Transfer Pricing in Brazil
Towards Convergence with the OECD Standard

A JOINT ASSESSMENT OF THE SIMILARITIES AND DIFFERENCES BETWEEN THE BRAZILIAN AND OECD FRAMEWORKS
Transfer Pricing in Brazil: Towards Convergence with the OECD Standard

A joint assessment of the similarities and differences between the Brazilian and OECD frameworks
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Please cite this publication as:


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It is my pleasure to present the outcomes of the work jointly conducted by Receita Federal do Brasil and the OECD to assess the similarities and differences between the Brazilian and OECD transfer pricing frameworks. The findings reflect the fact that while the OECD system has evolved over time— from the release of the 1979 Report to the latest edition of the OECD Transfer Pricing Guidelines – the main features of the Brazilian system have for the most part remained unchanged since the adoption of our system in 1996. Through the mutual analysis of the Brazilian and OECD systems, we have developed a comprehensive understanding of the gaps and divergences between the two, which are described in this report and assessed according to the policy objectives of transfer pricing rules. The conclusions of this work show that while some of the existing features of our system may perform positively in achieving some of the general policy objectives of transfer pricing rules – such as ease of tax administration or tax certainty from a domestic perspective – they may not always achieve the same results in respect of tax certainty from an international perspective. While designed to achieve ease of tax compliance, we have to admit that our rules do not always achieve that objective either. When benchmarked to the dual objective of transfer pricing rules, our current system delivers results that fall short from what was expected and evidence of double taxation arising in a number of cases was collected, and the outcome of our system in protecting the tax base in Brazil, which was initially one of the design objectives of our rules, raises serious concerns. These outcomes made us reflect on whether we shall maintain the current system as it stands or whether we shall strive to address the weaknesses of our system and build on its current strengths. While the answer to this question is simple, the solution will certainly require a lot of efforts and I count on all the stakeholders in joining our knowledge and forces to design a system which will be in line with the international standard as represented by the OECD Guidelines, yet also achieve the objectives that we strived to achieve from the early days, when our system was developed. Therefore, the report also outlines the direction of our next efforts, which is the full alignment with the OECD transfer pricing standard, and this is because our vision for the future aims at increasing integration and openness of Brazil. I would like us also to make it our joint effort with a view to producing an outcome that will be appropriate and work for Brazil, and which could be also an inspiration for other countries to follow. I count on all the stakeholders as well as on the OECD Secretariat and the countries who provided their generous assistance and support to achieve this goal.

José Barroso Tostes Neto
Special Secretary of Receita Federal do Brasil
This joint report marks yet another important step in strengthening cooperation between OECD and Brazil in tax matters. It builds on the collaboration started in 2010, when Brazil joined the Global Forum on Transparency and Exchange of Information for Tax Purposes, which today has over 155 members on an equal footing. This partnership was further expanded when Brazil became a member of the G20/OECD BEPS Project in 2013. Brazil has played a critical role in the ongoing development of both initiatives and has benefited from the implementation of the associated standards and peer reviews. It is also working with more than 130 countries and jurisdictions through the Inclusive Framework on BEPS to develop a consensus solution to the tax challenges arising from the digitalisation of the economy.

The dialogue initiated with Receita Federal do Brasil 15 months ago on transfer pricing represents yet another major step forward in OECD-Brazil relations given the importance of transfer pricing policy in international taxation and the current differences in approaches. I am therefore very pleased that we can jointly present this report on the outcomes of our work on this thus far, which includes an in-depth analysis of the similarities and differences between the Brazilian and OECD transfer pricing frameworks as well as an assessment of these differences.

The OECD Transfer Pricing Guidelines have evolved over time to ensure that they continue to achieve the dual objectives of transfer pricing rules, which are to secure the appropriate tax base in each jurisdiction and to avoid double taxation, thereby minimising conflict between tax administrations and promoting international trade and investment. Changes have been made to respond to changing business models, new issues and lessons learned by tax administrations around the world. This was most evident in the BEPS Project and is also a key objective in the ongoing work to address the tax challenges arising from the digitalisation of the economy.

It is quite positive that Brazil is undertaking the first fundamental and comprehensive review of its transfer pricing rules in decades and the OECD is very pleased to be part of this process. The findings in this joint report highlight the importance that Brazil attaches to simplicity and the ease of application and administration of transfer pricing rules. This is a critical factor not only for Brazil but also for many other countries, and we are keeping these objectives in mind in our ongoing work on transfer pricing at the OECD. The report also emphasises the importance of tax certainty in the area of transfer pricing, not only in the domestic but also in the international context, given that MNEs operate internationally and risk double taxation where countries do not follow the same standards and principles. Achieving these noble objectives, yet failing to assure that Brazil is also able to determine the appropriate tax base and effectively collect the tax on the profits earned by the MNEs in Brazil would mean that the dual objective of transfer pricing rules has not been achieved, and this would undermine the development and transformation objectives of the country.

The OECD looks forward to continuing to serve as a trusted partner to Receita Federal do Brasil in the next phase of this project.

Grace Perez-Navarro
Deputy Director of the OECD Centre for Tax Policy and Administration
Foreword

The purpose of this report is to present the results of the technical analysis carried out as part of the joint OECD-Brazil “Transfer Pricing in Brazil” project. This project was carried out jointly by the OECD and Receita Federal do Brasil (RFB) with the objective to examine the similarities and divergences between the Brazilian and OECD transfer pricing approaches to valuing cross-border transactions between associated enterprises for tax purposes.

The 15-month work programme carried out by the OECD jointly with RFB included an in-depth analysis of the Brazilian transfer pricing legal and administrative framework as well as its application. Based on the assessment of its strengths and weaknesses, possible options were explored for Brazil’s alignment with the OECD internationally accepted transfer pricing standard, using the OECD Transfer Pricing Guidelines and other relevant OECD guidance as a reference for the analysis.

Throughout this process, valuable input was collected both from multinational enterprise (MNE) groups with operations in Brazil and Brazil’s major trade and investment partners, to supplement and complete the assessment.

In the perspective of aligning Brazil’s system with the OECD transfer pricing standard, the objective of any future efforts is to set the conditions for the implementation of a modern, simple and efficient transfer pricing system that is in line with the OECD standard. Such a system should achieve the dual objective of securing the appropriate tax base in Brazil and other concerned jurisdictions as well as avoiding double taxation, but it should also preserve simplicity for tax administrations and taxpayers alike, in an environment that fosters tax certainty both at the domestic and international level.
Acknowledgements

This project could not have been undertaken without the strong and generous support from the United Kingdom Government, in particular from the Foreign and Commonwealth Office (FCO), HM Revenue and Customs (HMRC) and HM Treasury, as well as the jurisdictions which contributed to the project, namely Argentina, Australia, Austria, Belgium, Canada, Colombia, Finland, France, Germany, India, Israel, Italy, Korea, Mexico, the Netherlands, Nigeria, Norway, Peru, Portugal, Singapore, Spain, Sweden and the United States. The contribution of the business community is also acknowledged, and particularly the support provided by Business at OECD, the National Confederation of Industry of Brazil (CNI), and the Applied Tax Study Group (GETAP).
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# Abbreviations and acronyms

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<th>Description</th>
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<tr>
<td>APA</td>
<td>Advance pricing arrangement</td>
</tr>
<tr>
<td>BACEN</td>
<td>Brazilian Central Bank (Banco Central do Brasil)</td>
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<tr>
<td>BEPS</td>
<td>Base erosion and profit shifting</td>
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<tr>
<td>CARF</td>
<td>Administrative Tax Court of Appeals (Conselho Administrativo de Recursos Fiscais)</td>
</tr>
<tr>
<td>CAP</td>
<td>Acquisition or Production Cost Plus Taxes and Profit Method (Método do Custo de Aquisição ou de Produção Mais Tributos e Lucro)</td>
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<tr>
<td>CbCR</td>
<td>Country-by-Country Reporting</td>
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<tr>
<td>CCA</td>
<td>Cost contribution arrangement</td>
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<tr>
<td>CFA</td>
<td>Committee on Fiscal Affairs</td>
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<tr>
<td>CFC</td>
<td>Controlled foreign company</td>
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<tr>
<td>COSIT</td>
<td>General Co-ordination Office for the Federal Revenue Taxation System (Coordenação-Geral de Tributação)</td>
</tr>
<tr>
<td>CNI</td>
<td>National Confederation of Industry in Brazil (Confederação Nacional da Indústria)</td>
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<tr>
<td>CPL</td>
<td>Production Cost Plus Profit Method (Método do Custo de Produção Mais Lucro)</td>
</tr>
<tr>
<td>CUP</td>
<td>Comparable uncontrolled price</td>
</tr>
<tr>
<td>CSLL</td>
<td>Social Contribution on Profits (Contribuição Social sobre o Lucro Líquido)</td>
</tr>
<tr>
<td>DDL</td>
<td>Disguised distribution of profits (Distribuição Disfarçada de Lucros)</td>
</tr>
<tr>
<td>DEMPE</td>
<td>Development, enhancement, maintenance, protection, and exploitation</td>
</tr>
<tr>
<td>ECF</td>
<td>Digital Tax Accounting Bookkeeping (Escrutação Contábil Fiscal)</td>
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<tr>
<td>FDI</td>
<td>Foreign direct investment</td>
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<tr>
<td>FHTP</td>
<td>Forum on Harmful Tax Practices</td>
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<tr>
<td>HTVI</td>
<td>Hard-to-value intangible</td>
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INPI  Brazil's National Institute of Intellectual Property (Instituto Nacional de Propriedade Intelectual)
IRPJ  Corporate Income Tax (Imposto de Renda Pessoa Jurídica)
LLC   Limited Liability Company
MAP   Mutual agreement procedure
MLI   Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting
MNE   Multinational enterprise
MTIP  Major trading and investment partner
OECD  Organisation for Economic Co-operation and Development
PE    Permanent establishment
PECEX Price Under Quotation on Export Method (Método do Preço sob Cotação na Exportação)
PCI   Price under Quotation on Import Method (Método do Preço sob Cotação da Importação)
PIC   Comparable Independent Price Method (Método dos Preços Independentes Comparados)
PRL   Resale Price Less Profit Method (Método do Preço de Revenda Menos Lucro)
PVA   Wholesale Price in the Country of Destination Less Profit Method (Método do Preço de Venda por Atacado no País de Destino Menos Lucro)
PVEx  Export Sales Price Method (Método do Preço de Venda nas Exportações)
PVV   Retail Price in the Country of Destination Less Profit (Preço de Venda por Atacado no País de Destino, Diminuido do Lucro)
RFB   Brazil Federal Revenue (Receita Federal do Brasil)
SELIC Brazilian Basic Interest Rate (Sistema Especial de Liquidação e Custódia)
SISCOMEX Integrated System of International Trade (Sistema Integrado de Comércio Exterior)
SISCOSERV Integrated System of International Trade of Services, Intangibles, and Other Transactions that Result in Modification of Net Worth or Equity (Sistema Integrado de Comércio Exterior de Serviços, Intangíveis e Outras Operações que Produzam Variações no Patrimônio)
TNMM  Transactional Net Margin Method
UN    United Nations
WP6   Working Party No. 6 on the Taxation of Multinational Enterprises
WTO   World Trade Organization
Executive summary

In February 2018, the OECD and Brazil launched a joint project to examine the similarities and divergences between the Brazilian and OECD transfer pricing approaches to valuing cross-border transactions between associated enterprises for tax purposes. This initiative builds on Brazil’s robust engagement in the OECD’s tax work, which began in 2010 when it joined the Global Forum on Transparency and Exchange of Information for Tax Purposes, and was further strengthened in 2013 when it became a member of the G20/OECD Project to counter Base Erosion and Profit Shifting (BEPS), which had a substantial focus on transfer pricing. Beyond just taxation, in 2017, Brazil also expressed interest in initiating the process to join the OECD.

Objective: assessing the strengths and weaknesses of Brazil’s transfer pricing framework

The 15-month work programme carried out by the OECD jointly with Receita Federal do Brasil (RFB) included an in-depth analysis of the Brazilian transfer pricing legal and administrative framework as well as its application. Based on the assessment of its strengths and weaknesses, possible options were explored for Brazil’s alignment with the OECD internationally accepted transfer pricing standard, using the OECD Transfer Pricing Guidelines and other relevant OECD guidance as a reference for the analysis.¹

Methodology – gap analysis and assessment of effectiveness

The technical analysis considered whether the main elements, concepts and objectives of the OECD guidance on transfer pricing were reflected in the Brazilian transfer pricing framework (gap analysis). The gaps or issues identified in the Brazilian framework were then assessed according to five objective criteria. The two first criteria are derived from the two main policy objectives of transfer pricing legislation, also referred to as the dual objective of transfer pricing rules, namely securing the appropriate tax base in each jurisdiction and avoiding double taxation. The other three are derived from other general tax policy objectives, namely ease of tax administration, ease of tax compliance, and tax certainty (from a domestic and international perspective).

Throughout this process, valuable input was collected both from multinational enterprise (MNE) groups with operations in Brazil and Brazil’s major trade and investment partners, to supplement and complete the assessment.

¹ The three key OECD instruments on transfer pricing and income allocation are the 1995 OECD Council Recommendation, the 2008 Council Recommendation on Attribution of Profits to Permanent Establishments, and the 2016 BEPS Transfer Pricing Recommendation. They contain important recommendations related to transfer pricing and income allocation.
Stages of the project

The work programme was carried out in three stages:

- **Stage 1**: preliminary analysis of the legal and administrative framework of Brazil’s transfer pricing rules;
- **Stage 2**: assessment of the strengths and weaknesses of Brazil’s existing transfer pricing rules and administrative practices; and
- **Stage 3**: options for alignment with the OECD transfer pricing standard.

Key outcomes

The analysis led to the identification of a number of issues resulting from gaps and divergences in the Brazilian transfer pricing framework as compared to the OECD framework. The assessment of these issues with regard to achieving the policy objectives of transfer pricing rules reveals there are weaknesses in Brazil’s framework, which result in BEPS and double taxation. The assessment also recognises the strengths of the Brazilian approach in terms of ease of compliance for taxpayers and ease of administration by the tax authority, which are also important policy objectives. However, these objectives should not undermine the achievement of the dual objective of transfer pricing rules, namely to secure the appropriate tax base in each jurisdiction and to avoid double taxation. Simplicity and administrability must not compromise the protection of the tax base against BEPS or create uncertainty for cross-border business resulting from double taxation. Ease of administration and compliance are nevertheless important goals for Brazil, and for any transfer pricing system in general but they can be achieved through measures that can be consistent with the arm’s length principle and internationally accepted practice.

In the context of considering alignment of Brazil’s system with the OECD transfer pricing standard, the objective of any future efforts is to set the conditions for the implementation of a modern, simple and efficient transfer pricing system that is in line with the OECD standard.

Such a system should achieve the **dual objective of securing the appropriate tax base in Brazil and other concerned jurisdictions as well as avoiding double taxation, but it should also preserve simplicity for tax administrations and taxpayers alike, in an environment that fosters tax certainty both at the domestic and international level.**

Options for greater alignment with the *OECD Transfer Pricing Guidelines* were explored in light of the findings of the technical analysis and two possible options for alignment were identified – both **leading to full alignment with the OECD standard, with one of the options contemplating an immediate alignment while the other option contemplates a gradual alignment process.**

Background

Brazil’s position as the ninth largest economy in the world and the continuous process of globalisation make the taxation of MNE groups, and transfer pricing in particular, a key tax policy issue in Brazil.

Transfer pricing rules aim at ensuring that the profits arising from commercial and financial transactions between members of an MNE group are allocated in a manner that reflects the value contributed by each of the parties. Accordingly, transfer pricing rules should ensure the appropriate tax base is secured and thus also contribute to the prevention of the erosion of countries’ tax bases and the shifting of profits to jurisdictions with low or no tax liability and where little or no economic activities occur, while also preventing double taxation and distortion of investment decisions and competition among companies.
Key reasons for the project

- Brazil operates a transfer pricing regime that has remained relatively unchanged since it was enacted in 1996;
- The system was inspired by the work of the OECD (1979 Report) but has not evolved significantly since then, whereas the OECD transfer pricing guidance was revised significantly with the publication of the OECD Transfer Pricing Guidelines in 1995, and has been updated and clarified on a regular basis, with significant updates in 2010 and 2017;¹
- The most significant changes resulted from the BEPS Project – particularly BEPS Actions 8-10 to address and limit tax avoidance and abuse through transfer pricing practices;
- The Brazilian transfer pricing system contains a number of significant gaps and divergences from the OECD system, which reportedly led to double taxation on the one hand and BEPS opportunities on the other. It was therefore considered desirable to better understand the specific divergences and their effects (impact on investment and revenue collection);
- Given Brazil’s expression of interest to join the OECD, it was useful to already start considering the degree of alignment of the existing regime with the OECD standards that would be desirable to improve the Brazilian system as well as the changes needed to avoid obstacles to accession.

Origins of Brazil’s transfer pricing legislation

Brazil enacted transfer pricing legislation in 1996. Specific provisions with regard to transfer pricing were necessary given the increase in foreign investment inflow during the 1990s, which, despite periodic decreases that reflected worldwide crises, has continued since then. With the adoption of transfer pricing rules, Brazil aimed at “preventing the detrimental transfer of resources to foreign countries through the manipulation of prices used in the importation or exportation of goods, services or rights, in transactions with non-resident related parties”.³

In the international context, the OECD guidance enshrined in the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations is followed by most countries around the world in their efforts to ensure the appropriate tax base is secured and that both double taxation and base erosion and profit shifting are prevented. While the Brazilian transfer pricing legislation was clearly inspired by the OECD transfer pricing guidance available at the time of its introduction in 1996, it has not significantly evolved since then or incorporated the subsequent changes to the OECD guidance. As a result, Brazil’s transfer pricing regime is not fully aligned with the international standard, the “arm’s length principle”, embodied in Article 9 of the OECD Model Tax Convention and the United Nations Model Tax Convention and the application of which is interpreted in detail in the OECD Guidelines.

Brazil’s active role in OECD work

Over the past two decades, Brazil has actively participated in international debates on tax issues in different multilateral fora, including the OECD and the United Nations, and through regional initiatives. As a G20 country, Brazil has been in the front line of the most recent and decisive projects shaping the rules of international taxation, such as the G20/OECD BEPS Project and the ongoing work on the tax challenges arising from digitalisation.

¹ Changes to the OECD Guidelines do not require their formal re-edition, as any guidance approved by the Inclusive Framework on BEPS becomes effective upon approval and publication, even before they are incorporated in the OECD Guidelines. The revised guidance resulting from the BEPS Project was only incorporated in the 2017 edition.

³ Explanatory Statement (Exposição de Motivos) nº 470, 15 October 1996.
Focus on transfer pricing

The BEPS Project provided a new opportunity for the OECD to engage with Brazil on transfer pricing matters, with two policy dialogue events being held in 2014 and 2015. In May 2017, at the request of Brazil and with the support of the European Commission, the OECD held a third workshop with tax officials from Receita Federal do Brasil (RFB), focussed on building a better mutual understanding of the Brazilian and OECD transfer pricing systems.

The “Transfer Pricing in Brazil” project provided an opportunity for the OECD and Brazil to jointly carry out a detailed and thorough analysis of the strengths and weaknesses as well as the similarities and differences between the two systems. In light of the findings of this assessment, the project also explored the potential for Brazil to move closer to the OECD transfer pricing standard, which is a critical benchmark for OECD member countries, and followed by most countries around the world.

Brazil’s position on key instruments

Ensuring the primacy of the arm’s length principle as set out in the OECD Transfer Pricing Guidelines is required as one of the OECD Committee on Fiscal Affairs’ Core Principles for assessing accession candidate countries (i.e. adherence to the Guidelines).

Eliminating double taxation through ensuring the primacy of the arm’s length principle, as set out in the OECD’s Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, for the determination of transfer pricing between associated enterprises.

The three key OECD instruments on transfer pricing and income allocation are the 1995 OECD Council Recommendation,4 the 2008 Council Recommendation on Attribution of Profits to Permanent Establishments,5 and the 2016 BEPS Transfer Pricing Recommendation.6 As of today, Brazil has not adhered to the 1995 OECD Council Recommendation or the 2016 BEPS Transfer Pricing Recommendation, which means that Brazil has not undertaken the commitment to follow the OECD Transfer Pricing Guidelines. Brazil has not adhered to the 2008 Council Recommendation on Attribution of Profits to PEs either. In addition, Brazil introduced a footnote in the OECD Guidelines for Multinational Enterprises,7 which reads as follows:

One non-OECD adhering country, Brazil, does not apply the OECD Transfer Pricing Guidelines in its jurisdiction and accordingly the use of the guidance in those Guidelines by multinational enterprises for purposes of determining taxable income from their operations in this country does not apply in the light of the tax obligations set out in the legislation of this country.

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Broader context of accession

On 29 May 2019, Brazil sent a formal request for initiating an accession process to the OECD. As mentioned above, within the context of the possible accession of Brazil to the OECD, adherence to the arm’s length principle is expected by OECD member countries. Therefore, changes to Brazil’s transfer pricing framework with a view to aligning the existing rules with the OECD standard should be contemplated in the light of a future accession process.

Findings of the assessment of effectiveness and general conclusions

- A large number of the gaps and divergences lead to instances of double taxation. The differences identified between Brazil’s framework and the OECD framework increase the risk of double taxation, and therefore hinder international trade and investment by creating distortions and tax uncertainty for businesses operating cross-border. The input collected from the business community and Brazil’s key trading partners confirms this conclusion.

- A large number of the gaps create BEPS risks, leading to loss of tax revenue. Significant weaknesses can be found in the Brazilian transfer pricing system, notably because of the absence of special considerations for more complex transactions (e.g., transactions involving the use or transfer of intangibles, intra-group service transactions, and transactions comprising business restructurings, among others) and the general inadequacy of the current rules for dealing with these transactions. Weaknesses can also be found in particular due to the combination of unique features of the system, such as the fixed margins approach, the freedom of selection of the method, among others. The input collected from the business community and key trading partners also confirms this conclusion.

- The existing system favours some categories of taxpayers to the detriment of others and provides tax planning opportunities. Some categories of taxpayers or taxpayers in specific situations may be able to exploit the existing system to their advantage and benefit from under-taxation, which is exploited by tax planning strategies, while other taxpayers suffer over-taxation leading to potentially unrelied double taxation.

- Tax administration and tax compliance aspects of the Brazilian system are generally conducive to ease of tax administration and tax compliance. Brazilian transfer pricing system is often characterised by its practicality, predictability and tax certainty, but only domestically. Some of the features of the current transfer pricing rules may be perceived as attractive qualities with respect to providing simplicity, such as the absence of the need for comprehensive comparability (including functional and risk) analysis, the freedom of selection of the method, the use of the fixed margins approach, among others. However, it emerged from the assessment that these perceptions of simplicity are relative and complexity does arise from other features, mainly the item-per-item approach, the strict standard of comparability, and documentation requirements in certain situations. Notwithstanding the unintended consequences of certain aspects of the transfer pricing legislation in Brazil, which negatively affect the ability of the country to attract trade and investment and also lead to losses of tax revenues, the Brazilian system is characterised by its ability to bring simplicity and practicality to the process of performing a transfer pricing analysis. The methodology applied in Brazil overcomes challenges related to the lack of information available on comparable uncontrolled transactions and profitability levels and requires only limited resources to be applied, and the prescriptive nature of the rules also potentially reduces costs and time involved in litigating transfer pricing cases.
• **Tax certainty is generally provided but only from a domestic perspective; significant tax uncertainty is observed from an international perspective.** Tax certainty is provided from a domestic perspective, but it also benefits some taxpayers by assuring in some cases that the tax planning strategies introduced by taxpayers, which lead to losses of revenues in Brazil, cannot be challenged by the Brazilian tax administration. Tax certainty, however, matters also from the cross-border perspective, but due to the existing divergences between the Brazilian system and OECD compliant systems around the world, taxpayers face the risks and uncertainty related to double taxation as well as potential disputes and challenges raised by tax administrations in other jurisdictions.

• **Further tax uncertainty, even domestically, results from the absence of special considerations or very limited guidance for issues related to specific types of transactions,** i.e. transactions involving the use or transfer of intangibles, intra-group services, transactions comprising business restructurings, cost contribution arrangements, and issues related to the attribution of profits to permanent establishments.

Towards convergence with the OECD standard: what are the options for alignment?

Options for greater alignment with the OECD Transfer Pricing Guidelines were explored in light of the findings of the technical analysis.

**Full alignment: immediate vs. gradual**

The two options for alignment under consideration are the following:

- **Full and immediate alignment:** the first option would seek to immediately align the Brazilian transfer pricing rules with the OECD standard, including the arm’s length principle and the guidance for its application contained in the OECD Transfer Pricing Guidelines and other relevant guidance and make the new rules and regulations applicable to all taxpayers immediately.

- **Full and gradual alignment:** the second option involves the same process, but this process is structured in stages so as to allow for the gradual implementation of the new and/or amended provisions over a longer period of time. This approach also offers the opportunity to prioritise the different needs with respect to the tax structure, administrative aspects, expertise of the workforce including the preparedness of the taxpayers, etc., as changes are progressively implemented. A gradual alignment could follow different approaches. It appears that the most reasonable approach would be to set the conditions for a progressive transition of bringing the taxpayers represented by large MNE groups (to be determined with a reference to a reasonable group revenue threshold) into the new system in the short-term, while allowing the voluntary entry in the new regime also by smaller MNE groups. Gradually, by lowering the threshold based on an analysis of the population of taxpayers, as many times as deemed necessary (in the longer-term), all taxpayers will start applying the new regime. In the meantime, the necessary simplification measures will be developed to ensure continuous ease of tax compliance, efficiency of tax administration as well as tax certainty from both a domestic and international perspective.

**Why not partial alignment and/or a dual system?**

A partial alignment was also considered and evaluated during the project. A partial alignment, which could entail alignment only in certain areas (e.g. specific types of transactions), implies that significant gaps would remain in the system with negative effects on tax certainty, the compliance burden, as well as risks of persisting double taxation and loss of tax revenue.
Partial alignment was thus dismissed as a viable option, along with any connected idea of a dual system that would offer taxpayers the choice to continue applying the existing rules. A dual system could have disastrous consequences for revenue collection, as it would further open the door to tax planning that would allow taxpayers to apply the regime that is the most favourable from a tax perspective.

