Yes	Yes	Maybe	No
Rigorous application of the “item per item” approach and prohibition of the use of the basket approach and set-offs	No	No	Yes	Yes	Yes	No
Limited comparability adjustments	Yes	No	Yes	No	Yes	No
Absence of transfer pricing rules or special measurements for intangibles, including hard-to-value intangibles	No	No	Yes	Yes	Yes	No
Absence of benefits test	Maybe	No	Yes	Yes	Maybe	No
Absence of special considerations to determine arm's length prices for intra-group services	No	No	Yes	Yes	Yes	No
Limited guidance on cost sharing agreements	No	Yes	Yes	Yes	Yes	Yes
Possible misuse of safe harbors	No	No	Yes	Yes	Maybe	No
Financial transactions	No	No	Yes	Yes	Yes	No
Compliance with transfer pricing rules	No	No	Yes	Yes	Yes	No
Documentation	No	N/A	Yes	Yes	Yes	Yes
Absence of Advanced Pricing Agreements (APAs)/inability to prevent double taxation	No	No	No	No	No	No
<b>Concerns regarding dispute resolution on transfer pricing</b>						
- Corresponding adjustments	No	No	No	Yes	No	No
- Mutual Agreement Procedure (MAP)	No	No	No	Yes	No	No

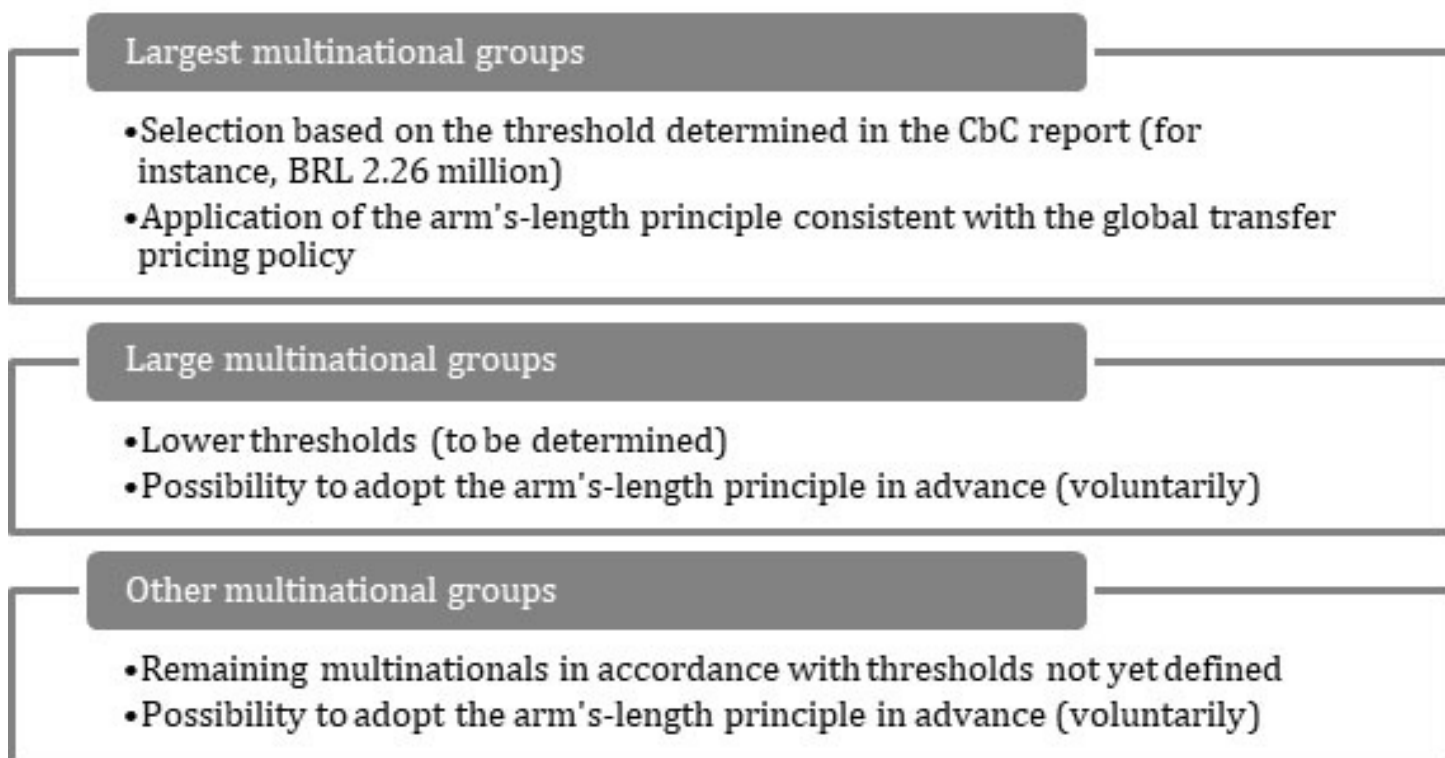
### Stage 3: Exploration of options for aligning Brazil's transfer pricing rules with the OECD's transfer pricing standard

In stage 3, the group explored possible options for aligning the current Brazilian system with the OECD transfer pricing guidelines, which resulted in the following options:

- ▶ **Immediate alignment:** Under this option, Brazil's rules would be immediately aligned with the OECD's rules, which means all taxpayers would be affected as of a defined date.
- ▶ **Gradual alignment:** This option would allow for a gradual transition over a certain period until total alignment with the OECD guidelines is achieved. The group discussed two possible options for the gradual alignment. Under the first option, Brazil's transfer pricing rules would be immediately aligned with the OECD's rules for transactions related to services and rights. For transactions involving goods, Brazil's transfer pricing rules would be aligned with the OECD's rules in a second phase.

Under the second option, alignment with the OECD's rules would depend on a taxpayer threshold. In the first phase, the largest corporations in Brazil (classified by the limits determined in the country-by-country (CbC) report<sup>1</sup>) would transition to the OECD model. In the second phase, other large corporations would transition, and the remaining corporations subject to transfer pricing rules would transition in the third phase. The illustration below demonstrates the phases for the gradual alignment by group.

#### Alignment of multinational groups with the OECD's rules:



The group had considered partial alignment, under which only a few areas or types of transactions would be aligned with the OECD rules. This option, however, was entirely rejected by the OECD counsel.

Even if one of these alignment possibilities is adopted, Brazil will still have to be evaluated by different committees, including the Fiscal Affairs Committee (*Comitê de Assuntos Fiscais*, or CFA). The committees will evaluate Brazil's adherence to the arm's-length principle and verify that Brazil has satisfied the primary objectives of the OECD's transfer pricing rules.

## Next steps

With the issuance of the study, Brazil must decide how it will align with the OECD's transfer pricing guidelines.

The next steps will include identifying the specific needs for implementing new transfer pricing rules in Brazil and developing a course of action to determine the issues that need to be addressed by the new rules. Any course of action will involve the drafting of legislation, which will have to take into consideration the level of investment in implementing new transfer pricing rules, changes to the current tax administration structure, and changes to the tax compliance measures.

OECD members are expected to endorse the basic principles of eliminating double taxation and base erosion through the application of the arm's-length principle. Brazil will be subjected to an in-depth analysis on multiple tax topics. The majority of the issues identified in the Brazilian transfer pricing rules are relevant to the analysis, and Brazil's commitment to aligning with the OECD guidelines will affect the result of the ascension discussions.

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## Endnote

1. RFB Normative Instruction (NI) 1681/2016 established in Article 4 that corporations with a total group consolidated revenue of over BRL2.26 billion (€750 million) are subject to completing the CbC report if the ultimate parent entity is established in Brazil.

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