A partial alignment that would address only the missing elements in the current framework but would maintain all the other features of the Brazilian system would still lead to double taxation and losses of revenue and would make it difficult for Brazil to both integrate global value chains and to accede to the OECD. A partial alignment in the form of allowing for the possibility of opting-out of the current regime to apply rules that follow the arm’s length principle would lead to transfer pricing “regime-shopping”, and consequently to a loss of revenue. It would allow continued BEPS practices, as taxpayers would cherry-pick the regime they wish to apply with the motivation to pay less tax.

**Reasons for favouring a gradual alignment**

In light of the evaluation of the advantages and disadvantages of the two options, the gradual option in its horizontal conceptualisation (i.e. applying to an established group of taxpayers rather than a group of transactions) rather than its vertical conceptualisation (i.e. gradually applying to different types of transactions) appears to be the most sensible way forward for the following reasons:

- It allows the process to address the **specific challenges of small and medium enterprises** by distinguishing them based on their ability and likely preparedness to apply a new system of rules;
- It allows small and medium enterprises to continue applying the existing rules for a short period until the new specific safe harbours and simplification measures are designed and implemented;
- It avoids the **challenges related to the interaction between types of transactions** (e.g., interrelated, embedded transactions); and
- It provides the **opportunity to prioritise and sequence the implementation of the different components** of the system.

**Preserving simplicity as a key policy goal**

Full alignment does not mean that Brazil will lose the “positive” aspects of the current transfer pricing system. Both scenarios consider simplification, ease of tax administration, ease of tax compliance, and tax certainty as critical objectives and simplicity and certainty should remain high on the agenda of priorities in the process of aligning the system.

**Therefore, the options for alignment also consider how to maintain a number of elements of simplification, which provide ease of tax administration, ease of tax compliance and tax certainty.** An important consideration relates to preserving the benefits of the existing system in terms of simplicity and predictability. This could mean transforming the existing fixed margins into carefully designed safe harbours and further refining them to ensure conformity with the arm’s length principle and that they reflect economic reality and industry practices, which is not the case of the fixed margins currently.

**A series of carefully designed safe harbours, i.e. simplified approaches for determining or approximating the arm’s length price, can achieve similar benefits in terms of simplicity and certainty, and contribute towards reduced tax compliance costs for taxpayers and towards more efficient tax administration and tax certainty.** These various safe harbours, if properly designed (in line with the arm’s length principle) and applied in appropriate circumstances (under specified eligibility criteria), may prove to be a more effective tool than the current rigid fixed margins approach, while at the same time neutralise its negative effects (double taxation and loss of tax revenue).
Motivations to align and main benefits of alignment

Divergences and gaps are harmful to Brazil in multiple ways:

- Certain aspects of the current system can be gamed and exploited to the detriment of Brazil’s tax base and revenue collection, and significant risks of BEPS were identified;
- The current rules lead to outcomes that result in an unlevel playing field for taxpayers, where some taxpayers face excessive tax burdens in relation to the profits earned in Brazil, while others benefit from significantly lower tax burdens, where the rules allow them to recognise only a minimal amount of income in Brazil thereby enabling profits to be shifted abroad to lower or no tax jurisdictions;
- Numerous taxpayers with operations in Brazil suffer from double taxation, which is sometimes referred to as a “sunken cost” of doing business in the country;
- Other taxpayers avoid Brazil as the destination of their investments due to the inherent double taxation risks, which significantly increase the cost of doing business in Brazil in addition to the other barriers currently preventing Brazil from integrating the global value chains of MNE groups;
- The existing rules fail to appropriately apprehend more complex and sophisticated types of transactions and fail to recognise some of the key profit drivers of modern business models, which means that the rules cannot cope with today’s technology-driven business world and integrated way of doing business in many respects;
- The simplicity and certainty offered by the current system is perceived as an important feature, but as the rules currently interact, it is delivering simplification outcomes at best only in some cases, and only from a domestic perspective, while tax uncertainty in the cross-border context clearly prevails; and
- Brazil is missing out on trade and investment opportunities as a result of the double taxation risks and Brazil is losing significant revenue due to the gaps and divergences presented by the Brazilian approach to transfer pricing, which departs from internationally accepted policies and practices, and is partially responsible for deterring foreign investments.

Therefore, comprehensive changes to Brazil’s transfer pricing framework have the potential to address some of the gaps and divergences identified and, together with other measures and co-ordinated with other policies, to contribute towards achieving important benefits in terms of revenue and trade/investment opportunities as well. In addition to mobilising additional tax revenue that is currently being forfeited, it will promote trade and investment in Brazil and contribute to the country’s integration in global value chains, while also minimising conflict and disputes with other tax administrations. The main benefits of alignment include:

- **Avoiding and eliminating double taxation**, which results from the existing gaps and divergences;
- **Preventing loss of revenue due to current BEPS practices**, which also creates inequality within the current system, where some taxpayers are treated more favourably than others;
- **Increasing tax certainty from an international perspective**;
- **Integrating Brazil in global value chains and fostering trade and investment in Brazil**; and
- **Facilitating Brazil’s accession to the OECD**.
Introduction

1. This report is a consolidated version of the outcomes of the three stages of the OECD-Brazil “Transfer Pricing in Brazil” project. A project which represents another milestone in deepening the dialogue between Brazil and the OECD on transfer pricing matters, and has led to a comprehensive joint assessment by the OECD Secretariat and Receita Federal do Brasil (RFB) of the strengths and weaknesses of existing transfer pricing rules and administrative practices in Brazil based on a two-step analysis: gap analysis to analyse the similarities and differences between the Brazilian rules and the OECD Guidelines and an assessment of the effectiveness of the Brazilian transfer pricing rules and administrative practices on achieving important tax policy objectives, including the dual objective of transfer pricing legislation, which is to secure the appropriate tax base in each jurisdiction and to avoid double taxation, as well as broader tax policy objectives, namely ease of tax compliance, ease of tax administration and tax certainty, in the areas where they depart from the OECD standard.

2. The structure of this report is as follows. Part 1 provides the background of the OECD-RFB dialogue on transfer pricing matters and an overview of the project. Part 2 contains the in-depth analysis of existing transfer pricing rules and administrative practices in Brazil and the findings of the assessment. It describes the relevant OECD guidance and identifies the gaps and differences as compared to the transfer pricing framework in Brazil, before assessing how these differences interact with the policy objectives of transfer pricing legislation and other general tax policy objectives in the particular case of Brazil. Part 3 explores possible options for alignment between Brazil’s transfer pricing framework and the internationally accepted OECD transfer pricing standard. This part contains a discussion of two ways to achieve full alignment of the Brazilian transfer pricing system with the OECD system, either immediately or gradually, in light of the issues that should be addressed in the process of aligning Brazil’s policies and practices.

3. The report also has two annexes. Annex A contains a summary of the submissions received from entities that are member of multinational enterprise groups with business activities in Brazil in response to a questionnaire on their experience regarding the application of the Brazilian transfer pricing rules. Annex B contains a summary of the input provided by jurisdictions which are considered Brazil’s key trading and investment partners in response to a questionnaire on their experience with the interaction of existing transfer pricing rules and practices in Brazil with the OECD-compliant transfer pricing rules and practices followed by these jurisdictions.
Part I Background of the OECD-Brazil dialogue on transfer pricing matters and overview of the “Transfer Pricing in Brazil” project
1 Background of the OECD-Brazil dialogue on transfer pricing matters

This chapter provides the background of the OECD-Brazil dialogue on transfer pricing matters by describing the authoritative framework of the OECD transfer pricing standard and the origins of Brazil’s transfer pricing framework. It then provides a description of Brazil’s positions on the relevant legal instruments and OECD guidance on transfer pricing.
1.1. The OECD transfer pricing standard

4. The OECD transfer pricing standard finds its authority in the relevant Core Principles of the Committee on Fiscal Affairs and the recommendations found in the relevant OECD legal instruments.

1.1.1. CFA’s Core Principles related to transfer pricing

5. Ensuring the primacy of the arm’s length principle as set out in the OECD Transfer Pricing Guidelines is required of OECD member countries as one of the OECD Committee on Fiscal Affairs’ Core Principles.

**Box 1.1. Core Principles**

The Core Principles for Accession serve as a technical basis to evaluate a candidate country’s policies and practices as compared to the OECD best policies and practices in the area of taxation. This evaluation forms one part of the two-pronged analysis by the Committee on Fiscal Affairs. The evaluation of a candidate country’s willingness and ability to implement the relevant OECD legal instruments forms the second part of the analysis.

The relevant Core Principles are:

(i) Eliminating international double taxation on income and capital without creating opportunities for non-taxation or reduced taxation through complying with the key substantive conditions underlying the OECD Model Tax Convention;

(...) 

(iii) Eliminating double taxation through ensuring the primacy of the arm’s length principle, as set out in the OECD’s Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, for the determination of transfer pricing between associated enterprises;

(iv) Addressing Base Erosion and Profit Shifting (BEPS) in accordance with the BEPS package and the ongoing work of the Inclusive Framework on BEPS;


1.1.2. OECD legal instruments on transfer pricing

6. The three key OECD instruments on transfer pricing and income allocation are the 1995 OECD Council Recommendation, the 2008 Council Recommendation on Attribution of Profits to Permanent Establishments, and the 2016 BEPS Transfer Pricing Recommendation. They contain important recommendations related to transfer pricing and income allocation.
Box 1.2. OECD Council Recommendations on transfer pricing

1995 OECD Council Recommendation

This OECD legal instrument formulate the following recommendations to Members and non-Members:

I. RECOMMENDS that Members and non-Members adhering to this Recommendation (hereafter the “Adherents”):

i) follow, when reviewing, and if necessary, adjusting transfer pricing between associated enterprises for the purposes of determining taxable income, the Guidelines – considering the whole of the Guidelines and the interaction of the different chapters – for arriving at arm’s length pricing for transactions between associated enterprises;

ii) encourage taxpayers to follow the Guidelines; to that effect Adherents should give the Guidelines publicity and have them translated, where necessary, into their national language(s);

iii) develop further co-operation, on a bilateral or multilateral basis, in matters pertaining to transfer pricing.

2008 Council Recommendation on Attribution of Profits to PEs

This OECD legal instrument formulates the following recommendation to the governments of member countries:

I. RECOMMENDS to the Governments of Member countries:

i) that their tax administrations follow, when applying the provisions of their bilateral tax conventions that are drafted on the basis of the pre-2010 Article 7 of the Model Tax Convention, the guidance in the 2008 Report to the extent that its conclusions do not conflict with the 2008 Commentary on Article 7;

ii) that their tax administrations encourage taxpayers to follow the guidance in the 2008 Report when applying the provisions of bilateral tax conventions that are drafted on the basis of the pre-2010 Article 7 of the Model Tax Convention and, to that end, that they give the 2008 Report publicity in their country and have it translated, where necessary, into their national language(s);

iii) that their tax administrations follow, when applying the provisions of their bilateral tax conventions that are drafted on the basis of the 2010 Article 7 of the Model Tax Convention, the guidance in the 2010 Report;

iv) that their tax administrations encourage taxpayers to follow the guidance in the 2010 Report when applying the provisions of bilateral tax conventions that are drafted on the basis of the 2010 Article 7 of the Model Tax Convention and, to that end, that they give the 2010 Report publicity in their country and have it translated, where necessary, into their national language(s).

2016 BEPS Transfer Pricing Recommendation

This OECD legal instrument formulates the following recommendation:

I. RECOMMENDS that Members and non-Members having adhered to this Recommendation (hereafter the “Adherents”) follow the guidance set out in the Actions 8-10 Report and the Action 13 Report.

1.2. Origins of the transfer pricing legislation in Brazil

7. The adoption of transfer pricing rules in Brazil took place in 1996, several years after Brazil had developed its tax treaty network. The tax conventions entered into by Brazil contain the elements of the arm's length principle, but they reflect only the wording of paragraph 1 of Article 9 of the OECD Model Tax Convention. To date, Brazil has 33 tax treaties in force, including treaties with Brazil's main trading partners, with the exception of the United States, Germany and the United Kingdom.

8. The tax treaties signed in the 1970s were the result of the economic policy of Brazil at that time, which was aimed at improving the inbound flow of capital and also outbound export transactions. In the following years, Brazil received substantial amounts of foreign direct investment and, even today, it is considered a capital importing country, since its inward foreign direct investment (FDI) stock exceeds its outward FDI stock.

9. The enactment of specific provisions with regard to transfer pricing in the Brazilian legislation was necessary given the increase in foreign investment inflow during the 1990s. The numbers grew significantly from 1994 onwards, with periodic slight decreases that reflected worldwide crises but that did not jeopardise the continuity of capital inflow. The adoption of transfer pricing rules in Brazil was however focussed only on one of the objectives of transfer pricing rules. The legislative intent clearly aimed at “preventing the detrimental transfer of resources to foreign countries through the manipulation of prices used in the importation or exportation of goods, services or rights, in transactions with non-resident related parties”.

1.2.1. Adoption of transfer pricing legislation

10. Accordingly, in 1996, Brazil enacted domestic legislation with regard to transfer pricing, i.e. Law 9430/1996, effective as of 1 January 1997. The Brazilian transfer pricing rules determine the maximum deductible price for imports and the minimum taxable price for exports. Transfer pricing adjustments have consequences for income tax purposes, as well as for the social contribution on profits. Since its adoption, the transfer pricing system has been amended several times, most recently in 2019. In developing its transfer pricing rules, Brazil’s legislature seems to have given weight to some of the challenges presented by the implementation and administration of a transfer pricing system, such as the lack of information available on comparable uncontrolled transactions and profitability levels, limited administrative resources, and the costs and time involved in litigating transfer pricing cases.

11. Considering these factors, Brazil developed a system that is often characterised as:

- **Protecting the Brazilian tax base**: the Brazilian transfer pricing rules require multinational enterprises doing business in Brazil to report for tax purposes gross margins fixed by the legislation, regardless of the actual economic features of the controlled transactions.

- **Ensuring predictability**: one of the aims of the system is to reduce uncertainty about the taxation of profits.

- **Respecting strict legality**: the Brazilian transfer pricing system complies with the Brazilian Constitution, which authorises discretionary powers to the administration when assessing the taxpayer's tax liability within the limits of the law.

- **Being practical**: the Brazilian transfer pricing rules minimise administrative and compliance costs for both the administration and taxpayers. This is especially important when a country does not have a highly specialised tax administration, as was the case in Brazil when the rules were adopted.

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8 Explanatory Statement (Exposição de Motivos) no 470, 15 October 1996.
1.2.2. The Brazilian transfer pricing system and the arm’s length principle

12. When the system was adopted in 1996, the Brazilian Congress indicated that the transfer pricing rules were in accordance with the rules adopted by the OECD members.

13. According to the Explanatory Statement to Law 9430/1996:

   The rules set forth in articles 18 to 24 represent a significant improvement in domestic legislation in view of the current globalization process, which affects all modern economies. In this specific case, in accordance with the rules adopted by the OECD members, certain rules have been proposed in order to control so called “transfer pricing”, to prevent the detrimental transfer of resources to foreign countries, through manipulation of prices used in the importation or exportation of goods, services or rights, in transactions with a non-resident related party.9

14. Despite this statement, neither the legislation nor the regulations in force contain an explicit reference to the arm’s length principle or to the OECD Transfer Pricing Guidelines.

15. The differences between the Brazilian transfer pricing rules and the interpretation of the arm’s length principle contained in the OECD Guidelines may raise the question of whether the Brazilian transfer pricing rules are actually consistent with the arm’s length principle. Brazil has previously explicitly indicated that its transfer pricing legislation is in line with the arm’s length principle (see further below the footnote included at its request in the Executive Summary of the BEPS Actions 8-10 Report). Also, the Administrative Tax Court of Appeals (CARF) has indicated in three important administrative decisions that the Brazilian transfer pricing rules are compatible with the arm’s length principle.10

16. On the other hand, various practitioners and academics argue that the Brazilian transfer pricing system is not based on the arm’s length principle, as the Brazilian system is aimed at securing a minimum tax revenue, as opposed to determining the price for tax purposes of cross-border transactions between associated enterprises based on what independent parties would have agreed in comparable circumstances. It is relevant to highlight that even those authors who view the Brazilian rules as consistent with the arm’s length principle acknowledge that the rules can lead to results that differ from arm’s length outcomes; however, they add that this divergence is compensated by a greater degree of simplicity and certainty compared to the OECD transfer pricing approach.

1.3. Brazil’s positions on OECD legal instruments and guidance related to transfer pricing

17. Adherence to the OECD Guidelines is one of the OECD CFA’s Core Principles, which candidates to OECD membership are expected to follow. The specific commitment of OECD member countries in the area of transfer pricing requires:

   Eliminating double taxation through ensuring the primacy of the arm’s length principle, as set out in the OECD’s Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, for the determination of transfer pricing between associated enterprises.

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10 CARF, First Chamber, judgment 101-96665 (17.04.2008); CARF, Eighth Chamber, judgment 108-09.763 (29.01.2009); CARF, First Chamber, judgment 1103-00.60 (17.01.2012).
18. The consistent application and adherence to a common international standard of transfer pricing represented by arm’s length principle should ensure that no double taxation of the same profits arises due to the fact that the same profits are allocated to two different enterprises in two different jurisdictions.

19. Where such situation nevertheless arises, because one country increases the profits of an enterprise due to application of transfer pricing rules ("primary adjustment"), the resulting double taxation is to be eliminated through a mechanism to be included in bilateral tax treaties, which provides for an obligation of the other contracting state to reduce the profits of the other enterprise ("corresponding adjustment"). The corresponding adjustment may be implemented either on the basis of Article 9, paragraph 2, of the OECD Model Tax Convention, which contains the explicit obligation for elimination of double taxation, or it can also be implemented on the basis of an agreement reached under the mutual agreement procedure contained in Article 25 of the OECD MTC.

20. As of today, Brazil has not adhered to the 1995 OECD Council Recommendation, the 2016 BEPS Transfer Pricing Recommendation,\(^\text{11}\) which means that Brazil has not undertaken the commitment to follow the OECD Guidelines. Brazil has not adhered to the 2008 Council Recommendation on Attribution of Profits to PEs either.

21. Brazil has also expressed a position on Article 9 of the OECD MTC to reserve the right not to insert paragraph 2 in their tax treaties. In this regard, it is worth noting that none of Brazil’s bilateral tax treaties contain paragraph 2 of Article 9 of the OECD MTC.

22. Brazil expressed its position on the OECD Transfer Pricing Guidelines in an OECD instrument for the first time in 2011. At that time, Brazil requested the insertion of a footnote in the OECD Guidelines for Multinational Enterprises’ Tax Chapter indicating that "one non-OECD adhering country, Brazil, does not apply the OECD Transfer Pricing Guidelines in its jurisdiction and accordingly the use of the guidance in those Guidelines by multinational enterprises for purposes of determining taxable income from their operations in this country does not apply in the light of the tax obligations set out in the legislation of this country".\(^\text{12}\)

23. More recently, in 2017, Brazil expressed a position on the Commentary on Article 9 of the OECD MTC stating:

Brazil reserves its right to provide for an approach in its domestic legislation that makes use of fixed margins derived from industry practices in line with the arm's length principle. In consequence, it reserves the right not to adhere to the application of the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations where the guidelines contradict this approach.

24. It is important to also analyse the commitments of Brazil in the context of the BEPS Project. Brazil, as a G20 country, formally endorsed the final BEPS package at the G20 Summit in 2015, which included the Report on BEPS Actions 8-10 covering transfer pricing. The Explanatory Statement of the BEPS Actions 8-10 Final Report states that the revised guidance contained in the report "represents an agreement of the countries participating in the OECD/G20 BEPS Project. For countries that formally subscribe to the Transfer Pricing Guidelines, the guidance in this Report takes the form of amendments to the Transfer Pricing Guidelines. Therefore this Report also reflects how the changes will be incorporated in those Guidelines."

\(^{11}\) This legal instrument allows non-OECD members to adhere to the guidance in the Reports on Actions 8-10 and 13 without adhering to the rest of the guidance in the OECD Guidelines. Actually, the Executive Summary of the 2015 BEPS Package (para. 11) indicates that "existing standards have been updated and will be implemented, noting however that not all BEPS participants have endorsed the underlying standards on tax treaties or transfer pricing"

25. In the case of Brazil, this agreement was qualified by the following footnote:

*Brazil provides for an approach in its domestic legislation that makes use of fixed margins derived from industry practices and considers this in line with the arm’s length principle. Brazil will continue to apply this approach and will use the guidance in this report in this context. When Brazil’s Tax Treaties contain Article 9, paragraph 1 of the OECD and UN Model Tax Conventions and a case of double taxation arises that is captured by this Treaty provision, Brazil will provide access to MAP in line with the minimum standard of Action 14.*
The first phase of the “Transfer Pricing in Brazil” project was initiated with a work programme organised in three stages over a 15-month period. This phase set out to conduct an analysis of Brazil’s existing transfer pricing legal and administrative framework and its practical application; an assessment of the strengths and weaknesses of that framework; and the exploration of options for closer alignment between the transfer pricing rules applied by Brazil and the international OECD standard. This chapter describes this process and the methodology used for the assessment.
2.1. Description of the stages of the “Transfer Pricing in Brazil” project

26. With the aim to carry out a dialogue on transfer pricing matters with Brazil’s Receita Federal do Brasil (RFB), the OECD launched, jointly with RFB, the “Transfer Pricing in Brazil” project. In three stages over a 15-month period, the project involved an analysis of Brazil’s existing transfer pricing legal and administrative framework and its practical application; an assessment of the strengths and weaknesses of that framework; and the exploration of options for closer alignment between the transfer pricing rules applied by Brazil and the international OECD standard.

27. The project was initiated with a preparatory stage (Stage 1), during which the OECD Secretariat carried out initial research and a desk-based analysis of the key elements and issues in relation to transfer pricing in Brazil. The project was officially announced on the launch event which took place in Brasilia on 28 February - 1 March 2018. This event also allowed for the collection of input from academia and the business community and provided an opportunity to hold initial discussions with and receive input from RFB officials during a joint inception workshop held on 2 March 2018. Following this event, the findings from the preliminary research and analysis were summarised in a first report providing a high-level overview of the legal and administrative framework of transfer pricing in Brazil, based on an initial review of primary and secondary legislation, as well as a review of the relevant academic and professional literature, and information collected from preliminary interviews with selected tax practitioners and business representatives in Brazil. The objective of the report was to make a preliminary identification of key issues to focus on and analyse in depth in the next stage of the project.

28. The outcome of the second stage of the project (Stage 2) was a second report containing an in-depth analysis of Brazil’s existing transfer pricing rules and administrative practices based on detailed discussions, assessment, comparisons and clarifications provided by RFB as well as additional input from key stakeholders – namely the multinational enterprises (MNEs) applying these rules on a day-to-day basis and representatives of the tax administrations of jurisdictions which represent their major trading and investment partners. The report describes the existing gaps and differences in the Brazilian transfer pricing rules and practices as compared to the OECD standard, as well as an assessment of the strengths and weaknesses of the framework. The objective of the assessment was to determine whether these rules, where they diverge from the internationally accepted OECD standard, effectively serve the dual policy objective of securing the appropriate tax base in each jurisdiction and avoiding double taxation. The assessment also considers whether these rules achieve broader tax policy objectives, namely ensuring efficiency of tax administration, ease of tax compliance, and tax certainty. Accordingly, the methodology required to first identify the similarities and differences between the transfer pricing rules in Brazil and the guidance for applying the arm’s length principle contained in the OECD Guidelines and other relevant OECD guidance, and then to assess how these differences interact with the policy objectives pursued by the adoption of transfer pricing legislation in the particular case of Brazil.

29. The third stage of the project further endeavoured to continue the dialogue with RFB with a view to identifying possible options for alignment between the transfer pricing rules and practices in Brazil, and the OECD transfer pricing standard. The third stage built on the findings of the assessment of the strengths and weaknesses performed in Stage 2.

30. The assessment of the strengths and weaknesses of existing transfer pricing rules and administrative practices in Brazil was divided in two main workstreams:

- The “gap analysis” which identifies the specific differences between the Brazilian transfer pricing rules and the OECD Transfer Pricing Guidelines; and
- The “assessment of effectiveness” which assesses the system based on five objective criteria: (i) prevention of BEPS risks; (ii) prevention of double taxation; (iii) ease of tax administration; (iv) ease of tax compliance; and (v) tax certainty.
31. Both workstreams have been carried out jointly with RFB. The preliminary findings identified by the OECD Secretariat were extensively discussed and commented on by RFB. Clarifications and explanations by RFB were instrumental in ensuring the correctness, completeness and validation of the information at various points of the process. The findings and their description, as presented in this report, were approved by RFB.

32. In addition, the analysis involved the structured contribution of key stakeholders. Accordingly, the findings of the analysis were supplemented by input collected from taxpayers (Brazilian-headquartered MNE groups and foreign-headquartered MNE groups with operations in Brazil) and countries which are major trading and investment partners of Brazil through questionnaires prepared in collaboration with RFB. A third questionnaire was also addressed to RFB, which allowed the collection of additional input on specific issues and administrative practices.

2.2. Methodology for the assessment

33. The following sections describe in more detail the methodology for the gap analysis and the assessment of effectiveness. Information on the activities conducted under the first phase of the project is also included.

2.2.1. Gap analysis

34. The methodology for the gap analysis requires identifying gaps and issues in the Brazilian transfer pricing rules and administrative practices using the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations as a benchmark. For each chapter of the OECD Guidelines, the analysis considered whether the main concepts, elements and objectives of the guidance were reflected in the Brazilian framework. The application of the arm’s length principle to financial transactions was assessed with reference to the standards and principles set out in the Guidelines as well, and with reference to the discussion draft providing guidance on intra-group financing issues, taking into consideration that the final version of this guidance has not yet been released to the public. The issues discussed in the OECD Guidelines also arise in the treatment of permanent establishments, so the relevant guidance (i.e. the Report on the Attribution of Profits to Permanent Establishments and the Additional Guidance on the Attribution of Profits to a Permanent Establishment under BEPS Action 7) was also made part of the analysis. Part II of this report contains the comparative analysis of the existing transfer pricing rules and administrative practices in Brazil vis-à-vis the OECD Guidelines.

35. The objective of this analysis is to identify issues in the form of gaps (i.e. areas left unaddressed by the existing transfer pricing framework) and divergences, before considering how they may potentially undermine the policy objectives of transfer pricing rules as well as other more general policy objectives.


14 The discussion draft, which is described as “not yet presenting a consensus position of the Committee on Fiscal Affairs or its subsidiary bodies”, and was published to invite comments from the public, is available at: www.oecd.org/tax/transfer-pricing/BEPS-actions-8-10-transfer-pricing-financial-transactions-discussion-draft-2018.pdf.

15 See paragraph 11 of the Preface to the OECD Guidelines.

Table 2.1. Overview of the OECD transfer pricing framework

Overview of the contents of the OECD Transfer Pricing Guidelines and other relevant guidance used as a benchmark for the analysis

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<th>Topic</th>
<th>Benchmark</th>
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<tbody>
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<td>The arm’s length principle</td>
<td>Chapter I of the OECD Guidelines</td>
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<tr>
<td>Transfer pricing methods</td>
<td>Chapter II of the OECD Guidelines</td>
</tr>
<tr>
<td>Comparability analysis</td>
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<td>Administrative approaches to avoiding and resolving transfer pricing</td>
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<td>Special considerations for intra-group services</td>
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2.2.2. Assessment of effectiveness

36. In order to determine the interaction between divergences or gaps and the policy objectives of transfer pricing rules, the methodology required performing an assessment of the effectiveness of the concerned rules according to objective criteria. These criteria are derived from the dual objective of transfer pricing rules, i.e. securing the appropriate tax base in each jurisdiction and avoiding double taxation, and other important tax policy objectives, i.e. ease of tax administration, ease of tax compliance and tax certainty.

37. The main objective of transfer pricing rules is the appropriate allocation of the tax base in each jurisdiction. This objective achieves two goals: by ensuring the appropriate allocation of the tax base in each jurisdiction, it addresses some BEPS risks resulting from inappropriate allocation of the tax base, but also contributes to achieving prevention of double taxation. Additional criteria selected for the purposes of the assessment include other general tax policy objectives, namely ease of tax administration, ease of tax compliance, and tax certainty.

38. These five criteria have been selected for the assessment because they correspond to important policy objectives that are relevant to transfer pricing legislation, and which form the basis for developing guidance on a common approach to applying internationally agreed principles.

39. It should be noted that not all of the issues identified through the gap analysis lend themselves to an assessment of their effectiveness. Therefore, this assessment of effectiveness is only performed where appropriate and relevant.

40. To the extent possible, a similar assessment of the OECD Guidelines is also performed in parallel to comparatively measure the effectiveness of the Brazilian framework against the OECD framework.

41. The assessment of effectiveness was complemented by the contributions of external stakeholders. They included academics, practitioners, tax representatives of MNE groups with operations in Brazil, and tax officials from the tax administrations of jurisdictions which are considered to be Brazil’s major trading and investment partners. This input was collected on various occasions throughout the project and also

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17 See paragraph 4 of the Preface to the OECD Guidelines.

18 See paragraph 7 of the Preface to the OECD Guidelines.
through more formal and structured contributions. The formal contributions made by business and key trading partners are discussed in Section 2.3.

42. The outcome of the assessment for each criterion is nuanced for a number of issues. In other words, different cases and situations may lead to different outcomes under the application of the same rules.

43. No attempt is made as part of this assessment to quantify the effectiveness of the Brazilian transfer pricing framework.

*Prevention of BEPS risks*

44. As noted above, one prong of the dual objective of transfer pricing rules is to secure the appropriate tax base in each jurisdiction. This concerns the risks of inappropriate taxation (including under-taxation), in particular risks of base erosion and profit shifting (the so-called “BEPS risks”) and exploiting opportunities of unintended double non-taxation.

45. In applying the principles concerning the taxation of MNEs incorporated in the OECD Model Tax Convention, including Article 9 of the OECD MTC, one of the most difficult issues that has arisen is the establishment for tax purposes of appropriate transfer prices. In this respect, alignment of domestic transfer pricing rules with the internationally accepted principles set forth in the OECD Guidelines has the potential to provide countries with the necessary tools to fight base erosion and profit shifting by MNEs.

46. Aligning domestic transfer pricing rules with the internationally accepted principles set forth in the Guidelines also provides a level playing field between countries. This level playing field further reduces BEPS opportunities and cross-border tax arbitrage, which may be one of the key motivating factors for MNE groups to exploit these opportunities, and which consequently leads to BEPS practices.

47. For some elements of the transfer pricing system in Brazil, it may be the case that BEPS risks will arise in Brazil, but in some cases they may also arise in other jurisdictions than Brazil. This possibility is also reflected in the assessment.

*Prevention of double taxation*

48. The other prong of the dual objective of transfer pricing rules is to avoid double taxation. International double taxation encompasses both so-called juridical double taxation and economic double taxation. Juridical double taxation arises when comparable taxes are imposed in two or more states on the same taxpayer in respect of the same taxable income or capital. For instance, double taxation may arise where income is taxable in the source country and in the country of residence of the recipient of such income. Economic double taxation arises if more than one person is taxed on the same item. This could be the case where a controlled transaction takes place between two associated enterprises and different approaches to transfer pricing have been applied among countries, thus leading to different outcomes.

49. The international aspects of transfer pricing are more difficult to deal with (than the domestic aspects, which are not considered in the OECD Guidelines) because they involve more than one tax jurisdiction and therefore any adjustment to the transfer price in one jurisdiction implies that a corresponding change in another jurisdiction is appropriate. However, if the other jurisdiction does not agree to make a corresponding adjustment the MNE group will be taxed twice on this part of its profits. In order to minimise the risk of such double taxation, an international consensus is required on how to establish transfer prices on cross-border transactions for tax purposes. In the absence of adherence to common principles and approaches, the risks of double taxation are amplified.

19 See paragraph 11 of the Preface to the OECD Guidelines.
Ease of tax administration

50. Among the broader tax policy objectives that should also be considered in elaborating transfer pricing rules, one should particularly consider ease of tax administration, which refers to the administrative burden borne by the tax authorities and the associated mobilisation of resources employed for the control of transfer prices.\footnote{The relevant work of the OECD Forum on Tax Administration (FTA) consulted for the purpose of the assessment, which aims to help tax administrations increase the efficiency, effectiveness and fairness of tax administration, is available on the FTA website: www.oecd.org/tax/forum-on-tax-administration/publications-and-products/. In particular, see OECD (2016), Rethinking Tax Services: The Changing Role of Tax Service Providers in SME Tax Compliance, OECD Publishing, Paris, \url{https://doi.org/10.1787/9789264256200-en}; and OECD (2014), Tax Compliance by Design: Achieving Improved SME Tax Compliance by Adopting a System Perspective, OECD Publishing, Paris, \url{https://doi.org/10.1787/9789264223219-en}.} The general importance of reducing compliance burdens is set out in the introduction to the OECD’s Tax Administration Series 2019.\footnote{OECD (2019), Tax Administration 2019: Comparative Information on OECD and other Advanced and Emerging Economies, OECD Publishing, Paris, \url{https://doi.org/10.1787/74d162b6-en}, Section 1.1.}

51. Capacity concerns are important for a large number of countries, in particular developing countries, hence the need to consider whether alternative, simplified rules – if they are easier to apply – could be deemed more effective. Correlatively, the complexity related to certain aspects of transfer pricing guidance found in the OECD Guidelines, which could make them less efficient in the specific context of, e.g., lower-capacity tax administrations, is also taken into consideration for the assessment.

52. This criterion is intended to recognise, where appropriate, the merits of transfer pricing rules which are easy to administer for tax administrations and improve effectiveness of tax collection and administration.

Ease of tax compliance

53. Also among general tax policy objectives, ease of tax compliance represents the extent of the compliance burden and costs that should be borne by a taxpayer.\footnote{The relevant work of the OECD Forum on Tax Administration (FTA) consulted for the purpose of the assessment, which aims to help tax administrations increase the efficiency, effectiveness and fairness of tax administration, is available on the FTA website: www.oecd.org/tax/forum-on-tax-administration/publications-and-products/.} In principle, these compliance costs should remain reasonable. Compliance concerns are addressed in the OECD Guidelines in different sections, notably in the context of performing a comparability analysis.\footnote{See paragraphs 3.80 and subsequent of the OECD Guidelines.}

54. The need for comparability analyses arguably exacerbates the burden of taxpayers. For example, it is recognised in the Guidelines that the cost of information can be a real concern, especially for small to medium sized operations, but also for MNEs that deal with a very large number of controlled transactions in many countries.

55. This criterion is intended to recognise, where appropriate, the merits of transfer pricing rules which are easy to comply with for taxpayers.
56. Increasing evidence suggests that various forms of tax uncertainty adversely affect investment and trade.24 A main source of tax uncertainty in the context of the OECD Guidelines relates to misalignment of domestic transfer pricing rules with the internationally accepted principles set forth therein.

57. Also useful are the key findings of the surveys conducted as part of the work on tax certainty, although targeted at OECD and G20 countries, which revealed the main causes of tax uncertainty for business and tax administrations.

58. The issues raised related to:

- Tax administration (bureaucracy to comply with tax legislation, including documentation requirements, compliance costs, and unpredictable or inconsistent treatment by the tax authority);
- International tax issues (inconsistency or conflict between two or more tax administrations in the application of international tax standards, lack of international experience within the tax administration, and the evolution of new business models);
- Dispute resolution mechanisms (lengthy processes, unpredictable or inconsistent application of international standards); and
- Legislative and tax policy design (complexity in tax legislation, unclear and poorly drafted legislation).

59. The assessment with respect to tax certainty is performed in consideration of these drivers of tax uncertainty. It also differentiates between tax certainty from a domestic perspective and tax certainty from an international perspective, considering, e.g., that companies headquartered in Brazil may benefit from a degree of certainty as well as foreign companies who may rely on tax certainty when exploiting the weaknesses of existing rules; but tax certainty matters also from the cross-border perspective – to ensure that the existing divergences do not give rise to disputes and challenges raised by tax administrations in other jurisdictions.

2.2.3. Project activities

60. The stages of the “Transfer Pricing in Brazil” project involved different types of activities carried out by the OECD Secretariat in collaboration with RFB.

61. The activities carried out over the course of the 15-month project can be categorised into: (i) desk-based analysis performed by OECD Secretariat for the purposes of producing preliminary findings; (ii) analysis and incorporation of the input provided by RFB in writing or in person during joint workshops, bilateral meetings, and also in response to a tailored questionnaire; (iii) analysis and incorporation of the input provided by external stakeholders, including through written responses to tailored questionnaires (for the business community and major trading and investment partners) and meetings with business representatives; and (iv) consolidation of the information collected into this report.

2.3. Collection of input

62. The structured contribution of key stakeholders was made possible with tailored questionnaires. The input collected from taxpayers (Brazilian-headquartered MNE groups and foreign-headquartered MNE groups with operations in Brazil) and Brazil’s key trading partners served to feed the analysis, notably to inform and complement the analysis with information on practical experience. A third questionnaire was

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also addressed to RFB with specific questions regarding the practical experience of administering the Brazilian transfer pricing rules.

### 2.3.1. Business stakeholders

63. The questionnaire for business covering the various aspects of the transfer pricing framework in Brazil was used for the purpose of enhancing the assessment of the strengths and weaknesses of existing transfer pricing rules and administrative practices in Brazil. More precisely, the questionnaire contained questions regarding the following aspects of the transfer pricing framework in Brazil:

- Scope of transfer pricing legislation;
- Relevance of the comparability analysis in the application of transfer pricing rules;
- Transfer pricing methods;
- Comparability analysis and comparability adjustments;
- Transfer pricing adjustments and prevention/elimination of double taxation;
- Transfer pricing documentation;
- Intangibles;
- Intra-group services;
- Cost-contribution arrangements;
- Business restructurings; and
- Other more general questions.

64. The questionnaire was distributed with the assistance of Business at OECD, which also ensured co-ordination with professional and trade associations, including the Confederação Nacional da Indústria (CNI), Grupo de Estudos Tributários Aplicados (GETAP), Fórum das Empresas Transnacionais (CNI-FET) and Fórum de Competitividade das Exportações (CNI-FCE). Through the sectorial industry associations represented by CNI (e.g., automotive, chemicals, pharma, extractives, etc.) the questionnaire reached hundreds of MNEs. Co-ordination with Business at OECD ensured that the questionnaire reached the appropriate headquarters abroad, not only through direct engagement with MNEs which actively participate in Business at OECD. Accordingly, it is understood that the questionnaire was delivered to the tax departments of most, if not all, major MNEs worldwide.

65. A total of 51 questionnaires from a broad range of industry sectors were submitted by both Brazilian-headquartered MNEs and foreign-headquartered MNEs with operations in Brazil. Annex A contains a summary of their input.

66. A number of meetings were organised with business stakeholders to collect their inputs in addition to the written questionnaires. An additional meeting with CNI and business stakeholders took place on 1 February 2019 in Brasília, following the collection of input, to present an overview of the submissions and validate the findings. It was also an opportunity to elaborate on specific issues and raise additional concerns. The summary of business comments was shared with and approved by all respondents.

### 2.3.2. Major trading and investment partners

67. A questionnaire for jurisdictions which are considered to be major trading and investment partners of Brazil, also referred to as “key trading partners” in this report, covering various aspects of the transfer pricing framework in Brazil served to collect input on their perception of and experience with the existing Brazilian transfer pricing rules and administrative practices.
68. The questionnaire was structured in the following way:
   - Section A. Perception of the Brazilian transfer pricing system;
   - Section B. Potential challenges to trade and investment related to the transfer pricing framework in Brazil;
   - Section C. Avoiding and resolving transfer pricing disputes; and
   - Section D. Capacity and resources.

69. The questionnaire was distributed to a list of 39 countries, selected based on: (i) inbound/outbound volume of transactions; and (ii) foreign direct investment (in- and out-) flows. The selected countries had (i) high volumes of importations; or (ii) of exportations; or (iii) high volumes of both import and export transactions combined. Most of these countries also ranked high based on the foreign direct investment data. In addition, a number of countries were selected for other reasons, including historic relations.

70. Sixteen countries submitted the full questionnaire and four additional countries, who reported to have little or no experience with transfer pricing rules in Brazil to report on submitted answers only to questions in Section D dealing with capacity and resources. Amongst the twenty countries that provided (complete or partial) input, fifteen are OECD members. A total of ten of the responding countries have concluded a bilateral tax treaty (currently in force) with Brazil.

71. A briefing workshop took place on 27 June 2019 in Paris, bringing together officials from the OECD Secretariat and RFB, and representatives from the tax administrations of key trading partners. The purpose of the workshop was to provide an update on the project, to present a summary of their input, and to exchange views on the findings.

2.3.3. Receita Federal

72. The third questionnaire addressed to RFB served to collect further information regarding the practical experience with administration of the Brazilian transfer pricing system, such as the number of affiliates of foreign MNEs operating in Brazil or headquartered in Brazil, above and below the Country-by-Country (CbC) threshold, statistical data of the frequency of application of the different transfer pricing methods, the current capacity and resources dedicated to transfer pricing, among others. It also included a section on attribution of profits to permanent establishments under Brazilian domestic and treaty law.

2.4. Milestones of the project

2.4.1. Launch event

73. The launch event held in Brasília on February 28 - March 1 2018 marked the official start of the joint dialogue. This two-day event consisted of keynote speeches delivered by high-level representatives, roundtable discussions among key stakeholders representing the business sector, and several panels dedicated to technical discussions among tax experts from both the private and public sectors. This event allowed OECD and RFB to collect initial input on the experience of both the business sector and government officials of some of Brazil's key trading partners.

2.4.2. High-level event

74. A high-level event hosted by National Confederation of Industry (CNI) brought together approximately 300 senior officials from the Brazilian government, the OECD, representatives of MNEs operating in Brazil, and government representatives from Brazil’s key trading partners, with the objective of presenting the results of the assessment of the strengths and weaknesses of Brazil’s existing transfer pricing framework and possible options for Brazil’s alignment with the OECD standard. A joint statement by OECD and RFB was issued on the occasion of the event.27

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Part II Assessment of the strengths and weaknesses of existing transfer pricing rules and administrative practices in Brazil
The first chapter contains the analysis of Brazil’s relevant transfer pricing rules as compared with Chapter I of the OECD Transfer Pricing Guidelines providing a background discussion of the arm’s length principle, which is the international transfer pricing standard that OECD member countries have agreed should be used for tax purposes by MNE groups and tax administrations. This principle is the cornerstone of the Guidelines, the purpose of which is to elaborate and clarify its application. The main findings of the analysis are the absence of restatement of the arm’s length principle in Brazil’s system and that the concept of accurate delineation of the actual transaction is not reflected in the rules and practices. There are also differences pertaining to the material, personal and territorial scope of application of the rules. These three issues are then separately assessed according to the policy objectives of transfer pricing rules.
1.1. Statement of the arm’s length principle

75. The authoritative statement of the arm’s length principle is found in paragraph 1 of Article 9 of the OECD Model Tax Convention:

[Where] conditions are made or imposed between the two [associated] enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.28

76. In the view of OECD member countries, the arm’s length principle should govern the evaluation of transfer prices and conditions set among associated enterprises and the OECD Guidelines stress the importance of maintaining the arm’s length principle as the international consensus.

77. The arm’s length principle is justified because it effectively serves the dual objective of securing the appropriate tax base in each jurisdiction and avoiding double taxation, thereby minimising conflict between tax administrations and promoting international trade and investment.29

78. When transfer pricing does not reflect market forces and the arm’s length principle, the profits of associated enterprises may be adjusted for tax purposes as necessary to correct any distortion in the tax liabilities of the associated enterprises and the tax revenues of the host countries, and thereby ensure that the arm’s length principle is satisfied. An appropriate adjustment is achieved by establishing the conditions of the commercial and financial relations that would be found between independent enterprises in comparable transactions under comparable circumstances. Where both countries in which an MNE operates make adjustments following the same principle, the potential double taxation will be prevented or eliminated.

1.1.1. Restatement of the arm’s length principle

79. By way of introduction,30 the OECD transfer pricing framework revolves around two key OECD instruments, namely the 1995 OECD Council Recommendation,31 and the 2016 BEPS Transfer Pricing Recommendation.32 They contain important OECD recommendations in relation to the standards and principles applicable in the area transfer pricing. Another key OECD instrument closely related to transfer pricing is the 2008 Council Recommendation on Attribution of Profits to Permanent Establishments,33 which concerns issues discussed in a separate section of this report.34

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29 See paragraph 7 of the Preface to the OECD Guidelines.

30 See Chapter 1 of Part 1 for a more detailed description of the instruments and their recommendations.


34 See Part 2, Chapter 11, of this report.
Ensuring the primacy of the arm’s length principle as set out in the Guidelines is also required of OECD member countries as one of the OECD Committee on Fiscal Affairs’ Core Principles.

**Bilateral tax treaties**

The application of transfer pricing rules that would be based on different standards or principles, or that would be interpreted inconsistently even if based on the same principle, creates a risk of economic double taxation. These types of economic double taxation can be resolved through Article 9 in bilateral tax treaties (and/or Article 25 under a mutual agreement procedure), but achieving this objective requires common understanding and interpretation of the arm’s length principle.

When countries or jurisdictions sign bilateral tax treaties containing Article 9 of the OECD MTC (or an equivalent article), that article will usually be interpreted in accordance with the OECD Guidelines, setting the boundaries for the application of the transfer pricing rules in the domestic legislation of the contracting states in relation to transactions that are covered by the provisions of Article 9. It is worth noting that Article 9 of both the OECD MTC and the UN MTC are based on the arm’s length principle. This is also confirmed by the UN Practical Manual on Transfer Pricing, which includes the following statement:

*The United Nations Model Double Taxation Convention between Developed and Developing Countries considers (at Article 9—“Associated Enterprises”) whether conditions in commercial and financial relations between related enterprises, such as two parts of a multinational group, “differ from those which would be made between independent enterprises”. The same test is applied at Article 9 of the Organisation for Economic Co-operation and Development (OECD) Model Tax Convention on Income and on Capital.*

To ensure that double taxation resulting from the application of transfer pricing rules is relieved, it is desirable for countries and jurisdictions to develop a network of bilateral tax treaties containing Article 9 to align their domestic transfer pricing legislation with the relevant internationally agreed principles.

**Domestic legislation**

The adoption of a transfer pricing system embodying the arm’s length principle is essential in achieving the dual objective of securing the appropriate tax base in each jurisdiction and avoiding double taxation.

It is emphasised in the Guidelines that alignment of domestic transfer pricing rules with the internationally accepted principles has the potential to provide countries with the necessary tools to fight base erosion and profit shifting by MNEs, provide MNEs with tax certainty, and provide a level playing field between countries and between MNEs and independent enterprises.

Further, the Guidelines stress that a departure from the arm’s length principle would reconsider the sound theoretical basis behind the principle and threaten the international consensus, which would result, among other things, in a significant increase of the risk of double taxation. It is therefore desirable

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37 See paragraph 7 of the Preface to the OECD Guidelines.


39 See paragraph 1.15 of the OECD Guidelines.
to avoid any significant discrepancy between domestic transfer pricing legislation and internationally agreed principles.

87. Finally, it is specified in the introduction of Chapter I of the Guidelines that it should not be assumed that the conditions established in the commercial or financial relations between associated enterprises will invariably deviate from what the open market would demand. In other words, the consideration of transfer pricing should not be confused with the consideration of problems of tax fraud or tax avoidance, even though transfer pricing policies may be used for such purpose.

1.1.2. Scope of application

88. The scope of application of transfer pricing rules aims to establish the personal scope, which is demonstrated through a definition and/or other approaches to determine whether enterprises are associated or related and the material scope, which sets out the types of transactions which are covered. Finally, the scope of application aims to establish the territorial scope – i.e. whether the transfer pricing rules only apply to cross-border transactions or to domestic transactions as well.

Personal scope

89. The OECD Guidelines provide that “two enterprises are associated enterprises with respect to each other if one of the enterprises meets the conditions of Article 9, sub-paragraphs 1a) or 1b) of the OECD MTC with respect to the other enterprise”.

90. These conditions are the following:

Where a) an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State, or b) the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State.\(^{40}\)

91. Article 9 does not provide a minimum level of participation.

92. The personal scope of application of transfer pricing rules, i.e. the definition of associated enterprises, including the level of participation, is usually specifically provided for in the domestic law and may vary among countries or jurisdictions. For example, the definition of control or management may be different from one jurisdiction to another. As a result, the personal scope may be broader or narrower in each jurisdiction.

Box 1.1. Concept of associated enterprises

Examples in OECD member countries

Domestic rules may refine (by restricting or expanding) what transactions or arrangements are subject to transfer pricing rules based on the conditions set for two entities or persons to be considered “associated enterprises”. A number of OECD member countries have opted for a broad scope that considers unrelated parties as related for transfer pricing purposes.

### Czech Republic

The personal scope of transfer pricing rules in Czech Republic covers “close persons” and “persons that have created a relationship mainly for the purposes of tax avoidance (by reducing the tax base or increasing tax losses)” as provided in Section 23, paragraph 7, of the Income Tax Act. Thus, the definition of related parties includes situations where otherwise unrelated parties have created a legal relation mainly for the purpose of reducing their tax base or increasing their tax loss. This allows the application of transfer pricing rules also to transactions between unrelated parties in tax avoidance cases.

### Chile

The definition of “associated enterprises” in Chile notably includes, among others, situations where there is a transaction with a foreign company incorporated or having its domicile in a country or territory considered to have a preferential tax regime, as specified in a list published by the Ministry of Finance (see Decree 628 of 3 December 2003); or when one of the parties performs one or more operations with a third party that in turn performs, directly or indirectly, with a related subject of that party, one or more operations similar or identical to those performed with the first party, regardless of the status of this third party or of the parties involved in these operations.

### Italy

The transfer pricing rules in Italy apply only to transactions carried out by entities connected by a link of interdependence, which is defined by Article 110, paragraph 7, of the Corporate Tax Act as “control”. The Ministerial Decree of 14 May 2018 provides guidelines for the application of the provisions of that article, which is supplemented by further guidance provided through regulations and circular letters. Circular Letter 32/9/2267 provides a list of illustrative examples that, jointly or separately, may indicate the existence of “control” includes, among others, the exclusive sale of products manufactured by the other enterprise; the inability of an enterprise to operate without capital, products and technical cooperation given by another enterprise (this includes joint ventures); the right to appoint directors or managerial staff; common members of the board of directors or of the managerial staff; family relationship between the parties; the granting of large credits or extensive financial dependence; participation of the enterprise in supply/purchasing stations; the enterprise’s participation in cartels and consortia, particularly when they aim at fixing prices; the control of supplies or outlets; a series of contracts which lead to a monopoly situation; generally speaking, all cases in which potential or actual influence on business decisions is exerted.

### Portugal

In order to contravene harmful tax competition, the transfer pricing rules in Portugal apply to any transactions entered into between resident entities or non-resident entities with a permanent establishment in Portuguese territory and entities located in low-tax jurisdictions. Thus, all transactions between a resident entity or a non-resident entity with a permanent establishment in Portuguese territory and an entity located in a listed country or jurisdiction which clearly has a more favourable tax regime are considered controlled transactions, regardless of any other connection criteria between the two entities, for instance as a result of capital or voting rights. See Article 63(4)(h) of the Corporate Income Tax Code and the list in Appendix IV.

Note: The information in this box was retrieved from various, readily available, public sources, including the OECD Transfer Pricing Country Profiles and the relevant source legislation. See: [www.oecd.org/tax/transfer-pricing/transfer-pricing-country-profiles.htm](http://www.oecd.org/tax/transfer-pricing/transfer-pricing-country-profiles.htm).
Material scope

93. The material scope is broad in the OECD Guidelines. According to the Guidelines, a transfer price can be charged for any related-party transaction, such as a transfer of goods, assets, rights, or services. Special considerations are provided for specific types of transactions, such as commodity transactions, transactions involving the transfer or use of intangibles (including hard-to-value intangibles), intra-group services, transactions carried out as part of cost contribution arrangements or in the context of business restructurings. New guidance addressing financial transactions, which has not been finalised yet, is also underway.41

94. On the other hand, some jurisdictions may accidently or deliberately establish a narrower material scope for the application of transfer pricing rules and thus exclude certain types of transactions from the scope of transfer pricing rules in their domestic law. In such cases, the transactions outside of the scope of transfer pricing legislation do not fall under review and scrutiny from a transfer pricing perspective, but other general or special rules may still apply to achieve the relevant tax policy objectives.

Territorial scope

95. The transfer pricing rules can apply only to cross-border transactions, which are often the main focus – ensuring that the profits of the MNE are properly allocated among the relevant jurisdictions –, but there are also a number of OECD member countries that apply the transfer pricing rules and principles to domestic transactions as well. This is especially to address the risk of domestic profit shifting; for example, profit shifting to entities benefitting from preferential tax regimes and/or entities with accumulated losses (in cases where there is no consolidation for tax purposes in the jurisdiction). Therefore, the territorial scope can cover either both domestic and cross-border transactions or exclusively cross-border transactions.

96. Although the OECD Guidelines do not focus on domestic transfer pricing issues, it is worth noting that transfer pricing rules may still apply to operations between associated enterprises that are resident in the same tax jurisdiction depending on the domestic system in place and its determined territorial scope.

1.1.3. Identifying the commercial or financial relations and accurately delineating the actual transaction

97. Section D of Chapter I provides guidance on identifying the commercial or financial relations and the conditions and economically relevant circumstances attaching to those relations in order that the controlled transaction is accurately delineated.43 This guidance is intended to ensure that a subsequent

43 As a result of the BEPS Project, a number of revisions were made to Section D of Chapter I, which resulted in revised guidance for applying the arm’s length principle. The revisions emphasise the importance of accurately delineating the actual transaction between the associated enterprises by supplementing, where necessary, the terms of any contract with the evidence of the actual conduct of the parties. The revisions also expand the guidance on identifying specific risks and their impact, and provide an analytical framework to determine which associated enterprise assumes risk for transfer pricing purposes. Finally, the revisions help to accurately determine the actual contributions made by an associated enterprise that solely provides capital. See OECD (2015), Aligning Transfer Pricing Outcomes with Value Creation, Actions 8-10 – 2015 Final Reports, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, https://doi.org/10.1787/9789264241244-en.
step in the transfer pricing analysis – the comparison of the conditions and the economically relevant circumstances of the controlled transaction as accurately delineated with the conditions and economically relevant circumstances of comparable transactions between independent parties – is based on such accurate delineation of what the associated enterprises actually contribute in the transaction, and not merely on what is formalised in the contractual terms, including contractual assumption of risk.

98. The guidance describes in detail the economically relevant characteristics or comparability factors that need to be identified in the commercial or financial relations between associated enterprises in order to accurately delineate the actual transaction. This includes starting with the contractual terms of the transaction, but also analysing the functions actually performed by each of the parties to the transaction, the characteristics of property transferred or services provided, the economic circumstances of the parties and of the market in which the parties operate, and the business strategies pursued by the parties. While the analysis does start with a review of the contractual terms, if the characteristics of the transaction that are economically relevant are inconsistent with the written contract between the associated enterprises, the actual transaction should generally be delineated for the purposes of transfer pricing analysis in accordance with the characteristics of the transaction reflected in the conduct of the parties.

99. A broad-based analysis of the taxpayer’s circumstances (e.g., industry sector, transactions between MNE group members, conditions and economically relevant characteristics of the transactions) is essential for the accurate delineation of the actual transaction. It will guide the choice of the most appropriate transfer pricing method to the circumstances of the case, the choice of the tested party (where needed), the identification of the types of comparables to search for, the choice of the financial indicator that will be tested (in the case of a transactional profit method), and the identification of the significant comparability factors that should be taken into account.

Comparability analysis

100. The Guidelines provide guidance for performing a comparability analysis leading to the identification of reliable comparables, recognising that any other search process may also be acceptable if it achieves a reliable outcome. The process described in the Guidelines is considered an accepted good practice.

101. Accordingly, the Guidelines present the typical process for identifying the commercial or financial relations between the associated enterprises; and the identification of the conditions and economically relevant circumstances in connection to such relations require a broad-based understanding of the industry sector in which the MNE operates as well as the factors affecting the performance of business in that sector. More precisely, the process requires to carefully analyse the factors affecting performance such as business strategies, markets, products, supply chains, key functions performed, material assets used, and important risks assumed.

Contractual terms

102. Transactions may be formalised in written contracts, which may reflect the intention of the parties at the time the contract was concluded. Therefore, written contracts (where available) should be the starting point for a transfer pricing analysis. However, contracts are unlikely to provide all the information needed and must be supported by the analysis of the actual conduct of the parties. If the formalised contractual

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44 See paragraph 1.45 of the OECD Guidelines. It is worth noting that the UN Practical Manual also discusses the concept of accurate delineation of the actual transaction in Section B.2.3.1.4.

45 See paragraph 3.4 of the OECD Guidelines.

46 The nine steps of the typical process are discussed in Section 3.1.1 of this report.
terms are inconsistent or misaligned with the actual conduct of the parties, the transactions will be delineated in accordance with the actual conduct of the parties.

**Functional analysis**

103. The broad-based analysis of the relevant economic circumstances includes the functional analysis. The functional analysis as the foundation of the transfer pricing analysis aims to identify the economically significant activities, contributions and value drivers. It also aims to identify who is responsible for performing these functions and in what capacity. It takes into account the assets used and contributed, and who contributed them. In sum, it seeks to identify the economically relevant functions, assets and risks.

**Risk analysis**

104. A functional analysis is incomplete unless the material risks assumed by each party have been identified and considered since the actual assumption of risks would influence the prices and other conditions of transactions between the associated enterprises. In this respect, extensive guidance is provided in Section D of Chapter I, notably a risk analysis framework setting out a process in six steps for analysing risk in a controlled transaction, in order to accurately delineate the actual transaction in respect to that risk.47

**Other comparability factors**

105. Other factors may affect the commercial or financial relations between the associated enterprises and the economically relevant characteristics of the transactions. They include losses, the effect of government policies, the use of customs valuations, assembled workforce, and MNE group synergies. In this respect, the Guidelines provide additional guidance to reflect the effect of these comparability factors.

**Recognition of the accurately delineated transaction**

106. The transaction as accurately delineated may be disregarded (and if appropriate, replaced by an alternative transaction) in exceptional circumstances where the arrangements viewed in their totality differ from those which would have been adopted by independent enterprises behaving in a commercially rational manner in comparable circumstances, thereby preventing determination of a mutually acceptable price.

1.2. Description of the existing rules and practices in Brazil and gap analysis

107. The transfer pricing rules and administrative practices in Brazil are stated to be in accordance with the rules adopted by the OECD members,48 but there is no explicit reference to the arm’s length principle therein. Further, the scope of application of the transfer pricing rules is different than the scope foreseen in the Guidelines. Finally, a key aspect of the comparability analysis, which is to identify the commercial or financial relations between the associated enterprises and the conditions and economically relevant circumstances attaching to those relations in order that the controlled transaction is accurately delineated is absent from the Brazilian transfer pricing framework.

47See paragraph 1.60 of the OECD Guidelines.

1.2.1. Absence of restatement of the arm’s length principle in the domestic law

108. Although at the time of their adoption in 1996 the Brazilian Congress indicated that the transfer pricing rules were in accordance with the rules adopted by OECD members, there is no explicit reference to the arm’s length principle or to the Guidelines in the domestic legislation or the regulations in force in Brazil.

109. The absence of restatement of the arm’s length principle at the domestic level raises the overarching question of whether the Brazilian transfer pricing rules and administrative practices are consistent with the arm’s length principle, and whether their application is in line with the guidance for applying the arm’s length principle provided in the Guidelines. This absence of restatement also raises legitimate questions as regards if and how the outcome of a MAP procedure can be effectively agreed upon and implemented by Brazil.

110. Notwithstanding, Brazil has introduced paragraph 1 of Article 9 of the OECD MTC in the tax treaties entered into with all 35 of its treaty partners.49

111. The following paragraphs describe the position of Brazil on OECD instruments by way of background before discussing how the arm’s length principle is reflected at the domestic level, notably in the case law, despite the absence of its restatement in the domestic law.

Position of Brazil on OECD instruments

112. At the outset, the transfer pricing legislation in Brazil was enacted to curtail tax avoidance. The legislative intent clearly was to prevent the “detrimental transfer of resources to foreign countries through the manipulation of prices used in the importation or exportation of goods, services or rights, in transactions with non-resident related parties”,50 a statement which seems to reflect the existence of such an anti-abuse philosophy.

113. As previously noted, the insertion of paragraph 1 of Article 9 in a tax treaty generally means that it will be interpreted in line with the internationally accepted principles, including the arm’s length principle, in order to fulfil the dual policy objective of transfer pricing rules. It should be highlighted, however, that Brazil has entered into a limited number of tax treaties.51

114. The three key OECD instruments on transfer pricing and income allocation are the 1995 OECD Council Recommendation, the 2016 BEPS Transfer Pricing Recommendation and the 2008 Attribution of Profits to PEs Recommendation. While all three encourage non-OECD members to adhere to the relevant guidance, to date no non-OECD member, and neither Brazil, has adhered to any of these instruments.52

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49 Article 9 was introduced in Brazil’s (28 at the time) bilateral tax treaties prior to the enactment of its transfer pricing legislation in 1996, but was only applied after 1996 due to the absence of domestic provisions expressly providing for the possibility to make primary adjustments.


51 To date, Brazil has concluded treaties with 35 treaty partners, the two last treaties having been signed with Singapore and Switzerland in May 2018. The list of treaty partners is available on RFB’s official website: http://idg.receita.fazenda.gov.br/acesso-rapido/legislacao/acordos-internacionais/acordos-para-evitar-a-dupla-tributacao/acordos-para-evitar-a-dupla-tributacao (Acordos para evitar a dupla tributação e prevenir a evasão fiscal). It is worth noting that the bilateral tax treaty between Brazil and Germany that was concluded in 1975 was revoked on 7 April 2005.

52 It should be noted that due to the specificities of the Brazilian transfer pricing system, it would be difficult in the case of Brazil to adhere to the guidance in the OECD Guidelines and the BEPS Actions 8-10 Final Reports.
115. The position of Brazil on the Guidelines was first recorded in 2011 following a request to indicate, in a footnote attached to the OECD Guidelines for Multinational Enterprises’ Tax Chapter, that “one non-OECD adhering country, Brazil, does not apply the OECD Transfer Pricing Guidelines in its jurisdiction and accordingly the use of the guidance in those Guidelines by multinational enterprises for purposes of determining taxable income from their operations in this country does not apply in the light of the tax obligations set out in the legislation of this country”.

116. Brazil, as a G20 country, formally endorsed the final BEPS package at the G20 Summit in 2015. The BEPS package includes the BEPS Actions 8-10 Report. According to the Explanatory Statement to this report, the guidance contained therein “represents an agreement of the countries participating in the OECD/G20 BEPS Project. For countries that formally subscribe to the Transfer Pricing Guidelines, the guidance in this Report takes the form of amendments to the Transfer Pricing Guidelines. Therefore this Report also reflects how the changes will be incorporated in those Guidelines”. However, since Brazil expressed the view that its domestic law approach that makes use of fixed margins is in line with the arm’s length principle, Brazil explained that it would continue to apply this approach, adding that it would follow the guidance contained in the BEPS Actions 8-10 Report in this context.

117. In consequence, the role attributed to the Guidelines under the Brazilian transfer pricing system is not prominent. Brazil recognised that the Guidelines could be used as “subsidiary interpretation guidance, whenever [the Guidelines] do not contradict the Brazilian transfer pricing legislation and the national legal system” in its transfer pricing country profile.

118. Brazil expressed its position on the Commentary to Article 9 in the 2017 edition of the OECD MTC, stating that:

As regards paragraph 1 of the Commentary on Article 9, Brazil reserves its right to provide for an approach in its domestic legislation that makes use of fixed margins derived from industry practices in line with the arm’s length principle. In consequence, it reserves the right not to adhere to the application of the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations where the guidelines contradict this approach.

Reflection of the arm’s length principle at the domestic level

119. Despite the absence of an explicit statement demonstrating the adoption of the arm’s length principle under the Brazilian transfer pricing system, a number of elements seem to support the view that the arm’s length principle is recognised to some extent in the domestic law.

120. Brazil indicated in the Explanatory Statement of Law 9,430/96 that its rules were in line with the rules adopted by OECD members:

The rules set forth in articles 18 to 24 represent a significant improvement in domestic legislation in view of the current globalization process, which affects all modern economies. In this specific case, in accordance with the rules adopted by the OECD members, certain rules have been proposed in order to control so called...

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55 The Transfer Pricing Country Profile submitted by Brazil is available on the OECD website: www.oecd.org/tax/transfer-pricing/transfer-pricing-country-profile-brazil.pdf.
“transfer pricing”, to prevent the detrimental transfer of resources to foreign countries, through manipulation of prices used in the importation or exportation of goods, services or rights, in transactions with a non-resident related party.\textsuperscript{57}

121. A number of Brazilian administrative decisions have also supported the view that the Brazilian transfer pricing rules are compatible with Article 9 of the OECD MTC.\textsuperscript{58} One decision in particular strongly supports the fact that the Brazilian transfer pricing rules were inspired by the arm’s length principle, also recognising that it is this principle that governs the Brazilian transfer pricing system established by Law 9,430/96.\textsuperscript{59} However, the decision particularly stresses the anti-abuse function of the arm’s length principle by specifying that its application is intended to prevent residents in Brazil from transferring profits to related parties in low-tax countries. In another instance, the Administrative Taxpayer’s Council held that there was no contradiction between the domestic transfer pricing rules and Article 9 of the Brazil-Germany tax treaty.\textsuperscript{60} The decision recognised, however, that in some cases the fixed margins approach did not permit to reach the competition price (i.e. the arm’s length price) in the strict sense.

122. The way in which the arm’s length principle is applied in some cases considerably deviates from the OECD standard, prompting several practitioners and academics to argue that the system is not effectively based on the arm’s length principle. Even authors who support the view that the Brazilian transfer pricing system is consistent with the arm’s length principle as set out in the Guidelines have observed that differences in the rules can lead to outcomes differing from usual arm’s-length outcomes.

123. One significant deviation of the Brazilian transfer pricing rules thus seems to lie in the fixed margins approach, which eliminates to some extent the use of comparability analysis in some cases. The fixed margins approach is relevant for the Brazilian versions of the OECD-recognised resale price and cost plus methods.\textsuperscript{61} Fixed margins are predetermined profit margins imposed by law, which express a legal fiction according to which prices must be adjusted to conform to a parameter price, and which may differ depending on whether the transaction is an import or an export, and depending on the relevant industry. Therefore, the determination of the “range” within which a certain transaction can be considered to have been carried out at arm’s length is not solely based on internal or external comparables, but also based on these fixed, predetermined margins. A change of margin can be requested by taxpayers,\textsuperscript{62} but to date no request has ever been granted through this mechanism.

124. The application of the fixed margins approach produces non-arm’s-length results in some situations as a result of the trade-off between simplicity and accuracy. Considering the opacity under which the margins have been developed (in terms of the data employed and the criteria used), it is also difficult to control the parameters of the methodology and verify its robustness.

125. This approach that makes use of fixed margins derived from industry practices establishes the prevalence of the parameter price set forth in the law, which could be interpreted as an assumption that


\textsuperscript{58} See, e.g., CARF, Eighth Chamber, judgment 108-09.763 (13.11.2008).

\textsuperscript{59} CARF, First Chamber, judgement 1103-00.608 (17.01.2012).

\textsuperscript{60} CARF, First Chamber, judgement 101-96665 (17.04.2008).

\textsuperscript{61} See the analysis in Chapter II for a description of the transfer pricing methods in Brazil.

\textsuperscript{62} See Section 4.2.7 of this report for a description of the mechanism to challenge the fixed margins.
related parties have sought to manipulate their transfer pricing, and that such manipulation should be automatically prevented as a matter of principle to ensure that a minimum amount of profits is taxed.

1.2.2. Scope of application of transfer pricing rules

126. Important differences exist regarding the scope of application of the Brazilian transfer pricing rules compared to the OECD standard. These differences concern both the personal scope and the material scope and their implications are far-reaching for the pricing of intra-group transactions.

Personal scope

127. The personal scope of transfer pricing rules in Brazil is broad, and in some areas may be broader than the scope foreseen in Article 9 of the OECD MTC.

128. The situations described in the Brazilian legislation in which two parties are considered to be related include association where there is control based on corporate ownership or association based on the power of an individual or legal entity to participate in financial and operational policy decisions of the other party without controlling it. The latter could take the form of a legal entity domiciled in Brazil and a non-resident individual who is a relative or kin down to the third degree, spouse or cohabitant of its directors or officers, or of its direct or indirect controlling partner or shareholder; a legal entity domiciled in Brazil and a non-resident individual or legal entity for which the Brazilian entity is the exclusive agent, distributor or dealer of the Brazilian entity for the purchase and sale of goods, services and rights; or a legal entity domiciled in Brazil and a non-resident individual or legal entity for which the Brazilian entity is the exclusive agent, distributor or dealer for the purchase and sale of goods, services and rights.

Extension of personal scope

129. The scope also includes (i) transactions carried out by individuals or legal entities resident or domiciled in Brazil with any individual or legal entity, even if not related, resident or domiciled in a country which does not tax income or which taxes it at a maximum rate of less than 20%; and (ii) transactions carried out by individuals or legal entities residing in Brazil with any individuals or legal entities, related or not, residing in a country that does not disclose the composition or ownership of companies. This corresponds to a list of “low-tax jurisdictions”.

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63 The concept of “related party” is defined in Article 23 of Law 9,430/1996.
64 The concept of control is governed by the Brazilian Corporation Law (Law 6,404/76; in particular Article 243(2) and Article 243(1), (4) and (5)).
65 Article 24 of Law 9,430/1996. In addition to being subject to transfer pricing analysis regardless of whether the foreign party is related to the Brazilian entity, low-tax jurisdictions and privileged tax regimes are subject to more restrictive thin capitalisation rules as well as various adverse restrictions under the Brazilian controlled foreign corporation (CFC) rules. Also, payments made to residents of low-tax jurisdictions are generally subject to higher rates of withholding taxes on remittances, sales and applications in Brazilian capital markets.
66 These jurisdictions are listed under Article 1 of Normative Instruction 1,037/10, which has been regularly updated over the years (the last update with respect to low tax jurisdiction was made by Normative Instruction 1,658/16). Normative Instruction 1,037/10 provides the following list of jurisdictions: Andorra, Anguilla, Antigua, Ascension Island, Bahamas, Aruba, Bahrain, Bahamas, Barbados, Barbuda, Belize, Bermuda, British Virgin Islands, Brunei, Cayman Islands, Campione D’Italia, Channel Islands (Jersey, Guernsey, Sark and Alderney), Cyprus, Cook Islands, Curacao, Djibouti, Dominica, French Polynesia, Gibraltar, Grenada, Hong Kong, Ireland, Isle of Man, Kingdom of Swaziland, Kiribati, Labuan, Lebanon, Liberia, Liechtenstein, Macau, Maldives, Marshall Islands, Mauritius, Monaco, Montserrat, Nauru, Nevis, Nieuw, Norfolk Island, Panama, Pitcairn Islands, Qeshm Island, Samoa Islands, Saint Helena Island,
130. A list of “privileged tax regimes” also targets regimes that achieve taxation of income earned abroad at a maximum rate of less than 20%, and/or that grant a tax advantage to a non-resident individual or legal entity without any requirement of substance, and/or that do not allow access to information such as the nature of partners and the economic transactions carried out.

131. The number of regimes listed as “preferential tax regimes” has increased over the years. It contains regimes in OECD member countries, such as the regime applicable to corporations constituted in the form of a Limited Liability Company (LLC) incorporated in the United States, whose participation is composed of non-residents, not subject to federal income tax in the United States, the regime applicable to legal entities constituted in the form of a holding company which do not exercise a substantial economic activity in the Netherlands, the regimes applicable to legal entities constituted in the form of a holding company, domiciliary company, auxiliary company, mixed company and administrative company whose tax treatment results in the incidence of CIT as well as the regime applicable to other legal forms of constitution of legal entities, through rulings issued by tax authorities in Switzerland, the regime applicable to legal entities constituted in the form of an Entity for Holding of Foreign Securities (ETVEs) in Spain, and the regime applicable to legal entities constituted in the form of a holding company which do not exercise substantive economic activity in Denmark.

132. In addition, the scope covers transactions that have been entered into with a tax avoidance objective, including (i) imports made by a legal entity that acquires goods abroad for future sale to a predetermined domestic buyer, if the latter is related to the foreign seller; and (ii) transactions carried out in Saint Kitts and Nevis, Saint Lucia, Saint Martin, Saint Pierre and Miquelon Island, Saint Vincent and the Grenadines, Seychelles, Solomon Island, Sultanate of Oman, Tristan da Cunha, Tonga, Turks and Caicos Islands, United Arab Emirates, US Virgin Islands and Vanuatu.


67 As introduced by Law 11,727/08 in 2008. The list of preferential tax regimes is provided by Normative Ruling 1,037/2010.

68 Reduced to 17% for countries, dependencies and regimes aligned with the international standards of tax transparency.

69 For instance, Costa Rica, Madeira Island and Singapore were removed from the “low-tax jurisdiction” list and preferential tax regimes from these jurisdictions were added to the “privileged tax regimes” list, respectively the free trade regime (RZF) of Costa Rica and the Portuguese international business centre of Madeira (CINM), and with respect to Singapore the special rate of tax for non-resident ships owners, charterers, or air transport undertakings, the exemption and concessional rate of tax for insurance and reinsurance business; and concessional rates of tax for the finance and treasury centre, trustee company, (income derived from) debt securities, global trading company and qualifying company, financial sector incentive company, provision of processing services for financial institutions, shipping investment manager, trust income to which beneficiary is entitled, leasing of aircraft and aircraft engines, aircraft investment manager, container investment enterprise, container investment manager, approved insurance brokers, (income derived from) managing qualifying registered business trust or company, ship broking and forward freight agreement trading, shipping-related support services, managing approved venture company and international growth company.

70 Article 24-A of Law 9,430/96 states that the transfer pricing provisions are applicable to transactions subject to preferential tax regimes with any physical and legal persons, related or unrelated, residing or domiciled abroad.

71 Article 2, item VII, of Normative Instruction 1,037/10.

72 Article 2, item IV, of Normative Instruction 1,037/10.

73 Article 2, item X, of Normative Instruction 1,037/10.

74 Article 2, item VIII, of Normative Instruction 1,037/10.

75 Article 2, item III, of Normative Instruction 1,037/10.
by a resident company through unrelated third parties (interposed entity), where the non-resident party dealing with such parties is related to the resident company.

**Material scope**

133. Brazilian transfer pricing rules apply to goods, services and rights for both imports and exports. Goods include tangible and intangible property; services include intra-group services and services rendered under cost-sharing contracts; and rights include a wide range of rights with different forms of remuneration (e.g., rents, interests, premiums). The scope also includes payments or credits for interest paid or received on international loans with related parties.  

134. In contrast to the Guidelines, however, Brazil’s transfer pricing rules are narrower in that they expressly exclude outbound royalties and payments in regard to technical, scientific, administrative or similar assistance (with the consequence that such transactions are not governed by the arm’s length principle).

**Territorial scope**

135. The territorial scope of the Brazilian transfer pricing rules is limited to cross-border transactions, and the rules do not apply to transactions between associated enterprises conducting domestic transactions within Brazil. This creates domestic BEPS risks, such as profit shifting in situations of profit-making and loss-making companies in the same group or profit shifting between companies subject to the general tax regime and those benefiting from special tax regimes.

136. It should be noted that there is a special “anti-avoidance” measure in place, which targets disguised distribution of profits (DDL). This measure has only a limited scope and applies in cases of potential profit shifting from the subsidiaries to the shareholders. The rule does not apply between sister companies and to transactions involving profit shifting from parent to subsidiary companies. The rule applies where the conditions attached to the transactions differ from market conditions. In this case, tax authorities may perform adjustments on these transactions and impute taxable income to the Brazilian related entities.

1.2.3. Identifying the commercial or financial relations and accurately delineating the actual transaction

137. While the identification of the commercial or financial relations is also relevant for the application of the transfer pricing rules in Brazil, there is seemingly no specific guidance or concept similar to the concept of accurate delineation of the actual transaction based on a broad-based analysis of the economically relevant circumstances of the taxpayer and other comparability factors underlying the transfer pricing analysis in Brazil.

138. The transfer pricing analysis in Brazil usually starts from the contracts, the accounting records, invoices, and customs documentation provided by the taxpayer. These documents constitute the starting point for the identification of the commercial or financial relations between the associated enterprises.

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76 Article 22 of Law 9,430/1996.
77 Article 18, paragraph 9, of Law 9,430/96.
78 This is stated in Articles 18 and 19, of Law 9,430/1996 and also Normative Instruction 1,312/2012.
79 Articles 60-62 of Decree 1,598/1977.
80 The choice of the method is also not dictated by this analysis. See analysis in Chapter II.
139. Similarly to documents submitted for compliance with the rules of other jurisdictions, these documents must reflect the real intentions of the parties in relation to the aspects of the transaction covered by the contract that matters for the application of the Brazilian rules. If there is a mismatch between the terms of the contract and the real intention of the parties, and a lack of substance, the transaction may be disregarded by the tax authorities based on concepts such as simulation, fraud, and substance-over-form doctrine, provided in the tax and civil law and in case law.

140. The transfer pricing analysis in Brazil is thus not restricted to the formal documentation and to the terms of the contracts. The application of the rules also requires the identification of the characteristics of the controlled transaction, but not to the same extent that is required by the Guidelines. In this sense, some elements that are at the heart of the Guidelines and constitute basic features of the accurate delineation of the actual transaction are currently not fully present in the Brazilian rules.

141. The extent of the analysis of facts and circumstances that would support the accurate delineation of the actual transaction is extremely limited. Most economically relevant characteristics and comparability factors described in the Guidelines are not relevant. The contractual terms of the transaction and the characteristics of property transferred or services provided are taken into account, but the functions performed by each of the parties to the transaction, the economic circumstances of the parties and of the market in which the parties operate, and the business strategies pursued by the parties have little (or no) relevance for the analysis.

142. For example, the effect of government interventions such as the exchange rate policy, which should be treated as conditions of the market in the particular country and be taken into account in evaluating the taxpayer’s transfer price under the approach developed by the Guidelines, are not considered – even though exchange rate fluctuations in Brazil are frequent and variations of the quotation of a currency may vary greatly from one fiscal year to another. Similarly, a situation where the value of location specific advantages or premium prices in the local market for foreign products is transferred out of Brazil may easily arise (e.g., in applying the broadly corresponding to the resale price method for import transactions – the PRL method), whereas such value would be taken into consideration as a comparability factor in the transfer pricing analysis according to the Guidelines.

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81 Transactions may be considered simulated and thus void under Article 116, single paragraph of the Brazilian Tax Code. The question is one of fact to be determined on a case-by-case analysis.

82 See for instance CARF, judgment 1201-001.640 (29.05.2017), which is still pending a final decision by the higher Chamber of CARF, where the lower Chamber held it was a sham transaction to incorporate a fund for the sole purpose of avoiding income tax on capital gains in an M&A transaction. The taxpayer failed to present sufficient evidence of business purpose to refute the tax authority’s allegation of a sham corporate restructuring plan during a company purchase transaction.

83 Supplementary Law 104 of January 10, 2001, introduced, among other changes, a sole paragraph to Article 116 of the Brazilian National Tax Code, which provides that the “tax authority may disregard acts or legal acts performed for the purpose of dissimulating the occurrence of the event giving rise to the tax or the nature of the elements that compose the tax liability, subject to procedures to be established in ordinary law”. The provision is not self-enforceable and must be further regulated by ordinary law, which has not occurred to date. Nonetheless, Brazilian case law shows that the substance-over-form principle has relied on the old civil-law concepts of simulation and abuse of law, and, in particular, administrative decisions of the CARF regarding tax planning matters have relied on the substance-over-form approach.

84 See exchange rates in Brazil across the years: [https://data.oecd.org/conversion/exchange-rates.htm](https://data.oecd.org/conversion/exchange-rates.htm).
143. The standard of comparability is extremely strict and focuses on the characteristics of the property transferred or services provided, which form the foundation of the transfer pricing analysis.\(^{85}\) Except for some of the features of transfer pricing methods that incorporate elements of a functional analysis (e.g., importer/exporter, retailer/wholesaler), very limited consideration is given to the functions performed by each of the parties to the transaction.\(^{86}\) The analysis of the risks assumed by the parties is also not foreseen.

144. The versions of the comparable uncontrolled price (CUP) method adopted by Brazil follow an approach that appears to be broadly similar to the Guidelines in terms of the reliance on a comparability analysis. The other methods inspired by the OECD-recognised cost plus and resale price methods incorporate fixed margins for gross profit and mark-up instead of being based on finding comparable transactions. In this respect, there is no need for a comparability (including functional) analysis at this level.

145. The notion of comparability is limited for most methods,\(^ {87}\) in the sense that it is narrowed down to specific comparables selected with regard to their characteristics. In particular, it takes as a reference the arithmetic average prices or costs of “identical or similar” goods, services or rights (in the Brazilian and/or foreign markets depending on the methods), purchased or sold under similar payment conditions as those of the controlled transaction.

146. Therefore, without the requirement of a complete comparability (including functional) analysis in the transfer pricing analysis in Brazil, and without any consideration being given to most comparability factors, the role of the accurate delineation of the actual transaction is significantly undermined.

147. These key elements of the Guidelines are further addressed under the Chapter II analysis (addressing transfer pricing methods) and the Chapter III analysis (addressing the comparability analysis).

148. In conclusion, three main gaps or issues were identified in relation to Chapter I of the Guidelines. First, while the transfer pricing rules and administrative practices in Brazil are stated to be in accordance with the rules adopted by OECD member countries,\(^ {88}\) there is no explicit reference to the arm’s length principle therein. Second, the scope of application of the transfer pricing rules is different both in terms of the personal and material scopes. Finally, the notion of accurate delineation of the actual transactions is absent.

### 1.3. Assessment of effectiveness

149. The assessment of effectiveness covers the three gaps or issues identified in the comparative analysis of the Brazilian transfer pricing rules and Chapter I of the Guidelines. Based on the methodology

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\(^{85}\) See Chapter III analysis for a description of the standard of comparability based on the concepts of “identical” and “similar” governing the transfer pricing methods in Brazil.

\(^{86}\) The functional analysis of a controlled transaction, which is the foundation of the transfer pricing analysis for the typical OECD process, is extremely limited under the Brazilian transfer pricing system and the fixed margins approach makes it largely irrelevant. The only relevant factors with respect to the functions performed are those embedded in some of the transfer pricing methods, which dictate their application to import or export transactions, their application based on the industry sector in the case of the resale price equivalent method for import transactions (PRL method), or on whether the party is a wholesaler or a retailer in the case of the methods based on the OECD-recognised resale price methods for export transactions (PVA/PVV methods).

\(^{87}\) It is important to note that this requirement is not provided for in the legislation when applying the equivalents of the resale price method for imports (PRL method) and the cost plus method for exports (CAP method). It is unclear whether this is intentional or if the legislator overlooked the inclusion of this requirement when drafting the rules.

\(^{88}\) As previously noted, this was indicated in the Explanatory Statement of Law 9,430/1996, when the transfer pricing system was adopted in Brazil. See Explanatory Statement (Exposição de Motivos).
of the assessment of effectiveness, which aims to test whether the rules affected by the gaps or issues achieve the dual objective of securing the appropriate tax base and avoiding double taxation as well as the multiple objectives of providing ease of tax administration, ease of tax compliance and of offering tax certainty, the impact of the absence of restatement of the arm’s length principle, the effectiveness of having a broader personal scope and a narrower material scope, and the different process of identifying the commercial or financial relations (without accurate delineation of the actual transaction) for transfer pricing purposes are assessed based on whether they achieve the policy objectives of transfer pricing rules.

1.3.1. Absence of restatement of the arm’s length principle

150. While Brazil restates the arm’s length principle in its bilateral tax treaties, its domestic legislation does not, and arguably does not embody the arm’s length principle. As previously mentioned, the arm’s length principle as the international consensus on transfer pricing is justified because it effectively serves the dual objective of securing the appropriate tax base in each jurisdiction and avoiding double taxation. A critical question is thus whether the Brazilian transfer pricing system is actually based on the arm’s length principle or merely informed by it. If transfer pricing outcomes are ultimately similar between the Brazilian system and the OECD system, the commitment to the arm’s length principle expressed by its restatement in the domestic law and at the international level would only constitute a form of confirmation. However, if outcomes diverge, then dispute resolution matters would clearly be affected by this absence of commitment to the arm’s length principle and jeopardise the resolution of transfer pricing cases based on a common approach towards the application of the arm’s length principle.

Findings of the assessment

Prevention of BEPS risks

The absence of restatement of the arm’s length principle in the domestic law prevents the tax administration from applying this concept in securing the appropriate tax base in Brazil. The tax administration has to rely in most cases on special prescriptive rules, which, as described in the following sections of this report, do not contain special measures to deal with some common situations arising in MNE groups. This gives rise to situations where under-taxation and loss of revenue easily occur.

Prevention of double taxation

The absence of restatement of the arm’s length principle in the domestic law in Brazil presents a risk of divergent outcomes of transfer pricing adjustments in cross-border situations leading to double taxation as well as a risk that the cases of double taxation will not be effectively resolved.

Ease of tax administration

One could argue that the absence of restatement of the arm’s length principle in the domestic legislation makes the process of tax administration easier and less complex, because tax authorities are limited to applying prescriptive rules, rather than being able to exercise judgement in evaluating specific commercial situations. On the other hand, the absence of restatement of this principle does not enable the tax administration to collect all of the revenues resulting from value-creating activities taking place in Brazil.
Ease of tax compliance

The absence of restatement of the arm’s length principle in the domestic legislation does provide the theoretical benefit of simplification for taxpayers, who can follow the prescriptive rules in place, rather than exercise judgement in evaluating specific situations. This benefit may be outweighed by the administrative burden related to supporting the adjustment that the taxpayers have to extensively document in accordance with the existing rules (i.e. the item-per-item approach).

Tax certainty

The absence of restatement of the arm’s length principle results in tax uncertainty from an international perspective. This is explained by the fact that a majority of jurisdictions, including all OECD member countries, have committed to the arm’s length principle based on a common approach differing from the approach adopted by Brazil. It is also the case that, from a domestic perspective, taxpayers are unable to rely on the arm’s length principle to establish their transfer pricing; and even though the current rules provide certainty in terms of outcomes, there is no certainty that said outcomes will be in line with the arm’s length principle.

1.3.2. Scope of application of the transfer pricing rules

151. The personal scope of the Brazilian transfer pricing rules is generally broader than the personal scope set out in the OECD MTC because the definition of related parties covers more situations, whereas the material scope is narrower, since a number of transactions that would be addressed by the guidance contained in the Guidelines are not within the scope of the Brazilian transfer pricing rules. The territorial scope, which is limited to cross-border transactions, can also give rise to situations where domestic transfer pricing strategies lead to undesirable outcomes.

152. This creates a number of issues, notably issues related to inconsistencies across jurisdictions in the treatment of certain transactions, including situations where related parties in Brazil may not be considered to be related in other jurisdictions.

Findings of the assessment

Prevention of BEPS risks

A broader definition of associated enterprises limits to some extent the risk of BEPS, especially because it targets low-tax jurisdictions and preferential tax regimes in jurisdictions which do not effectively exchange information, with the intent to prevent such abuse. Similarly, as is the case in some OECD member countries which follow a similar approach, this broader personal scope may be justified from a tax avoidance perspective and by tax administration concerns resulting from information asymmetry.

A narrower material scope, on the other hand, creates increased likelihood of BEPS risks, which may not be fully eliminated, even with the special deductibility limitation rules. Depending on the facts and circumstances, such deductibility limitations could turn ineffective if deductions are still granted within the given limits without proper accurate delineation of the actual transaction or if the benefits test is not effectively applied. It needs to be seen whether the Brazilian rules contain a mechanism as effective as the benefits test described in the Guidelines.
The narrow territorial scope, which only applies to cross-border transactions can enable abusive domestic transfer pricing practices, where the profits may be shifted between entities operating in different special tax regimes (including tax holidays, tax incentives and others) and/or between entities, where one of the parties to the transaction has extensive accumulated losses and the transfer of profits will enable the utilisation of those losses. The existing anti-avoidance rule addressing the disguised distribution of profits (DDL) has only limited effect to address these BEPS risks. As noted, this measure has only a limited scope and applies in cases of potential profit shifting from the subsidiaries to the shareholders; it does not apply between sister companies and to transactions involving profit shifting from parent to subsidiaries. Therefore, the scope of this rule is limited and may not provide full protection against BEPS risks identified above.

**Prevention of double taxation**

A broader definition of associated enterprises expands the personal scope, which, in combination with other features (notably the fixed margins), may increase the risk of double taxation. In particular, two parties could be considered to be related in Brazil based on conditions that do not exist in a majority of other jurisdictions. Because transfer pricing rules may also apply to third parties as if they were related parties (e.g., when they are exclusive distributors or residents in low-tax jurisdictions), situations may exist whereby actual arm’s-length prices become subject to transfer pricing adjustments in Brazil based on the assumption that they are related parties. This assumption is not rebuttable and thus even in cases where it could be established that the prices are actually arm’s-length potential double taxation may arise for transactions between two unrelated parties. In addition, relief in the other country becomes unlikely if these genuinely unrelated parties are considered to be out of the scope of that other country’s transfer pricing rules and also outside of the scope of Article 9 of bilateral tax treaties.

A narrower material scope which excludes certain types of transactions, in combination with other features (e.g., fixed margins), may also increase the risk of double taxation. For example, a situation may occur where deductions are denied in Brazil and taxable income is accrued in the foreign jurisdiction.

The input provided by business generally pointed to the narrower material scope (particularly the deductibility limitation rules with respect to royalty payments) as being a major disadvantage of the Brazilian transfer pricing system, notably because it dismisses the application of the arm’s length principle to such transactions, and thus potentially leads to non-arm’s-length outcomes and cases of double taxation.

**Ease of tax administration**

A broader definition of associated enterprises requires enhanced control of transactions for transfer pricing purposes, both in identifying such associated enterprises and the additional transactions being carried out (that would not normally be in-scope). This turns into a need for heightened monitoring from the tax administration’s side. On the other hand, this approach reduces the administrative burden that the tax administration would otherwise bear if it was aiming to challenge the potentially abusive transactions, which *prima facie* look like transactions between unrelated parties when in reality these are structured transactions involving back-to-back arrangements or nominee shareholder/director arrangements, but effectively still carried out within a controlled environment.

A narrower material and territorial scope is expected to simplify the tax administration burden, notably because certain transactions involving the transfer or use of intangibles are out of scope, and deductibility limitation rules applying to those out-of-scope transactions are more prescriptive or because the transfer pricing rules do not apply to domestic transactions at all.
Ease of tax compliance

A broader definition of associated enterprises corresponds to a heavier compliance burden for some taxpayers as they may be required to apply transfer pricing rules to more transactions. This is especially true in cases where the parties to the transaction are genuinely unrelated and may thus have limited access to the information proprietary to the counterparty, which also limits the choice of applicable transfer pricing methods.

The tax compliance burden is however reduced as a result of a narrower material and territorial scope for similar reasons as listed under the ease of tax administration criterion (i.e. exclusion of certain complex transactions from the scope of transfer pricing rules and more prescriptive rules for specifically defined transactions).

Tax certainty

From a domestic perspective, having a broader personal scope does not seem to affect tax certainty as long as the conditions are clear and objective, but, from an international perspective, the inconsistencies between different definitions of associated enterprises could create some degree of uncertainty.

From a purely domestic perspective, the Brazilian approach provides some tax certainty by having a reduced material scope for which more prescriptive rules apply. However, significant uncertainties result from the existence of diverging approaches, which may lead to unrelieved double taxation, when considering the international perspective.

With respect to the territorial scope, tax certainty is guaranteed because domestic transactions are not subject to transfer pricing rules, meaning that they will not be scrutinised and/or challenged.

1.3.3. Absence of accurate delineation of the actual transaction in identifying the commercial or financial relations

The appropriate identification of the commercial or financial relations, including the accurate delineation of the actual transactions, is essential in terms of achieving the dual policy objective of transfer pricing rules. This absence implies inefficient prevention of BEPS risks and potential double taxation. Concerning the tax administration and tax compliance burdens, the approach adopted by Brazil simplifies the control of transfer prices and alleviates the obligations imposed on taxpayers.

Findings of the assessment

Prevention of BEPS risks

The transfer pricing analysis in Brazil is not based on a complete comparability analysis, which would include appropriate identification of the commercial or financial relations and careful consideration of the economically relevant circumstances of the taxpayer, in particular the functions performed, assets used, and risks assumed, and of other comparability factors. The concept of accurate delineation of the actual transaction set out in the Guidelines is also not reflected, potentially leading to under-taxation and creating significant BEPS risks.
The following example illustrates the concept of clarifying and supplementing the written contractual terms based on the identification of the actual commercial or financial relations.\textsuperscript{89} Company P is the non-resident parent company of an MNE group situated in Country P. Company B, situated in Brazil, is a wholly-owned subsidiary of Company P and acts as an agent for Company P’s branded products in the Brazilian market. The agency contract between Company P and Company B is silent about any marketing and advertising activities in Brazil that the parties should perform. Analysis of other economically relevant characteristics and in particular the functions performed, determines that Company B launched an intensive media campaign in Brazil in order to develop brand awareness. This campaign represents a significant investment for Company B. Based on evidence provided by the conduct of the parties, it could be concluded that the written contract may not reflect the full extent of the commercial or financial relations between the parties. Accordingly, the analysis should not be limited by the terms recorded in the written contract, but further evidence should be sought as to the conduct of the parties, including as to the basis upon which Company B undertook the media campaign. Under the Brazilian transfer pricing rules, the conduct of the parties in this case may not be appropriately considered in the transfer pricing analysis and the full extent of the commercial or financial relations between Company P and Company B would not be fully taken into account.

**Prevention of double taxation**

Prevention of double taxation is less likely without appropriate identification of the commercial or financial relations and accurate delineation of the actual transaction. In fact, the approach that makes use of fixed margins adopted in Brazil ignores a majority of the aspects of the guidance contained in Section D of Chapter I of the Guidelines. In consequence, there is a high risk of double taxation, provided that the transfer pricing analysis in Brazil considerably deviates from the transfer pricing analysis as performed in jurisdictions that follow these Guidelines.

**Ease of tax administration**

Without the requirement to perform a complete transfer pricing analysis based on a broad-based analysis of the circumstances and a comparability (including functional) analysis of the taxpayer, as set out in the Guidelines, the tax administration burden is significantly reduced. Applying the arm’s length principle is a complex process informed by extensive guidance. Therefore, a simplified approach which bypasses the need for such an analysis is less resource- and time-intensive. It also does not require a high level of expertise of the tax auditors.

**Ease of tax compliance**

Without the requirement to perform a complete transfer pricing analysis based on a broad-based analysis of the circumstances and a comparability (including functional) analysis of the taxpayer, as set out in the Guidelines, the tax administration burden is significantly reduced. Applying the arm’s length principle is a complex process informed by extensive guidance. Therefore, a simplified approach which bypasses the need for such an analysis is less resource- and time-intensive. It also does not require a high level of expertise of the tax auditors.

\textsuperscript{89} This example is based on the example provided in paragraph 1.44 of the OECD Guidelines.
Tax certainty

Tax certainty from an international perspective is undermined for the reasons listed above, which may give rise to double taxation. Tax certainty at the domestic level should not be an issue based on the reasons listed above (i.e. absence of a complete transfer pricing analysis).
The second chapter contains the analysis of Brazil's transfer pricing rules and practices as compared with Chapter II of the OECD Guidelines, which provides guidance in relation to the transfer pricing methods. Part I contains an analysis of the principles used for selecting the transfer pricing method. Parts II and III contain the comparative analysis of the relevant transfer pricing methods in Brazil with the five OECD-recognised methods that can be used to establish whether the conditions imposed in the commercial or financial relations between associated enterprises are consistent with the arm’s length principle. Three of these methods – the comparable uncontrolled price (CUP) method, the resale price method, and the cost plus method are referred to as the “traditional transaction methods”. Although Brazil has adopted methods which are broadly equivalent with these traditional transaction methods, there are notable differences between the way they are applied and the comparability analysis plays only a limited role in the case of the methods which rely on rigid fixed margins. The two other OECD-recognised methods – the transactional net margin method and the transactional profit split method – were introduced in the Guidelines in 1995 and significantly reconsidered and expanded in 2010; they are referred to as the “transactional profit methods”. They have not been implemented in Brazil and the use of “other” methods is also not permitted.
SELECTION OF THE TRANSFER PRICING METHOD

154. The first part of the chapter discusses the selection of the transfer pricing method, which is a key step in the process of applying the arm’s length principle. According to the Guidelines, the comparability analysis, among the other important factors to consider for the selection of the method, plays a crucial role in the selection of the most appropriate transfer pricing method in light of the circumstances of the case and in applying the selected transfer pricing method to determine the arm’s length price.

155. The 2010 update of the Guidelines introduced the concept of the most appropriate method. Previously, the hierarchy for the selection of a transfer pricing method as established in 1995 imposed an order for the application of the methods. This hierarchy of methods has been replaced by the most appropriate method criterion, although it is still recognised that “[where] a traditional transaction method and a transactional profit method can be applied in an equally reliable manner, the traditional transaction method is preferable to the transactional profit method” and that “[where] the CUP and another transfer pricing method can be applied in an equally reliable manner, the CUP method is to be preferred”.

2.1. Selection of the most appropriate transfer pricing method to the circumstances of the case

156. The selection of a transfer pricing method under the Guidelines always aims at finding the most appropriate method in a particular case, recognising that no one method is suitable in every possible scenario, but also that it is not necessary to prove that a particular method is not suitable under the circumstances.

2.1.1. Factors to consider

157. The selection of the method takes account of the respective strengths and weaknesses of the OEDC-recognised methods; the appropriateness of the method considered in view of the nature of the controlled transaction, determined in particular through a functional analysis; the availability of reliable information (in particular on uncontrolled comparables) needed to apply the selected method and/or other methods; and the degree of comparability between controlled and uncontrolled transactions, including the reliability of comparability adjustments that may be needed to eliminate material differences between them.

158. In terms of challenging the selection of the method, while it is not implied by the most appropriate method criterion that all the transfer pricing methods should be analysed in depth or tested in each case, the selected method could be challenged on the basis of its inappropriateness, i.e. in view of the aforementioned factors.

2.1.2. Possibility to apply “other methods”

159. The Guidelines give MNE groups the possibility to apply “other methods” that are not described in Chapter II of the Guidelines. Such other methods should however not be used in substitution for OECD-recognised methods where the latter are more appropriate to the facts and circumstances of the case. In cases where other methods are used, their selection should be supported by an explanation of why OECD-recognised methods were regarded as less appropriate or nonworkable in the circumstances of the case.

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90 The application of transactional profit methods was to be considered only under exceptional circumstances or as a last resort.

91 See paragraph 2.3 of the OECD Guidelines.
and of the reason why the selected other method was regarded as providing a better solution.\textsuperscript{92} In this context, valuation techniques can also be useful tools where there are no reliable comparables. The Guidelines not only make the application of such methods possible, but also recommend that such methods be used in some cases (e.g., for transfers of intangibles or of an ongoing concern).

2.1.3. Use of more than one method

160. The OECD Guidelines do not require either the tax examiner or taxpayer to perform analyses under more than one method. However, for difficult cases, where no one approach is conclusive, the Guidelines contemplate the use of a flexible approach that would allow the evidence of various methods to be used in conjunction.\textsuperscript{93}

2.2. Description of the existing rules and practices in Brazil and gap analysis

161. The selection of a transfer pricing method in Brazil does not aim to find the most appropriate method in a particular case. Nor is it based on a hierarchy of method. The taxpayer is free to select any transfer pricing method provided in the legislation.\textsuperscript{94}

2.2.1. Freedom of selection of the transfer pricing method

162. The selection of the applicable transfer pricing method in Brazil is not determined based on its appropriateness to a particular case or a hierarchy of methods. The choice of the method is left to the taxpayer who is free to select any method, even if the selection is made with the purpose of achieving the most favourable tax outcome, as long as the established price complies with the minimum income or the maximum deductible expense required in transactions between related parties.

163. That said, the choice of method may be imposed by factors associated with the specificities of the methods (e.g., availability of information from foreign related parties) and the absence of transactional profit methods for some cases. A given method may not be available to the taxpayer as a result of conditions embedded in the method itself as well as the documentation required to support its selection.

164. For example, Brazilian companies importing from abroad are more likely to apply the PRL method (which is a method conceptually similar to the OECD-recognised resale price method but used only for import transactions) given that all of the information needed to apply the method (such as the import cost, local production cost and resale price information) is readily available in Brazil.

Legal basis

165. The basis for this principle is found in Article 18 and Article 19, paragraph 3, of Law 9,430/1996 and additional guidance can be found in Article 40 of Normative Instruction 1,312/12, which explicitly gives the taxpayer the option to choose one of the methods provided in Chapters II and III of this Normative Instruction, except when the legislation establishes the application of certain mandatory methods to specific transactions (i.e. commodity transactions), or special rules for financial transactions (i.e. interest

\textsuperscript{92} See paragraph 2.9 of the OECD Guidelines.

\textsuperscript{93} See paragraph 2.12 of the OECD Guidelines.

\textsuperscript{94} As an exception to the rule, the application of the methods designed for commodity transactions is mandatory. Interest payments derived from financial transactions are also subject to a specific methodology.
The taxpayer's faculty to choose any method is also interpreted as not being restricted by Law 9,430/96 providing the methods available to the taxpayer for calculating the parameter price.

**Case law**

166. Several decisions of the highest administrative court for federal taxes (CARF) support this interpretation. The first decision concluded that Article 18 of Law 9,430/96 establishes that any of the methods laid out therein could be chosen in order to determine the parameter price for the deductibility of expenses. Further, it indicated that paragraph 4 of Article 18 recognises that the taxpayer can use all of the methods and choose the most favourable one according to the facts and circumstances of a particular case. The selection of the most favourable method was also approached from the same perspective in another judgment of the same administrative court, confirming that the choice of the method was "at the taxpayer's discretion without any further approval to be given by the tax authorities", taking account of the distinction between methods for import and export transactions. The position of the court continues to be consistent as evidenced by a more recent decision. In this decision, the court had a similar reasoning, stating that the legislative intent behind Law 9,430/96 was clear in granting the taxpayer the possibility to "go through" the methods that are applicable to a particular case by expressly allowing the use of one or another method to determine the amount to be deducted.

**Challenge of the method**

167. The transfer pricing method selected by the taxpayer may be challenged by the tax administration if the taxpayer has failed to present sufficient documentation to support the application of the method.

168. As explained in Brazil's transfer pricing country profile, the "taxpayer is free to use any method and the tax administration can only change the taxpayer choice of the method if the taxpayer cannot provide enough documentation to support its calculation of the arm's length price". In this sense, the legislation provides that the selection of one of the methods must be made for each calendar year and cannot be changed by the taxpayer if a tax inspection has been initiated, unless the method or calculation criteria have been disqualified by the tax authorities. If this is the case, the taxpayer will be notified to submit the new calculation within 30 days, in accordance with the legislation.
with any of the methods provided by the law.\textsuperscript{102} If the 30-day period is not respected, the tax authorities can determine the parameter price based on the documents available and apply one of the methods provided in the legislation.\textsuperscript{169}

169. While the method selected must be used consistently by the taxpayer for each product, service or right throughout each calendar year, taxpayers can change the applicable method from one year to the next for the same product, service or right.\textsuperscript{103}

\textit{Use of more than one method}

170. The use of more than one method (i.e. a flexible approach allowing the evidence of various methods to be used in conjunction) is not permitted under the Brazilian transfer pricing system.

\textbf{2.2.2. Use of “other methods” not permitted}

171. In Brazil, the use of “other methods” is not allowed, meaning that other methods than those provided in the legislation cannot be considered, even if they lead to better approximations of an arm’s-length pricing. It was expressly rejected in a decision of the Administrative Court of Appeals.\textsuperscript{104}

\textbf{2.3. Assessment of effectiveness}

172. The assessment of effectiveness focusses on the freedom of selection of the method and the unavailability of “other methods”.

\textbf{2.3.1. Freedom of selection of the transfer pricing method}

173. The rules governing the selection of the transfer pricing method should be assessed also in consideration of other aspects of the transfer pricing legislation, including among others the list of methods available (and the absence of transactional profit methods), the mandatory nature of the methods designed for commodity transactions, and the specificities of available methods.

\textbf{Findings of the assessment}

\textbf{Prevention of BEPS risks}

In principle, the taxpayer can choose any method (except for commodity transactions), even if it results in the lowest transfer pricing adjustment. Therefore, taxpayers are more likely to select the method that leads to the most favourable tax outcome, which may lead to under-taxation and loss of revenue, and may also open avenues for BEPS.\textsuperscript{105}

Input submitted by business suggests that taxpayers tend to test the possible outcomes (adjustments) under different methods as a first step. After evaluation of the likely outcomes, they choose to apply the method which leads to no or the lesser transfer pricing adjustment.

\textsuperscript{102} Article 40 of Normative Instruction 1.312/2012.

\textsuperscript{103} Article 4 of Normative Instruction 1.312/2012.

\textsuperscript{104} CARF, judgment 9101-002.313 (03.05.2016).
Prevention of double taxation
The absence of a requirement to consider an economic (or other) rationale for the selection of the method may lead to the application of the method that is not the most appropriate for a particular case. However, because taxpayers will be inclined to select the method that leads to a lower or no tax adjustment, this may actually reduce the risk of double taxation or the negative effect of the actual double taxation.

Ease of tax administration
Tax administration aspects of the selection of the method are simplified by the absence of a need to verify whether the selected method is the most appropriate to the circumstances of the case – i.e. no disputes with taxpayers about the determination of the most appropriate method to the facts and circumstances of the case.

Ease of tax compliance
The freedom of selection of the method ensures ease of compliance to the extent that taxpayers benefit from the flexibility to choose the method that suits their reality based on information and documentation available. Taxpayers are also able to select a different method from one year to the other without having to justify or request approval.

Tax certainty
Freedom of selection should not lead to tax uncertainty from a domestic perspective because the selection of the method is not imposed based on complex criteria. It may also reduce the risks of double taxation and thus reduce the tax uncertainty in cross-border situations. However, it may create some uncertainty at the international level because it differs from the OECD standard, which aims to find the most appropriate method for a particular case, and is commonly found in the majority of jurisdictions’ tax legislation.

2.3.2. Use of “other methods” not permitted
174. Under the OECD system, “other methods” may be applied to establish prices provided those prices satisfy the arm’s length principle in accordance with the Guidelines, but such other methods should not be used in substitution of OECD-recognised methods where they are more appropriate to the facts and circumstances of the case.
Findings of the assessment

Prevention of BEPS risks
The use of “other methods” may help to establish prices that satisfy the arm’s length principle where OECD-recognised methods are not as appropriate or workable. Therefore, their use, if appropriate, could generate more reliable outcomes and more suitably secure the appropriate tax base in Brazil (e.g., in cases of transfer or use of intangibles). The absence of “other methods” in Brazil may thus lead to outcomes that deprive Brazil of the revenues associated with the value generated in Brazil and this represents a BEPS risk.

Prevention of double taxation
There may be cases in which none of the traditional methods lead to a reasonable outcome. Therefore, by ensuring the consistent application of the arm’s length principle, the use of “other methods” can serve the objective of avoiding double taxation. The absence of “other methods” in Brazil may thus present a risk from the perspective of double taxation.

Ease of tax administration
Monitoring the use of “other methods” may create challenges for the tax administration. By not allowing taxpayers to use “other methods”, the tax administration is not required to deal with their peculiarities and complexities. This is also related to the criterion used for the selection of the method, and it should be assumed that the use of such “other methods” would be made contingent on specific conditions.

Ease of tax compliance
The tax compliance burden is not heavier because “other methods” are not permitted. Nor is it lighter. However, it should be noted that the selection of “other methods” should typically be supported by an explanation of why the available methods were regarded as less appropriate or nonworkable in the circumstances of the case and of the reason why the selected other method was regarded as providing a better solution. It would also require to maintain documentation regarding how transfer prices were established for “other methods.

Tax certainty
Offering the possibility to use “other methods” would foster tax certainty from an international perspective, considering that their use is accepted by many jurisdictions that follow the OECD Guidelines. From a domestic perspective, the possibility of applying additional methods in some circumstances could create further complexity and the need for taxpayers to consider the application of other methods. One could argue that this could create more uncertainty from a domestic perspective.
TRADITIONAL TRANSACTION METHODS

175. Part II of Chapter II contains a description of traditional transaction methods that are used to apply the arm’s length principle, including examples of the application of each method.

2.4. OECD-recognised traditional transaction methods

176. Traditional transaction methods are regarded as the most direct means of establishing whether conditions between associated enterprises are arm’s-length.

2.4.1. Comparable uncontrolled price method

177. The comparable uncontrolled price (CUP) method compares the price charged for property or services transferred in a controlled transaction to the price charged for property or services transferred in a comparable uncontrolled transaction in comparable circumstances. If differences arise between the two considered prices, it may indicate that the conditions of the commercial or financial relations of the associated enterprises are not arm’s-length, and that the price in the uncontrolled transaction may need to be substituted for the price in the uncontrolled transaction.

178. An uncontrolled transaction is comparable to a controlled transaction (i.e. it qualifies as a comparable uncontrolled transaction) for purposes of the CUP method if one of two conditions is met: a) none of the differences (if any) between the transactions being compared or between the enterprises undertaking those transactions could materially affect the price in the open market; or b) reasonably accurate adjustments can be made to eliminate the material effects of such differences.

179. The comparable uncontrolled price method can be applied on the basis of the taxpayer’s transactions with independent enterprises (“internal comparables”), or on the basis of transactions between other independent enterprises (“external comparables”).

180. Specific guidance for establishing the arm’s length price for the transfer of commodities between associated enterprises is also provided.\footnote{This guidance especially applicable to commodity transactions was added as a result of the work conducted under Action 10 of the BEPS Project. It draws from experiences of countries that have introduced domestic rules aimed at pricing commodity transactions. See OECD (2015), \textit{Aligning Transfer Pricing Outcomes with Value Creation, Actions 8-10 – 2015 Final Reports}, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, \url{https://doi.org/10.1787/9789264241244-en}.} Under the CUP method, the arm’s length price for commodity\footnote{The reference to “commodities” shall be understood to encompass physical products for which a quoted price is used as a reference by independent parties in the industry to set prices in uncontrolled transactions.} transactions may be determined by reference to comparable uncontrolled transactions and by reference to comparable uncontrolled arrangements represented by the quoted price.\footnote{The term “quoted price” refers to the price of the commodity in the relevant period obtained in an international or domestic commodity exchange market. In this context, a quoted price also includes prices obtained from recognised and transparent price reporting or statistical agencies, or from governmental price-setting agencies, where such indexes are used as a reference by unrelated parties to determine prices in transactions between them.} For commodities, the economically relevant characteristics include, among others, the physical features and quality of the commodity; the contractual terms of the controlled transaction, such as volumes traded, period of the arrangements, the timing and terms of delivery, transportation, insurance, and foreign currency terms. For some commodities, certain economically relevant characteristics (e.g., prompt delivery) may lead to a premium or a discount. Further, the guidance recommends that reasonably accurate adjustments should be made to ensure that the economically relevant characteristics of the transactions are comparable.
Contributions made in the form of functions performed, assets used and risks assumed by other entities in the supply chain should also be compensated in accordance with the guidance provided in the Guidelines. Although there is no specific source of references to be used, the guidance encourages taxpayers to provide reliable evidence and document to justify price adjustments or any other relevant information.

### 2.4.2. Resale price method

181. The resale price method begins with the price at which a product that has been purchased from an associated enterprise is resold to an independent enterprise. This price (the “resale price”) is then reduced by an appropriate gross margin (the “resale price margin”), determined by reference to gross margins in comparable uncontrolled transactions, representing the amount out of which the reseller would seek to cover its selling and other operating expenses and, in light of the functions performed (taking into account assets used and risks assumed), make an appropriate profit. What is left after subtracting the gross margin can be regarded, after adjustment for other costs associated with the purchase of the product (e.g. customs duties), as an arm’s length price for the original transfer of property between the associated enterprises.

182. Thus, in a resale price method, the resale price margin (i.e. the gross margin) that the reseller earns from the controlled transaction is compared with the gross margin from comparable uncontrolled transactions.

183. This method is usually most appropriate where it is applied to sales and marketing operations such as those typically carried out by a distributor. In some circumstances, the resale price margin of the reseller in the controlled transaction may be determined by reference to the resale price margin that the same reseller earns on items purchased and sold in comparable uncontrolled transactions (an “internal comparable”). In other circumstances (especially where reliable internal comparables are not available), the resale price margin may be determined by reference to the resale price margin earned by independent enterprises in comparable uncontrolled transactions (“external comparables”).

### 2.4.3. Cost plus method

184. The cost plus method begins with the costs incurred by the supplier of property or services in a controlled transaction for property transferred or services provided to an associated enterprise. An appropriate mark-up, determined by reference to the mark-up earned by suppliers in comparable uncontrolled transactions, is then added to these costs, to make an appropriate profit in light of the functions performed and the market conditions. Such arm’s length mark-up may be determined by reference to the mark-up that the same supplier earns in comparable uncontrolled transactions (an “internal comparable”), or by reference to the mark up that would have been earned in comparable transactions by an independent enterprise (“external comparable”).

185. Thus, in a cost plus method, the mark-up on costs that the manufacturer or service provider earns from the controlled transaction is compared with the mark-up on costs from comparable uncontrolled transactions.

186. This method probably is most useful where semi-finished goods are sold between associated parties, where associated parties have concluded joint facility agreements or long-term buy-and-supply arrangements, or where the controlled transaction is the provision of services.
2.5. Description of the existing rules and practices in Brazil and gap analysis

187. This section describes the transfer pricing methods available in Brazil. Brazil has adopted methods inspired by the three traditional transaction methods used for the determination of an arm’s length consideration, namely the comparable uncontrolled price, resale price and cost plus methods. However, those methods present a number of differences compared to the OECD-recognised methods.

2.5.1. Classification of methods between import and export transactions

188. The transfer pricing methods in Brazil are classified between those that are used to establish the transfer price for import transactions and those that are used for export transactions. The distinction appears in the rules for methods broadly equivalent to the CUP method with little theoretical difference. Accordingly, the PIC and PVEx methods set benchmark prices with the weighted arithmetic average of purchases and sales between unrelated parties of the same or similar goods, rights or services under similar payments conditions for import and export transactions respectively. Special methods subsequently introduced in 2013, designed for commodities, and which differ from the other methods in the sense that they are not based on annual average prices but establish the transfer price through averaging of published commodity prices from public exchanges on the transaction date on a transaction-by-transaction basis are mandatorily applicable. Methods inspired by the resale price method can be used for imports (PRL method) and for exports (PVA/PVV methods). The methods inspired by the cost plus method, namely the CPL method for imports and the CAP method for exports, follow the same binary approach. For the purpose of applying these methods, a base amount is calculated based on weighted averages (either of prices or of costs) to which a statutory profit margin is added.

189. Against this background, the following paragraphs describe in more detail the different methods available under the Brazilian transfer pricing rules.

Methods designed for import transactions

190. Article 18 of Law 9,430/96 provides the three methods designed for import transactions. This article effectively sets a maximum amount in excess of which the deductibility of expenses is not allowed, thereby limiting the deductibility of costs in regard to import transactions carried out with related parties. This ceiling price is determined by applying the three following methods.

Comparable independent price method

191. The “comparable independent price” method (Preços Independentes Comparados or PIC) determines the transfer price on the basis of the weighted arithmetic average of identical or similar goods, services and rights in transactions carried out either in domestic or foreign markets by the interested party itself or by third parties under similar payment conditions.

192. Commodity transactions are subject to methods which are broadly equivalent to the CUP method, but follow very specific guidance. There are two such methods for the transfer of commodities – one for imports and one for exports – and both were introduced in 2013.\(^\text{108}\) Their application is mandatory. The so-called “price under quotation on import” method (Preço sob Cotação da Importação or PCI) applies to import transactions of commodities between related parties. Article 18-A establishes a comparison with the daily average values of the quotation of goods or rights subject to public prices on internationally recognised exchange or securities markets.

\(^{108}\) Also referred to as the "sixth method".
Resale price less profit method

193. The “resale price less profit” method (Preço de Revenda Menos Lucro or PRL) is defined as the arithmetic average of resale prices of goods, services and rights in Brazil, in similar payment conditions, and is calculated according to the following methodology.

194. First, the law requires to use the net price of the sale, which is defined as the arithmetic average of the selling prices of the goods, services and rights, as applied by the importer in transactions with independent parties, less (i) unconditional discounts granted, (ii) taxes and contributions imposed on sales, and (iii) commissions and brokerage fees paid.109

195. Further, it is required to find the percentage of the participation of the imported goods, rights or services, in the total cost of the goods, rights or services sold by the Brazilian entity. The percentage of the participation of imported goods shall be calculated in accordance with the cost spreadsheets of the legal entity.110 Based on this percentage, the law then requires to find the amount of the participation of the items imported in the sales price.111

196. Subsequently, paragraph 12 of Article 18 prescribes the application of profit margins upon the above-mentioned participation amount of the imported items that is sold. The margins are 40%, 30% or 20% depending on the industrial sector of the enterprise subject to transfer pricing control.112 The parameter will be the resale price adjusted by participation less a profit margin, fixed by law. If the taxpayer is pricing the transaction below the parameter price, a transfer pricing adjustment will be required.

197. The percentage of the participation will effectively lead to the adjustment of the base to which the fixed margin will be applied.

Production cost plus profit method

198. Under the “production cost plus profit” method (Custo de Produção Mais Lucro or CPL), the determination of the transfer price is made based on the weighted average production cost of identical or similar products, services or rights in the country or jurisdiction where they were originally produced, increased by taxes paid in that jurisdiction and by a mandatory fixed profit margin (i.e. a 20% mark-up on cost) calculated on the production cost.

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109 Article 12, item I, of Normative Instruction 1,312/2012.

“I. Net sale price: the weighted arithmetic average of the sale price of the goods, services or rights, reduced by: a) unconditional discounts granted; b) taxes and contributions assessed on sales; c) commissions and brokerage fees paid.”

110 Article 12, item II, of Normative Instruction 1,312/2012.

“II. Percentage of participation of the goods, rights or services imported over the total cost of the good, right or service sold: the percentage ratio between the weighted average cost of the goods, rights or services imported and the total weighted average cost of the goods, rights or services sold, which shall be calculated in accordance with the cost spreadsheets of the legal entity.”

111 Normative Instruction 1,312/2012, Article 12, item III:

“III. Participation of goods, rights and services imported in the sale price of the goods, rights or services sold: the application of the percentage ratio of goods, rights or services imported to the total cost, calculated in accordance with item II, over the net sale price calculated in accordance with item I”.

112 Prior to 1 January 2013, the profit margins of the PRL method were 20% for resale and 60% in case of further manufacturing process in Brazil. The new margins were included in the transfer pricing legislation by Law 12,715/2012 (available at: www.planalto.gov.br/ccivil_03/_Ato2011-2014/2012/Lei/L12715.htm#art48).
Methods designed for export transactions

199. Article 19 of Law 9,430/96 provides the four methods designed for export transactions. Article 19 effectively sets the minimum amount of gross income in export transactions carried out by residents of Brazil with related parties. This approach is equivalent to setting a floor for income and assigning taxable income to the concerned exporting party.

200. The methods for exports contain a specific type of simplification, which could be also considered as a safe harbour or an exception from applying the transfer pricing rules. If the price charged is less than 90% of the average price charged on the sale of the same goods, services or rights on the Brazilian market during the same period under similar payment conditions, the transactions carried out will need to be adjusted through the application of one of the four following methods. This means that if the price charged is more than 90% of the average price charged, no transfer pricing adjustment or application of transfer pricing methods is needed.\(^\text{113}\)

Export sales price method

201. The “export sales price” method (Método do Preço de Venda nas Exportações or PVEx) is used to determine the transfer price based on the arithmetic average of prices of exports by the enterprise to unrelated parties, or by other domestic exporters of identical or similar goods, services or rights.

202. Commodity transactions are subject to methods which are broadly equivalent to the CUP method, but contain very specific guidance. There are two methods for the transfer of commodities – one for imports and one for exports – and both were introduced in 2013. Their application is mandatory. The so-called “price under quotation on export” method (Método do Preço sob Cotação na Exportação or PECEX) applies to export transactions of commodities between related parties. Article 19-A establishes a comparison with daily average values of the quotation of goods or rights subject to public prices on internationally recognised exchange or securities markets.

Wholesale price in the country of destination less profit method

203. The “wholesale price in the country of destination less profit” method (Preço de Venda por Atacado no País de Destino, Diminuído do Lucro or PVA) is used to determine the transfer price based on the arithmetic average of the wholesale price of identical or similar goods in the country of destination under similar payment terms, less taxes included in the price that are levied in the country of destination, less a profit margin of 15%.

Retail price in the country of destination less profit method

204. The “retail price in the country of destination less profit” method (Preço de Venda a Varejo no País de Destino, Diminuído do Lucro or PVV) is used to determine the transfer price based on the arithmetic average of the retail price of identical or similar goods in the country of destination under similar payment terms less taxes included in the price that are levied in the country of destination, less a profit margin of 30%.

Acquisition or production cost plus taxes and profit

205. The “acquisition or production cost plus taxes and profit” (Custo de Aquisição ou de Produção Mais Tributos e Lucro or CAP) is used to determine the transfer price based on the arithmetic average of

\(^\text{113}\) This provision is also discussed in the context of Chapter IV and safe harbours in Section B.5 of the OECD Guidelines.
the acquisition or production cost of exported goods, services or rights, plus domestic taxes and contributions, plus a profit margin of 15% on the sum of costs, taxes and contributions.

Practical considerations for the application of methods for export and import transactions

206. By way of conclusion, it is worth highlighting that practical aspects in terms of the application of these methods create bias in favour of certain methods. For example, in the case of the CPL method, production costs will be incurred in the country where the supply is originally manufactured including direct costs (manufacturing process) and other amounts for reasonable losses, depreciation, leases, and maintenance expenses regarding the production. In this respect, performing a calculation based on this level of detail is easier for the CAP method than the CPL method due to ready access to its own information by the Brazilian company. Therefore, there is a strong inclination to use the CAP method for export transactions. As another example, the PVA/PVV methods, which are equivalents of the resale price method for export transactions, will be more difficult to apply than the PRL method applied for import transactions, as they necessitate detailed accounting information from the foreign related party.

2.5.2. Use of fixed margins in methods equivalent to cost plus and resale price methods

207. The use of fixed margins for the Brazilian versions of the OECD-recognised resale price and cost plus methods, i.e. the adoption of predetermined profit margins imposed by law, constitutes a key difference and significant deviation from the application of the arm’s length principle in accordance with the OECD Guidelines. These fixed margins are asserted to be derived from industry practices, but no detailed explanation is provided in terms of how they were established.

208. For import transactions, the “resale price less profit” (PRL) method provides different margins based on the economic sector and type of products. The fixed mark-up of the “production cost plus profit” (CPL) method applies broadly to all sectors.

209. For export transactions, the “wholesale price” (PVV) and “retail price” (PVA) methods apply different rates (15% and 30% respectively), in order to account for the functional profile of the taxpayer (wholesaler vs. retailer). The 15% profit margin of the “acquisition or production cost plus” (CAP) applies broadly to all sectors.

210. Therefore, the classification between methods for import transactions and for export transactions has implications in terms of the applicable profit margins. These predetermined margins are supposedly based on industry practices, but they only take into account the economic sector for one method (PRL method) and the functional profile of the taxpayer for two others (PVV and PVA methods), while the fixed margins of the other methods apply broadly to all industries and taxpayers.

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115 The percentage is 40% for the products of (a) pharmachemical and pharmaceutical products; (b) tobacco products; (c) optical, photographic and cinematographic equipment and instruments; (d) machines, devices and equipment for dental-medical-hospital use; (e) extraction of oil and natural gas; and (f) oil derived products. Then, 30% for the products of (a) chemical products; (b) glass and glass products; (c) cellulose, paper and paper products; and (d) metallurgy. And finally, 20% for all other sectors.
211. The Minister of Finance may, under justified circumstances, change the fixed margins on its own initiative.\textsuperscript{116} A taxpayer may also request profit margins different from those provided,\textsuperscript{117} if the request is supported with documents of transactions carried out with non-related parties.\textsuperscript{118} A complementary element of proof that is also admissible is the information based on "government publications or reports of the buyer’s or seller’s country, or a statement issued by the tax administration of the same country, provided that Brazil has entered into an agreement with that country to avoid double taxation of income or to exchange information" and "research done by a company or institution well-known for its technical expertise or technical publications which specify the sector, period, companies researched and margins found, and identify data collected and reviewed per company".\textsuperscript{119}

212. In 2012, the profit margins of the PRL method were changed.\textsuperscript{120} The previous margins, which were 20\% for resale and 60\% in case of further manufacturing process in Brazil were replaced by new margins based on the economic sector and type of products (40\%, 30\% and 20\%, as indicated above). It has not been specified how these revised figures for the margins were reached, but some evidence seems to point to the conclusion that they potentially depart from the economic reality of many companies.\textsuperscript{121}

213. This approach that makes use of fixed margins has a number of other implications, notably the fact that it disregards important aspects of the standard comparability analysis and the economic circumstances of the commercial or financial transactions (as highlighted under the Chapter I analysis). Another implication is that it is only concerned with the profits of the Brazilian entity and ignores the actual amount of profits to be paid to the other related parties of the MNE group.

\textsuperscript{116} Article 20 of Law 9,430/1996.
\textsuperscript{117} Article 21, paragraph 2 of Law 9,430/1996.
\textsuperscript{118} The mechanism to challenge the fixed margins is provided in the Ordinance of Minister of Finance 222/08.
\textsuperscript{119} Article 21, I and II of Law 9,430/1996 and Article 43 of Normative Instruction 1,312/12.
\textsuperscript{120} The new margins were included in the transfer pricing legislation by Law 12,715/2012 (available at: www.planalto.gov.br/ccivil_03/_Ato2011-2014/2012/Lei/L12715.htm#art48).
\textsuperscript{121} See Annex A of this report for the summary of business comments.
Box 2.1. Brazilian methods with fixed margins

Strengths and weaknesses of fixed margins according to the UN Practical Manual on Transfer Pricing

The strengths and weaknesses of the Brazilian methods with fixed margins are discussed in the second edition of the United Nations Practical Manual on Transfer Pricing for Developing Countries (Section D.1. Brazil country practices). The highlighted strengths of predetermined profit margins pertain to the fact that they avoid the need for specific comparables; they free scarce human resources and can be applied without technical knowledge of specific transfer pricing issues; they stabilise expectations of taxpayers with respect to their Brazilian tax liability associated with inter-company transactions; they provide a low-cost system for companies and the tax administration by doing away with the need to empirically determine gross margins; they are practical; they do not distort competition among enterprises located where the methodology is applied; they allow for simple implementation by tax authorities when auditing taxpayers; and they provide simplicity of application for taxpayers.

The weaknesses of the approach are also discussed. They may lead to double taxation if there is no access to Competent Authorities to negotiate relief from double taxation; they require clear classifications and accounting conformity with respect to the allocation of expenses between COGS and operating expenses; and they make it unavoidable that some Brazilian enterprises will be taxed at (higher or lower) profit margins not compatible with their profitability because they apply regardless of the cost structures of taxpayers.

Note: The content of this box is drawn from the UN Manual. It does not reflect the concerns raised by business, some of which represent conflicting views as far as the strengths and weaknesses of the Brazilian methods with fixed margins are concerned.


2.5.3. Limited comparability

A further key difference is that the methods rely on a determination of average prices/costs of goods, rights or services, which for most methods – namely the broadly equivalent of the OECD-recognised CUP method for imports (PIC method) and of the cost plus method for imports (CPL method) and the broadly equivalent of the OECD-recognised CUP method for exports (PVEx method) and resale price methods for exports (PVA/PVV methods) – must follow a strict concept of “identical or similar”, with a focus on the features (i.e. they must have same nature and function, be interchangeable, and have equivalent specifications) of the goods, services or rights. It does not mean that all other comparability factors are ignored, but the extent of the resulting comparability analysis is extremely limited. For example, even though it is not explicitly stated in the transfer pricing law, elements used in the customs framework, such as the quality, commercial reputation may be considered for comparison purposes. Comparability adjustments are also foreseeable, but to a rather limited extent and mostly based on differences as regard to physical nature or content.

122 Article 15(2)(a) of the Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade (GATT) provides for these elements. Brazil is a member of the World Trade Organization (WTO) and therefore Brazilian law follows the GATT provisions, including the Agreement for Implementation of Article VII, which provides that customs calculation will be determined by the effective value of the transaction (ad valorem). Brazil adopted the GATT through Decree 1,355/1994. Moreover, Decree 6,759/09 (Customs Code) encompasses the Brazilian regulations that incorporates the GATT provisions in the domestic legislation.
215. The broadly equivalent of the OECD-recognised resale price method for imports (PRL method) and the broadly equivalent of the OECD-recognised cost plus method for exports (CAP method) do not incorporate the same element of comparability due to their modalities of application.123 These methods directly use the items involved in the transaction without the need to rely on the concept of “identical or similar”.

216. As the methods equivalent to the resale price and cost plus methods (i.e. PRL, PVA/PVV, CPL and CAP methods) are based on fixed profit margins – unlike the OECD-recognised traditional transaction methods that rely on a strong comparability element, and the application of which requires the availability of expansive information for the purpose of the determination of the gross profit margin and mark-up –, they do not require making such determinations based on pricing research and specific comparables.

217. In addition, the functional analysis required for the application of the OECD-recognised resale price and cost plus methods as part of the comparability analysis becomes largely irrelevant for the application of the Brazilian methods.

2.5.4. Application of methods for commodity transactions

218. The commodities subject to the mandatory application of the PCI (for imports) and PECEX (for exports) methods are listed in Normative Instruction 1,312/2012,124 which provides supplementary guidance in Annex I (list of commodities to which the method applies), Annex II (list of internationally recognised exchange markets), and Annex III (list of recognised research institutions). Products negotiated in exchange markets listed in Annex II are also within the scope of the application of these methods.125

219. For operations involving commodities subject to quotation on commodity and futures exchange markets, the “price under quotation on import” (PCI) and the “price under quotation on export” (PECEX) methods must be applied.126 A stricter tolerated deviation of 3% from the parameter price was established for commodity transactions,127 as opposed to the general tolerated deviation of 5%. The fact that the application of these methods is mandatory, combined with the non-application of the most appropriate method criterion, excludes the application in some cases of more suitable methods, particularly the PIC and PVEx methods when reliable comparables exist.

220. The OECD-recognised CUP method includes the possibility of using internationally quoted prices, provided appropriate comparability adjustments are made according to the functional analysis prescribed in the Guidelines. Even though the PCI and PECEX methods provide for the possibility to make

123 Hence why the terms “identical” and “similar” are not included in the provisions setting out these two methods. See Articles 12-14 (PRL method) and Article 33 (CAP method) of the Normative Instruction 1,312/2012.

124 The regulation has evolved through several Normative Instructions, starting with Normative Instruction 1,312/2012, which was amended by Normative Instructions 1,322/2013, 1,395/2013, 1,431/2014, 1,458/2014 and 1,498/2014. Normative instruction 1,395/2013 provided details regarding the concepts of commodities and premium. It included adjustments that may be made to the price of commodities, such as the term of payment and quantities negotiated. It also updated the list of products classified as commodities and the list of research institutes. NI 1,458/2014 then clarified the concept of premium and provided other possible adjustments to the price of commodities, such as packing, freight and insurance, costs of taxes on disembarkation at the port of destination. Finally, NI 1,498/2014 added more products to the list of commodities.

125 For access to the annexes attached to Normative Instruction 1,312/12, see: http://normas.receita.fazenda.gov.br/sijut2consulta/link.action?visao=anotado&idAto=39257.

126 Article 18, paragraph 16 (PCI method) and Article 19-A, paragraph 1 (PECEX method) of Law 9,430/1996, (included by Law nº 12,715/12).

127 Article 51, paragraph 2, of Normative Instruction 1,312/12.
adjustments, such adjustments are limited to those specified by the legislation and make no consideration of the functional analysis according to the OECD Guidelines. Indeed, the adjustments provided by the legislation for the PCI and PECEX methods include premiums and discounts related to the differences between the amount received by the seller and the variables that are considered in the specific commodities and futures exchange market.\(^{128}\) The variables which may be considered in the adjustments are: payment term; negotiated quantity; climatic influences on the characteristics of the goods; intermediation costs in purchase and sale transactions performed by non-related legal entities; packaging; and insurance and freight.\(^{129}\)

221. These permitted adjustments do not fully correspond to the adjustments contemplated by the OECD-recognised CUP method, which allows any reasonably accurate adjustments to eliminate the material effects of the differences between the transactions being compared or between the enterprises undertaking those transactions. This gap in the scope of the adjustments have been raised as a concern by business.\(^{130}\) In fact, although taking into account some relevant aspects, the permitted adjustments would not allow to reflect all the relevant characteristics, such as contractual terms, functional and risk profiles of the parties to the transaction and other relevant economic circumstances.

222. Hence, it may be concluded that, although broadly in line with the OECD-recognised CUP method, the PCI and PECEX methods are less flexible than provided in the OECD Guidelines because the permitted adjustments may not fully capture all relevant economic circumstances.

2.6. Assessment of effectiveness

223. The five OECD-recognised methods represent the international consensus on the manner of applying the arm’s length principle. It is therefore desirable that countries make available all five methods in their domestic rules and apply them in accordance with the OECD Guidelines.

224. From the perspective of tax administration and compliance, the available transfer pricing methods in Brazil present several advantages: they are less reliant on a comparability analysis; they avoid issues related to information asymmetry and their application potentially reduces compliance costs for taxpayers and administration costs for the tax authorities; they also lead to more predictable outcomes and thus lead to more tax certainty, at least from the domestic perspective; and, finally, they minimise the risks of conflict and litigation between taxpayers and the tax authorities.

225. The classification of the methods does not lend itself to an assessment of effectiveness based on the five criteria. Rather, the implications of this classification, such as the different fixed margins that apply accordingly, are subject to the assessment. The limited comparability aspects of the methods are assessed in the context of the fixed margins, and under the analysis in relation to Chapter III of the OECD Guidelines (comparability analysis).

Use of fixed margins

226. The use of fixed margins presents a number of advantages in terms of simplicity and practicality. However, it represents a trade-off between simplicity and accuracy when establishing transfer prices between related parties. For example, many companies indicate that the profit margins applied in the “resale minus profit” (PRL) method of 40%, 30% and 20% do not always reflect the commercial reality. As another example, the minimum profitability required for certain transfer pricing methods – e.g., fixed margin

\(^{128}\) Article 16, paragraphs 8 and 9, and Article 34, paragraphs 9 and 10, of Normative Instruction 1,312/2012.

\(^{129}\) Article 16, paragraphs 8 and 9, and Article 34, paragraphs 9 and 10, of Normative Instruction 1,312/2012

\(^{130}\) For details, see Annex A of this report.
of 15% for the costs of the service or sale – ignores the economic trends for the profitability of cross-border transactions, meaning that exporters could experience reduced profitability but continue paying the same amount of taxes regardless of the economic environment. This leads to some concerns with respect to the dual objective of securing the appropriate tax base and avoiding double taxation.

Findings of the assessment

Prevention of BEPS risks
In principle, the use of fixed margins seems to protect Brazil from certain BEPS practices by ensuring that a minimum amount of tax revenue is being collected, but it could also prevent Brazil from allocating revenue in excess of the fixed margins in some cases.

Prevention of double taxation
The use of fixed margins, which dismiss the need for a complete comparability analysis, and which are established in an opaque manner that is not always aligned with industry standards, may give rise to double taxation.

The input provided by business reflects the suggested concerns over double taxation occurrences because margins may, in some cases, be lower or higher than they would be if determined in accordance with the OECD approach. This approach may also result in taxation that is not in accordance with the profitability of the company.

Ease of tax administration
The use of fixed margins means that there is no longer a need to systematically perform a complex comparability analysis, resulting in administrative relief. In other words, it is easier to apply the transfer pricing methods or verify their appropriate application for the tax administration.

Ease of tax compliance
Similarly, the application of methods incorporating fixed margins also simplifies tax compliance for taxpayers. It is less time consuming and less resource-intensive than the comprehensive transfer pricing analysis described in the OECD Guidelines.

Tax certainty
From a domestic perspective, the use of fixed margins seems to provide certainty to taxpayers by generating objectively reliable expectations and the guarantying that the margins will not be challenged by the tax administration.

From an international perspective, however, the impact of fixed margins, which is an approach that differs from the interpretation of international tax standards in a majority of jurisdictions, may increase tax uncertainty.
TRANSACTIONAL PROFIT METHODS

227. Part III of Chapter II provides a discussion of the transactional profit methods, namely the transactional net margin method (TNMM) and the profit split method.\(^{131}\)

228. The OECD Guidelines indicate that under certain circumstances, transactional profit methods will be found to be more appropriate than traditional transaction methods. For instance, in cases where parties make unique and valuable contributions in relation to the controlled transactions, or where parties engage in highly integrated activities, a transactional profit method is generally more suitable. As another example, the transactional net margin method presents several practical strengths, including the fact that it is less affected by transactional differences (than is the case with price) as it is based on net profit indicators, and the fact that it only requires to examine a financial indicator for one of the associated parties.

2.7. OECD-recognised transactional profit methods

229. A transactional profit method examines the profits that arise from particular controlled transactions. Profit arising from a controlled transaction can be a relevant indicator of whether the transaction was affected by conditions that differ from those that would have been made by independent enterprises in otherwise comparable circumstances.

2.7.1. Transactional net margin method

230. The transactional net margin method examines the net profit relative to an appropriate base (e.g., costs, sales, assets) that a taxpayer realises from a controlled transaction (or transactions that are appropriate to aggregate).

231. Thus, a transactional net margin method operates in a manner similar to the cost plus and resale price methods. This similarity means that, in order to be applied reliably, the transactional net margin method must be applied in a manner consistent with the manner in which the resale price or cost plus method is applied.\(^ {132}\) This means in particular that the net profit indicator of the taxpayer from the controlled transaction (or transactions that are appropriate to aggregate) should ideally be established by reference to the net profit indicator that the same taxpayer earns in comparable uncontrolled transactions, i.e. by reference to “internal comparables”. Where this is not possible, the net margin that would have been earned in comparable transactions by an independent enterprise (“external comparables”) may serve as a guide. A functional analysis of the controlled and uncontrolled transactions is required to determine whether the transactions are comparable and what adjustments may be necessary to obtain reliable results.

2.7.2. Profit split method

232. The transactional profit split method seeks to establish arm’s length outcomes or test reported outcomes for controlled transactions in order to approximate the results that would have been achieved between independent enterprises engaging in a comparable transaction or transactions. The method first identifies the profits to be split from the controlled transactions (the relevant profits) and then splits them

\(^{131}\) The revised guidance, while not being prescriptive, clarifies and significantly expands the guidance on when a profit split method may be the most appropriate method. OECD (2018), Revised Guidance on the Application of the Transactional Profit Split Method, www.oecd.org/tax/transfer-pricing/revised-guidance-on-the-application-of-the-transactional-profit-split-method-beps-action-10.pdf.

\(^{132}\) See paragraph 2.64 of the OECD Guidelines.
between the associated enterprises on an economically valid basis that approximates the division of profits that would have been agreed at arm’s length.

233. As is the case with all transfer pricing methods, the aim is to ensure that profits of the associated enterprises are aligned with the value of their contributions and the compensation which would have been agreed in comparable transactions between independent enterprises for those contributions.

234. The transactional profit split method is particularly useful when the compensation to the associated enterprises can be more reliably valued by reference to the relative shares of their contributions to the profits arising in relation to the transaction(s) than by a more direct estimation of the value of those contributions.

2.8. Description of the existing rules and practices in Brazil and gap analysis

235. The transfer pricing system in Brazil does not allow the use of transactional profit methods, neither the transactional net margin method (TNMM) nor the profit split method.

2.9. Assessment of effectiveness

236. The absence of transactional profit methods may lead to difficulties for the determination of an arm’s-length price, particularly in cases where a transactional profit method would be more suitable than a traditional transaction method, such as cases where parties make unique and valuable contributions in relation to the controlled transactions, or cases where parties engage in highly integrated activities.

237. In general, the unavailability of transactional profit methods makes it difficult for global taxpayers to ensure consistency of their tax base across jurisdictions. The available transfer pricing methods in Brazil do not allow for the proper allocation of functions, assets and risks on a global basis.

238. Against this background, many companies identified important challenges related to the absence of the profit split and transactional net margin methods among the available transfer pricing methods, some going as far as indicating that it was easier to avoid cross-border transactions with related parties in Brazil.

2.9.1. Absence of transactional net margin method

239. The absence of the transactional net margin method is assessed as regards its effectiveness below. The TNMM presents a number of strengths, provided it is selected as the most appropriate method to the case at hand, especially for the determination of net profit indicators (e.g., return on assets, operating profit to sales, etc.) which are less affected by transactional differences than price, more tolerant to some functional differences between controlled and uncontrolled transactions, and which avoid problems in cases where public data as regards the classification of expenses in the gross or operating profits is difficult to access. However, these strengths are only relevant in combination with other aspects of the comparability analysis as developed by the OECD Guidelines.
## Findings of the assessment

### Prevention of BEPS risks

The TNMM allows the perspective of comparing the net profit margin results of the taxpayer based on its functional/risk profile with other comparable taxpayers. It may thus help to prevent BEPS in cases where the taxpayers may book gross profit, but erode the tax base through different types of operational expenses. The TNMM may be especially relevant in cases of low-risk profile entities, which are expected to make a stable but small net profit margin – especially due to their low risk profile. The absence of TNMM may limit the ability of the tax administration to address some of these BEPS risks.

### Prevention of double taxation

Double taxation may occur in relation to the unavailability of the TNMM, but rather indirectly as a result of the application of less appropriate methods if compared to the other internationally accepted and OECD-recognised methods, notably as a consequence of the use of fixed margins.

Further, the unavailability of the TNMM makes it more likely that transfer pricing adjustments under existing methods will lead to double taxation because the aggregation of closely related transactions is not permitted.

### Ease of tax administration

Like other methods, the TNMM has its strengths and weaknesses. It could simplify the pricing of transactions from a tax administration perspective in some cases where it is more appropriate but also efficient to analyse transactions on an aggregated basis, but it would also require further analysis, including performing a complete comparability (including functional) analysis.

### Ease of tax compliance

The TNMM is practically advantageous in some cases, notably when one of the parties to the transaction carries out many interrelated transactions, which can be grouped together or when it is difficult to obtain reliable information to apply other methods. Some cases where the TNMM is best applied are (contract) manufacturers, service providers that do not add significant unique intangibles, distributors that do not add significant value to the product, or manufacturers (if reliable comparables as regards cost are unavailable). However, unlike the existing methods in Brazil, it requires a complete comparability analysis.

### Tax certainty

The absence of the TNMM may not lead to increased tax uncertainty from the domestic perspective, especially when the taxpayers know that this method is not part of the applicable standard. The effect of gross profit methods may not always properly reflect the net economic outcomes of commercial operations, and that due to the use of fixed margins they may lead to double taxation. Therefore, there may be cases where taxpayers are being taxed with a fixed margin on a gross basis while they may be realistically making very little or no profit (e.g., due to the actual economic circumstances). This may not be known to the taxpayer in advance of the fiscal year and the tax uncertainty may originate from the fact that the taxpayer may not foresee the final economic results and thus also the fact whether there
will be an obligation to pay the income tax due when there is no profit or even net loss results from the commercial operations.

The absence of this internationally accepted method is a source of difficulty and potential uncertainty for taxpayers in establishing their global transfer pricing policy. For this reason, the absence of the TNMM creates uncertainty from an international perspective.

### 2.9.2. Absence of profit split method

240. Transactional profit splits can offer a useful method which has the potential, when properly applied,\(^ {133} \) to align profits with value creation in accordance with the arm’s length principle and the most appropriate method, particularly in situations where the features of the transaction make the application of other transfer pricing methodologies problematic.

241. The profit split method presents a number of strengths:

- The profit split method can offer a solution for cases where using a one-sided method is unlikely to be appropriate, including where as a result of the nature of the transaction, reliable comparables are unlikely to be found;
- It can offer flexibility by taking into account specific, possibly unique, facts and circumstances;
- Where each of the parties assumes economically significant risks, the profit split method can appropriately provide for the profits of each party to vary in accordance with those risks;
- It makes it possible for all parties to the transaction to be directly analysed and evaluated – provides for so-called two-sided analysis;
- The use of the profit split method should be consistent and there may be years when there are profits to be split, but there are also situations where MNE groups make losses in the relevant transactions and therefore, this method may also entail allocation of losses between MNEs.

### Findings of the assessment

#### Prevention of BEPS risks

The profit split method is the most appropriate method when enterprises make unique and valuable contributions and/or jointly control economically significant risks. In such cases, the profit (but also loss) potential of the enterprises can be significantly higher than in situations involving simple and routine activities. In such cases, the absence of the profit split method may jeopardise the proper allocation of income and limit the ability of the tax administration to allocate the appropriate tax base to the taxpayers in Brazil, thereby increasing the probability of BEPS risks.

#### Prevention of double taxation

The unavailability of the profit split method does not seem to create double taxation situations directly, but it leads to awkward results, such as where the outcomes of the application of the profit split method in other jurisdictions would not be accepted under the Brazilian transfer pricing system.

\(^ {133} \)The profit split method is best applied to highly integrated transactions (e.g., global trading of financial instruments), transactions where each party makes unique and valuable contributions (e.g., use or transfer of intangibles), and transactions in which the parties share economically significant risks, or separately assume closely related risks.
This essentially means that a different method will need to be applied at the level of the Brazilian entity. The application of less appropriate methods may lead to incorrect results, or at least to significant divergences if compared to the outcomes under the OECD standard. In this context, cases of double taxation are likely to arise. In cases where the profit split method would entail the split of losses (materialisation of economically significant risks), the absence of the profit split method clearly leads to double taxation, because under existing methods and applicable fixed margins, the taxpayers will still have to pay tax in situations where they actually incur losses.

**Ease of tax administration**

Because the profit split method is not available in Brazil, the complexities associated with the application of the profit split method do not aggravate the tax administration’s burden, but taken the fact the profit split method aims at dividing and allocating the relevant profits between the related parties despite potential significant volumes of transactions, which may be otherwise investigated item-per-item, the absence of profit split method could be in some cases a missed opportunity for pragmatic and simplified approaches.

**Ease of tax compliance**

Similarly, the burden is alleviated for taxpayers in theory because of the complexities of the profit split method. However, complexity could persist if other traditional transaction methods are used in cases where the profit split method would have been more appropriate, thus creating a different set of difficulties, especially for foreign-headquartered MNEs. In consequence, the compliance burden may be significantly increased because taxpayers will be forced to apply a traditional transaction method available in Brazil or to calculate the appropriate adjustment according to it.

**Tax certainty**

From a domestic perspective, the absence of the profit split method may not create additional tax uncertainty.

From an international perspective, the outcomes of the application of the profit split method in other jurisdictions are not transferrable in the Brazilian transfer pricing context. Other methods available in Brazil have to be used irrespective of the method applied by the foreign related party. This creates a significant uncertainty from the international perspective.
The third chapter contains the analysis of Brazil’s relevant transfer pricing rules as compared with Chapter III of the OECD Guidelines, which contains the guidance on the comparability analysis. The “comparability analysis” is at the heart of the application of the arm’s length principle. A complete comparability analysis, including functional and risk analyses, should be conducted in accordance to the principles of Chapters I - III of the OECD Guidelines, with Chapter III containing more detailed guidance on performing such comparability analysis. The findings of the analysis are that under Brazil’s transfer pricing framework, there is no complete comparability analysis and the typical process of performing a comparability analysis is not followed. The use of comparables is also more constrained, combined with other diverging features, such as the item-per-item approach and the limited ability to perform comparability adjustments. The assessment of effectiveness focusses on the absence of a complete comparability analysis and the strict use of comparables. It also includes an assessment of the item-per-item approach and the limited comparability adjustments allowed by the various methods.
3.1. Performing a comparability analysis

242. Any comparability analysis implies comparing a controlled transaction under review and the uncontrolled transactions that are considered to be potentially comparable. As part of a comparability analysis, the OECD Guidelines indicate that a search for comparables, i.e. a search for information on potentially comparable uncontrolled transactions and the process of identifying comparables, relies on a prior analysis of the taxpayer’s controlled transaction and of the economically relevant characteristics or comparability factors.

243. The Guidelines stress the importance of maintaining some continuity during the analytical process through a consistent and methodical approach, starting from the preliminary analysis of the conditions of the controlled transaction, to the selection of the transfer pricing method, through to the identification of potential comparables and ultimately a conclusion about whether the controlled transactions under review are consistent with the arm’s length principle. In performing the comparability analysis, only the most reliable comparables should be considered, and uncontrolled transactions with a lesser degree of comparability should be eliminated as a result, while also taking account of potential limitations in availability of information. In this regard, the Guidelines do not provide a requirement for an exhaustive search of all possible sources of comparables.

244. Further, it is emphasised in the Guidelines that it is good practice for both taxpayers and tax administrations to provide appropriate supporting information for the other interested party, i.e. tax auditors, taxpayers or foreign competent authorities, when using comparables.134

3.1.1. Typical process

245. The Guidelines describe a “typical process” in nine steps that can be followed when performing a comparability analysis.

Table 3.1. Performing a comparability analysis

Typical nine-step process of performing a comparability analysis

<table>
<thead>
<tr>
<th>Steps</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Step 1</td>
<td>Determination of years to be covered.</td>
</tr>
<tr>
<td>Step 2</td>
<td>Broad-based analysis of the taxpayer’s circumstances.</td>
</tr>
<tr>
<td>Step 3</td>
<td>Understanding the controlled transaction(s) under examination, based in particular on a functional analysis, in order to choose the tested party (where needed), the most appropriate transfer pricing method to the circumstances of the case, the financial indicator that will be tested (in the case of a transactional profit method), and to identify the significant comparability factors that should be taken into account.</td>
</tr>
<tr>
<td>Step 4</td>
<td>Review of existing internal comparables, if any.</td>
</tr>
<tr>
<td>Step 5</td>
<td>Determination of available sources of information on external comparables where such external comparables are needed taking into account their relative reliability.</td>
</tr>
<tr>
<td>Step 6</td>
<td>Selection of the most appropriate transfer pricing method and, depending on the method, determination of the relevant financial indicator.</td>
</tr>
<tr>
<td>Step 7</td>
<td>Identification of potential comparables: determining the key characteristics to be met by any uncontrolled transaction in order to be regarded as potentially comparable, based on the relevant factors identified in Step 3 and in accordance with the comparability factors set forth at Section D.1 of Chapter I.</td>
</tr>
<tr>
<td>Step 8</td>
<td>Determination of and making comparability adjustments where appropriate.</td>
</tr>
<tr>
<td>Step 9</td>
<td>Interpretation and use of data collected, determination of the arm’s length remuneration.</td>
</tr>
</tbody>
</table>

Note: This process is considered an accepted good practice but it is not a compulsory one, and any other search process leading to the identification of reliable comparables may be acceptable as reliability of the outcome is more important than process.

134 See paragraph 3.3 of the OECD Guidelines.
While this process is considered accepted good practice, other search processes may also be followed as long as they lead to the identification of reliable comparables. It should also be noted that the process, in practice, is not a linear one and some steps may need to be repeated or carried out in a different order.

### 3.1.2. Comparables

The Guidelines provide for the use of either a comparable transaction between one party to the controlled transaction and an independent party (“internal comparable”) or between two independent enterprises, neither of which is a party to the controlled transaction (“external comparable”).

Various sources of information can be used to identify potential external comparables, including commercial databases developed by editors who compile accounts filed by companies with the relevant administrative bodies and present them in an electronic format suitable for searches and statistical analysis. These databases present a number of limitations, which are addressed in the Guidelines.

The Guidelines also provide that non-domestic or foreign source comparables should not be automatically rejected just because they are not domestic. A determination of whether foreign source comparables are reliable has to be made on a case-by-case basis and by reference to the extent to which they satisfy the five comparability factors.

Finally, in the event that tax administrators have access to information from examinations of other taxpayers or from other sources that may not be disclosed to the taxpayer, the Guidelines consider that it would be unfair to apply a transfer pricing method on the basis of such information, unless it is disclosed.

### 3.1.3. Separate and combined transactions

In the context of the review of the controlled transaction and the choice of the tested party, the Guidelines provide for the evaluation of a taxpayer's separate and combined transactions. If ideally it is preferable to apply the arm's length principle on a transaction-by-transaction basis, it may often be the case that separate transactions will be closely linked or continuous, making it difficult to evaluate them separately (e.g. long-term contracts for the supply of commodities or services). When it would be impractical to determine pricing for each product or transaction, the Guidelines consider that such transactions should be evaluated together using the most appropriate arm’s length method. The Guidelines also address portfolio approaches, which is another example where a taxpayer’s transactions may be combined, but also package deals (i.e. transactions arranged together in a single comprehensive package) involving transactions that may need to be separated.

### 3.1.4. Intentional set-offs

An intentional set-off is a benefit provided by one associated enterprise to another associated enterprise within the group that is deliberately balanced to some degree by different benefits received from that enterprise in return.

Companies often offer a range of products and within this range, not all products are profitable, but it might still be necessary to keep them in stock to meet the customers' needs. The ability to consider all relevant transactions in the determination of the profits, which might ultimately be arm’s length overall, is thus provided by allowing some of the higher prices to be cancelled out by the fact that other prices were lower than market price.
3.1.5. Application of the arm's length principle through arm’s length range and statistical tools

254. In many occasions, the application of the most appropriate method produces a range of figures all of which are relatively equally reliable. The Guidelines thus provide guidance on selecting the most appropriate point in the range, taking into consideration extreme results and associated comparability considerations.

3.1.6. Comparability adjustments

255. According to the Guidelines, to be comparable means that none of the differences (if any) between the situations being compared could materially affect the condition being examined in the methodology or that reasonably accurate adjustments can be made to eliminate the effect of any such differences.

256. Comparability adjustments should be considered if (and only if) they are expected to increase the reliability of the results. The Guidelines allow for different types of comparability adjustments, such as adjustments for accounting consistency designed to eliminate differences that may arise from differing accounting practices between the controlled and uncontrolled transactions; segmentation of financial data to eliminate significant non-comparable transactions; adjustments for differences in capital, functions, assets, risks.

3.2. Description of the existing rules and practices in Brazil and gap analysis

257. The standard of comparability in Brazil is reduced to the features of the goods, rights or services being compared. The process of performing a comparability analysis thus begins with a calculation of the average sales price of comparable goods, rights or services or of the costs incurred. Most of the methods require strict comparability in terms of the physical characteristics (but also the function) of the goods, rights or services. Because of the fixed margins, other aspects of the comparability analysis become irrelevant, meaning that a complete comparability analysis as contained in the OECD Guidelines is absent from Brazil’s transfer pricing system.

3.2.1. Absence of complete comparability analysis

258. As a general rule, the comparison is made between the transactional prices (i.e. the prices effectively used by the taxpayer) and the parameter prices (i.e. the prices determined by the application of one or the other of the available transfer pricing methods) in Brazil.

259. However, the typical process spelt out in the Guidelines is not relevant under the Brazilian transfer pricing rules and the concept of comparability as contained in the Guidelines is generally not reflected. Instead, the concept of comparability is narrowed down to a specific scope that disregards many aspects of the guidance provided by the Guidelines, thereby establishing a more limited standard of comparability for a majority of the methods available. The concept of “identical” and “similar” is not relevant for the application the Brazilian versions of the resale price method for imports (PRL method) and the cost plus method for exports (CAP method). See paragraph 234.
260. The “broad-based analysis” (i.e. an analysis of the industry, competition, economic and regulatory factors and other elements that affect the taxpayer and its environment) in Step 2 of the typical process in the Guidelines is also not part of the comparability analysis under the Brazilian transfer pricing rules. For the review of the controlled transaction and the choice of the tested party, only separate transactions are considered (on a transaction-by-transaction or item-per-item basis). While under the Guidelines the choice of the tested party should be consistent with the functional analysis of the transaction (often leading to choosing the party that has the less complex functional analysis), the choice of the tested party in Brazil will be inferred from the method and its needs in terms of documentation. Most of the information on the comparability factors in relation to the controlled transaction (in particular on the functions, assets and risks of all the parties) that would be required under the OECD system is not necessary for the selection and application of the methods under the Brazilian system, and gathering information about foreign associated enterprises may present a taxpayer with difficulties that it does not encounter in producing its own information. Absent the requirement to select the most appropriate method, the only information needed is the information to support the application (and not the selection) of a given method. Brazilian data is more readily accessible and verifiable than foreign data that is more likely to be incomplete or unavailable. Only traditional transaction methods, which require the use of fixed margins and comparable uncontrolled prices, are available so there is also no reason to consider financial indicators that will be tested. Taken together, these aspects of the transfer pricing system in Brazil significantly simplify the process of performing a comparability analysis. This simplification, however, seems to come at the price of potential double taxation and also loss of tax revenue, as will be analysed further below.

3.2.2. Strict use of comparables

261. Brazilian transfer pricing rules generally provide that comparisons be made with “similar” and “identical” goods, rights, or services. As previously stated, the use of comparables is mainly required for the calculation of average prices under the PIC and PVEx methods (the Brazilian versions of the CUP method). These average prices must be calculated considering the transactions between the taxpayer and an unrelated party or between two unrelated parties. As a complementary element of proof, the taxpayer can support its calculation with “government publications or reports of the buyer’s or seller’s country, or a statement issued by the tax administration of the same country, provided that Brazil has entered into an agreement with that country to avoid double taxation of income or to exchange information” and “research done by a company or institution well-known for its technical expertise or technical publications which specify the sector, period, companies researched and margins found, and identify data collected and reviewed per company”. In this context, it should also be noted that the acceptance of internal/external and local/foreign comparables depends on the method being applied.

262. For other methods that are equivalent to the OECD-recognised cost plus and resale price methods (i.e. the PRL, PVA/PVV, CPL and CAP methods), taxpayers are also required to calculate average prices or costs, which form a basis for the application of these methods; however, no other comparable is needed due to the application of the relevant fixed margins.  

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136 This is not relevant for the Brazilian versions of the resale price method for imports (PRL method) and the cost plus method for exports (CAP method).

137 Article 21, items I and II of Law 9,430/1996 and Article 43 of Normative Instruction 1,312/12.

138 With the exception that the legislation does not include the terms “identical” and “similar” for the Brazilian versions of the resale price method for imports (PRL method) and the cost plus method for exports (CAP method), for which the concepts of “identical” or “similar” items are not relevant, as they require using the items involved in the transaction.

139 Although it should be noted that comparable margins based on the same requirement for submitting complementary elements of proof in the form of supporting documentation would have to be submitted in the context of the mechanism to challenge the fixed margins under Article 21, paragraph 2. See analysis in Chapter IV.
Scope of comparability

263. “Identical” means that the item must be exactly the same, including characteristics like its physical aspects its quality, and commercial reputation. This definition was established for custom purposes, but is still used for transfer pricing purposes because the rules of interpretation prescribe the use of predetermined definitions when no other express rule provides a more specific definition.\(^\text{140}\)

264. The concept of “similarity” is defined by three cumulative criteria, namely that they a) be of the same nature and used for the same function; b) be interchangeable; and c) possess equivalent specifications.\(^\text{141}\) The concept of “similar” has also been illuminated through administrative case law, and it was stated that similarity could be assessed in consideration of the nature, function, interchangeability and equivalent specifications.\(^\text{142}\)

265. Therefore, the concept of comparability under the Brazilian system is limited to items that present a very high degree of comparability because the terms “identical” and “similar” are interpreted in a strict sense while they strongly focus only on the properties of the goods, services or rights and disregard most other comparability factors described in the Guidelines. This may be especially problematic, for example, when the functional profile of the tested party is being ignored, leading to significant discrepancies in the price-setting, which cannot be reflected in the subsequent application of the method.

Internal/external and local/foreign comparables

266. The transfer pricing provisions involve considerations in relation to the acceptance of comparables on the basis of whether they are internal or external comparables or local or foreign comparables for the calculation of the average of prices or costs. Accepted comparables are subject to vary depending on the method, as will be explained below.

267. In terms of timing issues in comparability, the general rule is that comparable transactions must be contemporaneous to the transactions under examination.\(^\text{143}\) If there is no independent price in the calendar year corresponding to the importation, an independent price related to transactions performed in the previous calendar year may be used, adjusted by the exchange variation in the period.\(^\text{144}\)

Methods designed for import transactions

268. As regard to the comparable uncontrolled price method for imports (PIC), the prices of purchases and sales performed by the interested party itself or by third parties are accepted comparables (i.e. both internal and external comparables),\(^\text{145}\) for purchases and sales between unrelated buyers and sellers.\(^\text{146}\) The transactions selected for comparison purposes must also represent at least 5% of the value of import

\(^\text{140}\) Article 15(2)(a) of the agreement on implementation of Article VII of the GATT provides for the definition of “identical” as being the goods that “are equal in everything, including physical characteristics, quality and commercial reputation. Minor differences in appearance will not preclude the consideration of identical goods that fit the definition”.

\(^\text{141}\) Article 42, items I, II and III, of Normative Instruction 1,312/12.

\(^\text{142}\) See for example, Decision nº 16-4377 (24.11.2003), DRJ/SPOI, Delegacia da Receita Federal de Julgamento em São Paulo; Decision nº 10-2510 (30.05.2003), DRJ/POA, Delegacia da Receita Federal de Julgamento em Porto Alegre.

\(^\text{143}\) Article 11 and Article 43, paragraph 1, of Normative Instruction 1,312/12.

\(^\text{144}\) Article 18, paragraph 11, of Law 9,430/96.

\(^\text{145}\) Article 18, item I, of Law 9,430/96, defining the comparable uncontrolled price method for import transactions.

\(^\text{146}\) Article 18, paragraph 2, of Law 9,430/96.
transactions subject to transfer pricing control when the taxpayer is using its own transactions for calculation purposes (i.e. internal comparables) and correspond to independent prices applied in the same calendar year.\textsuperscript{147} This seems to put an additional threshold on the comparability of the data used for the PIC method and seems to serve an anti-avoidance purpose by limiting the possibility for taxpayers to “create” their own comparables through sporadic transactions with independent parties.\textsuperscript{148} Comparable prices include those charged on the Brazilian market or on the markets of other countries, meaning that both local and foreign comparables are accepted.

269. As regard to the production cost plus profit method (CPL), only costs from the supplier itself or from manufacturing units of other companies located in the country of origin of the goods, rights or services are accepted (i.e. both internal and external comparables).\textsuperscript{149}

270. The requirement to use identical and similar goods, rights or services is not relevant for the resale price less profit method (PRL), which directly uses the items involved in the transaction.

Table 3.2. Accepted comparables depending on the transfer pricing method for imports

<table>
<thead>
<tr>
<th>Methods designed for import transactions</th>
<th>Accepted comparables</th>
</tr>
</thead>
<tbody>
<tr>
<td>Comparable independent price (PIC)</td>
<td>Internal (if at least 5% of value of total import transactions and if in the same calendar year), or External comparables (if in the same calendar year), or Local or foreign comparables</td>
</tr>
<tr>
<td>Production cost plus profit (CPL)</td>
<td>Internal or external comparables</td>
</tr>
<tr>
<td>Resale price less profit method (PRL)</td>
<td>Foreign comparables</td>
</tr>
</tbody>
</table>

Note: For both internal and external comparables, if there is no independent price in the calendar year corresponding to the importation, an independent price related to transactions performed in the previous calendar year may be used, adjusted by the exchange variation in the period.

**Methods designed for export transactions**

271. As regard to the comparable uncontrolled price method for exports (PVEx), the sales prices on exports by the company itself to other unrelated-party customers or by another domestic exporter of identical or similar goods, rights or services to unrelated parties are accepted comparables,\textsuperscript{150} for purchases and sales with related buyers and sellers.\textsuperscript{151} In other words, only local internal or external comparables are accepted.

272. As regard to the wholesale price in the country of destination less profit method (PVA) and the retail price in the country of destination less profit method (PVV), only foreign internal or external comparables are accepted.\textsuperscript{152}

\textsuperscript{147} Article 18, paragraph 10, of Law 9,430/96. Paragraph 11 specifies that if there is no independent price in the calendar year corresponding to the importation, an independent price related to transactions performed in the previous calendar year may be used, adjusted by the exchange variation.

\textsuperscript{148} It should be noted that a similar threshold does not exist for the methods applicable to export transactions.

\textsuperscript{149} Article 15, paragraph 4, of Normative Instruction 1,312/12.

\textsuperscript{150} Article 19, paragraph 3, item I, of Law 9,430/96.

\textsuperscript{151} Article 19, paragraph 8, of Law 9,430/96.

\textsuperscript{152} Article 19, paragraph 3, items II and III, of Law 9,430/96.
273. The requirement to use identical and similar goods, rights or services is not relevant for the acquisition or production cost plus profit method (CAP), which directly uses the items involved in the transaction.

Table 3.3. Accepted comparables depending on the transfer pricing method for exports

<table>
<thead>
<tr>
<th>Methods designed for import transactions</th>
<th>Accepted comparables</th>
</tr>
</thead>
<tbody>
<tr>
<td>Export sales price (PVEx)</td>
<td>Internal or external comparables</td>
</tr>
<tr>
<td></td>
<td>Only local comparables</td>
</tr>
<tr>
<td>Wholesale price in the country of destination less profit (PVA)</td>
<td>Internal or external comparables</td>
</tr>
<tr>
<td></td>
<td>Only foreign comparables</td>
</tr>
<tr>
<td>Retail price in the country of destination less profit (PVV)</td>
<td>Internal or external comparables</td>
</tr>
<tr>
<td></td>
<td>Only foreign comparables</td>
</tr>
<tr>
<td>Acquisition or production cost plus profit method (CAP)</td>
<td>N/A</td>
</tr>
</tbody>
</table>

274. In conclusion, it is apparent that the transfer pricing methods in Brazil operate distinctions in terms of the acceptance of internal or external comparables and the acceptance of local or foreign comparables.

Sources of information and information undisclosed to taxpayers

275. The documentation required to support the prices and costs used for calculation purposes depends on the method elected by the taxpayer. Usually, these prices and costs are supported by transactions performed by the taxpayer and an unrelated company or between two unrelated parties (sales report, purchasing report, invoices, etc.). As a complementary element of proof, the taxpayer can support its calculation with “government publications or reports of the buyer’s or seller’s country, or a statement issued by the tax administration of the same country, provided that Brazil has entered into an agreement with that country to avoid double taxation of income or to exchange information” and “research done by a company or institution well-known for its technical expertise or technical publications which specify the sector, period, companies researched and margins found, and identify data collected and reviewed per company”.

276. For the methods related to import (PIC, PRL and CPL methods) and export (PVEx, PVV/PVA and CAP methods) transactions, the general rule establishes that the weighted arithmetic averages of prices and the weighted average production cost shall be calculated taking into account prices charged and costs incurred throughout the income tax period to which costs, expenses or charges refer.

277. Moreover, as a general rule, the parameter price calculation should be made in the calendar year in which the good, service or right is imported, except when the method chosen is the PRL method. Where the PRL method is used, the parameter price should be calculated considering sales prices in the period in which the products are written off from the inventories.

278. Additionally, with respect to the PIC method, the transactions used for the purpose of calculation should correspond to independent prices utilised in the same calendar year of the respective import transactions subject to transfer pricing control. In such a case, if there is no independent price in the calendar year corresponding to the importation, an independent price related to transactions performed in the previous calendar year may be used, adjusted by the exchange variation in the period.

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153 Article 21, items I and II, of Law 9,430/1996 and Article 43 of Normative Instruction 1,312/12.
154 Article 4, paragraph 3, of Normative Instruction 1,312/2012.
155 Article 18, paragraph 10, item II, of Law 9,430/1996.
156 Article 18, paragraph 11, of Law 9,430/1996.
279. Accordingly, as stated above, there are limits on the time of the data that taxpayers can use in order to support the prices and costs used in their calculation.

280. Concerning the methods for commodity transactions, public prices on internationally recognised exchange or securities markets should be used, but in the case where there is no quotation of the goods on internationally recognised exchange markets, the prices can be compared to those found in databases provided by internationally recognised research institutions.\textsuperscript{157}

281. The Brazilian transfer pricing rules do not provide any guidance on the use of information undisclosed to taxpayers (or so-called “secret comparables”). In practice, the Brazilian tax authorities use their own databases for risk assessment purposes,\textsuperscript{158} which are not accessible to taxpayers. For tax audit purposes, the tax administration is only allowed to use comparables from these databases if the independent parties whose data is used agree to disclose this data to the assessed taxpayer. In this respect, the practice appears to be in line with the Guidelines in terms of the use of information undisclosed to taxpayers.

### 3.2.3. Strict application of the item-per-item approach

282. Brazilian transfer pricing rules provide that the selected transfer pricing method must be consistently applied to each good, right or service during the calendar year.\textsuperscript{159} Methods apply on an item-per-item basis (i.e. per good, per right, and per service). Hence, applying the transfer pricing method to each good, right or service implies that transactions must be evaluated separately. In other words, there is no provision or other guidance which allow to combine or aggregate transactions or other similar approaches (such as package deal or basket approaches).

### 3.2.4. Intentional set-offs

283. Intentional set-offs are not specifically addressed by the transfer pricing legislation in Brazil and there is also no administrative guidance on this issue.

### 3.2.5. Impossibility to use an arm’s length range and statistical tools

284. The Brazilian approach is aimed at determining the maximum deductible expense upon importation from related parties and the minimum taxable income upon exportation to related parties. In the context of the fixed margins, which are in fact averages derived from industry practices (which may range from lowest to highest profit margins identified in the market), the actual transfer price set by the taxpayer may not exactly correspond to the parameter price determined based on the application of the methods.

\textsuperscript{157} Article 18-A, paragraph 4 (PCI method), and Article 19-A, paragraph 5, item I (PECEX method), of Law 9,430/96.

\textsuperscript{158} Two systems that are worth mentioned are SISCOMEX and SISCOERV. SISCOMEX means Sistema Integrado de Comércio Exterior (Integrated System of International Trade, SISCOMEX). SISCOERV means Sistema Integrado de Comércio Exterior de Serviços, Intangíveis e Outras Operações que Produzam Variações no Patrimônio (Integrated System of International Trade of Services, Intangibles, and Other Transactions that Result in Modification of Net Worth or Equity, SISCOERV).

\textsuperscript{159} Article 40 of Normative Instruction 1,312/12.
285. Consistently with this approach, a deviation of the established transfer price from the parameter price is tolerated, whereby no transfer pricing adjustment will be required.\textsuperscript{160} The rules tolerate a general deviation of 5% and a special deviation of 3% for commodity transactions.\textsuperscript{161}

286. This deviation is observed upon the determination of the parameter price and is not part of the comparability analysis itself. It constitutes a “divergence margin”, different from the concept of arm’s length range described in the Guidelines.

287. Finally, the use of statistical tools is not foreseen.

3.2.6. Limited comparability adjustments

288. The Brazilian transfer pricing rules provide that in the case of identical goods, rights or services, adjustments may be made so as to minimise any differences with respect to the business conditions, content and physical features.\textsuperscript{162} However, comparability adjustments are limited not only in terms of the types of comparability adjustments that can be performed, but also in terms of the transfer pricing methods that allow them, namely the Brazilian versions of the CUP method, including the methods for commodity transactions (PIC/PVEx and PCI/PECEX methods), and the resale price related method for exports (PVA/PVV methods).\textsuperscript{163}

289. Permitted comparability adjustments are explicitly listed in the respective provisions.\textsuperscript{164} The OECD-recognised CUP method includes the possibility of using internationally quoted prices, provided appropriate comparability adjustments are made according to the functional analysis prescribed in the Guidelines. Even though the PCI and PECEX methods provide for the possibility to make adjustments, such adjustments are limited to those specified by the legislation, and make no consideration of the functional analysis according to the Guidelines. Indeed, the adjustments provided by the legislation for the PCI and PECEX methods include premiums and discounts related to the differences between the amount received by the seller and the variables that are considered in the specific commodities and futures exchange market. As indicated in tables 3.4 and 3.5 below, the variables which may be considered in the adjustments are: payment term; negotiated quantity; climatic influences on the characteristics of the goods; intermediation costs in purchase and sale transactions performed by non-related legal entities; packaging; and insurance and freight.

Table 3.4. Permitted adjustments depending on the transfer pricing method for imports

<table>
<thead>
<tr>
<th>Methods designed for import transactions</th>
<th>Permitted adjustments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Comparable independent price (PIC)</td>
<td>Payment terms; volume of the transaction; guarantee of functionality of goods and applicability of services or rights; obligation of promotion through publicity or advertising of the goods, rights or services; responsibility for the costs of quality, service standards and sanitation certification and verification; costs of intermediating sales</td>
</tr>
</tbody>
</table>

\textsuperscript{160} Article 51 of Normative Instruction 1,312/12.

\textsuperscript{161} Article 51, paragraph 2, of Normative Instruction 1,312/12.

\textsuperscript{162} Article 9, paragraph 1, and Article 22, paragraph 1, of Normative Instruction 1,312/12.

\textsuperscript{163} The provisions established in paragraph 3 of Article 31 and in the single paragraph of Article 32 prescribe the adjustments allowed for the application of the PVA/PVV methods.

\textsuperscript{164} For the list of the permitted adjustments for import transactions, see the items under Article 9, paragraph 1, of Normative Instruction 1,312/12; for export transactions see Article 22, paragraph 1. For the importation of commodities, see Article 16, paragraph 9; for the exportation of commodities, see Article 34, paragraph 10.
Table 3.5. Permitted adjustments depending on the transfer pricing method for exports

<table>
<thead>
<tr>
<th>Methods designed for export transactions</th>
<th>Permitted adjustments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Export sales price (PVEx)</td>
<td>Payment terms; volume of the transaction; guarantee of functionality of goods and applicability of services or rights; obligation of promotion through publicity or advertising of the goods, rights or services; responsibility for the costs of quality, service standards and sanitation certification and verification; costs of intermediating sales transactions performed by the unrelated entity; packaging; freight and insurance.</td>
</tr>
<tr>
<td>Wholesale price in the country of destination less profit (PVA)</td>
<td>N/A</td>
</tr>
<tr>
<td>Retail price in the country of destination less profit (PVV)</td>
<td>N/A</td>
</tr>
<tr>
<td>Acquisition or production cost plus profit method (CAP)</td>
<td>N/A</td>
</tr>
<tr>
<td>Price under quotation on exports method (PECEx)</td>
<td>Payment terms; negotiated quantity; the impact of climatic conditions on the characteristics of the goods; intermediation costs for functions performed by non-related legal entities; packaging; and, freight and insurance.</td>
</tr>
</tbody>
</table>

290. Therefore, in contrast to the Guidelines which follow a principle-based approach to performing comparability adjustments, the comparability adjustments allowed under the Brazilian transfer pricing system are strictly limited by the legislation and are only allowed for a limited number of methods.

3.3. Assessment of effectiveness

291. The comparability analysis plays a limited role under the Brazilian transfer pricing framework. It ignores important aspects of a complete transfer pricing analysis as described by the Guidelines.

3.3.1. Absence of complete comparability analysis

292. The relevance of the comparability analysis set out in the OECD Guidelines is extremely limited. For comparison purposes, it is the goods, rights or services which are compared according to strict comparability factors that focus on their properties. Comparable margins do not need to be identified because of the fixed margins imposed by the legislation. Therefore, many situations arise where the comparability factors which are taken into consideration by the typical process of performing a comparability analysis laid out in the Guidelines are disregarded. This creates weaknesses in terms of preventing BEPS risks and preventing double taxation, but it also simplifies the process of selecting and applying transfer pricing methods in Brazil.
Findings of the assessment

Prevention of BEPS risks

Situations may arise where Brazil will not be able to allocate the appropriate amount of taxable income, with the consequence that double non-taxation, or under-taxation, may occur.

Such situations may include situations where fixed margins ignore the functional profile of the tested party and deviate from the arm’s-length margin that would be determined under a complete comparability analysis. For example, the application of the (broadly equivalent) cost plus method designed for export transactions (CAP method) does not take into account whether a manufacturer is a full-fledged manufacturer or a contract/toll manufacturer, or whether a distributor is a full-fledged distributor or a limited-risk distributor. Another example of this is the application of the (broadly equivalent) resale price method designed for import transactions (PRL method), which does not allow to take into consideration fluctuations in relation to the market conditions or the product’s lifecycle.

Prevention of double taxation

The absence of a comparability (including functional) analysis is likely to result in double taxation when the application of the methods produces outcomes that diverge from the arm’s length outcomes that would be produced in the presence of a complete comparability analysis. In other words, the embedded characteristics of the methods that substitute the need for a comparability analysis may lead to different, non-arm’s-length outcomes, and therefore double taxation.

For instance, some companies indicated that the application of the PRL and CAP methods (broadly equivalent to the OECD-recognised resale price method and cost plus method, respectively) usually resulted in transfer pricing adjustments in Brazil due to a lack of functional analysis and due to fixed margins set at the product level. Often, this fixed margin “presumed” for a certain industry to be at arm’s length is too high or too low compared with the results of a complete comparability analysis.

Ease of tax administration

The fact that it is not required to perform such a comparability analysis considerably reduces the administrative burden for tax authorities.

Ease of tax compliance

The same is true for taxpayers, the compliance burden of which is equally alleviated. Taxpayers are not required to perform a complete comparability analysis.

Tax certainty

The absence of complete comparability analysis itself has no direct impact on tax certainty from a domestic perspective, but taken together with the fixed margins approach, the alternative offered by Brazil represents an objective methodology based on mathematical formulae, which promotes tax certainty.
Concerns over the inconsistent approaches of different tax authorities towards the application of international tax standards is a main driver of uncertainty, and this major divergence found in the Brazilian transfer pricing rules is an illustration.

3.3.2. **Strict use of comparables**

293. The standard of comparability is generally higher under the Brazilian transfer pricing methods, especially for the application of the methods broadly equivalent to the CUP method (PIC and PVEx methods). This is because comparables must be “identical” and “similar” to be accepted. The higher standard of comparability does not, however, fully reflect all factual circumstances of the transactions. In particular, the functional profile of the parties is not factored into the comparison.

294. For most methods, the use of “identical” and “similar” items only affects the calculation of average prices or costs related to the calendar year.

295. Because of the high standard of comparability, acceptable comparables within the meaning of the OECD Guidelines are difficult to find for the Brazilian versions of the CUP method, including the methods for commodity transactions (PIC/PVEx and PCI/PECEX methods). For this reason, most taxpayers prefer other methods to the PIC/PVEx methods. For example, for some taxpayers, the use of the CUP method is only contemplated when particular transactions do not meet the margins. Methods that require information available in-house will be preferred, notably the Brazilian version of the cost plus method (CAP method) for exports.

### Findings of the assessment

**Prevention of BEPS risks**

In applying the PIC/PVEx methods, the high standard of comparability provides some protection against BEPS risks. It is also true for the other methods, which also require that “identical” and “similar” transactions be used for the calculation of average sales price or production costs, except for the Brazilian versions of the resale price method for imports (PRL method) and the cost plus method for exports (CAP method).

However, a key weakness observed in the strict use of comparables is the absence of consideration for the (high) value added by specific functions performed or assets used (e.g., intangibles). When significant elements of the functional profile are ignored, protection against BEPS risks is no longer provided.

The strict use of comparables, connected to the existence of the fixed margins, means that taxpayers will generally prefer methods that do not rely on comparables. However, taxpayers may be inclined to

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165 The legislation does not include the terms “identical” and “similar” for the Brazilian versions of the resale price method for imports (PRL method) and the cost plus method for exports (CAP method), for which the concepts of “identical” or “similar” items are not relevant, as they require using the items involved in the transaction.

166 As mentioned before, an independent price related to transactions performed in the previous calendar year may be used if there is no independent price in the calendar year corresponding to the importation, which shall be adjusted by the exchange variation in the period.
select the PIC/PVEx methods as a second choice in cases where they identify the need to perform adjustments, in order to achieve the most favourable tax outcome.

**Prevention of double taxation**

The approach contained in the OECD Guidelines is driven by the notion of comparability. Therefore, the fact that the Brazilian approach does not rely on comparables to the same extent creates discrepancies with consequences for the determination of the arm’s length price.

**Ease of tax administration**

The strength of the fixed margins approach is that it does not rely on the use of comparables and thus facilitates the application of some of the transfer pricing methods. On the other hand, administering stricter comparability requirements, as is the case with the requirement to use “identical” and “similar” items for the purpose of comparability analysis, is more burdensome.

**Ease of tax compliance**

The fixed margins make it simple for taxpayers to apply the transfer pricing methods. However, the strict use of comparables and associated high standard of comparability makes it difficult to identify appropriate comparables. Taxpayers share the view that reliable comparables are rare, especially in some industry sectors.

**Tax certainty**

Tax certainty is provided to some extent, thanks to a methodology incorporating fixed margins that generates predictable results, and which is also less likely to be challenged. This is conducive to certainty from a domestic perspective. Having said that, disagreements on comparability are more likely to occur.

From an international perspective, taxpayers are likely to face transfer pricing adjustments without the possibility to use comparables, even if such comparables may be available on their side, as a result of the fixed margins approach.
### 3.3.3. Strict application of the item-per-item approach

#### Findings of the assessment

**Prevention of BEPS risks**

The item-per-item approach would not appear to give rise to BEPS risks, except in specific circumstances (e.g., business restructurings), where a focus on individual items/assets will not recognise the value transferred resulting from multiple items or assets being transferred. Similar situations may also occur with respect to other types of transactions, when each individual item or transaction has a low value, but combined in the coherent bundle or group of transactions, the value is significantly higher.

The absence of guidance on recognition of intentional set-offs could create additional BEPS risks.

**Prevention of double taxation**

The item-per-item approach may give rise to double taxation because every transaction is forced to show a positive return regardless of the business circumstances or economic circumstances, which are not taken into account through this approach, combined with the effects of using fixed margin.

The absence of guidance on intentional set-offs could potentially lead to situations of double taxation.

**Ease of tax administration**

The tax administration is required to perform a granular analysis of taxpayers’ intra-group transactions, regardless of the prescriptive nature of the transfer pricing rules. This leads to an additional tax burden.

The absence of guidance on intentional set-offs could create potential additional complexity in terms of tax administration because different rules may apply also due to the fact that some transactions, which can be part of such intentional set-offs, may be outside of the scope of transfer pricing.

**Ease of tax compliance**

Similarly, taxpayers are required to perform a granular analysis of their intra-group transactions, which leads to a significant compliance burden.

The absence of guidance on intentional set-offs can also create potential additional compliance burden for the taxpayers who may need to separate the transactions and assess each transaction separately. It could lead to an additional tax compliance burden.

**Tax certainty**

The item-per-item approach may not create more tax uncertainty at the domestic level especially when the taxpayers understand that the item-per-item approach is the standard.

The item-per-item approach, which does not foresee the combination of transactions and intentional set-offs, differs from internationally accepted practice, and thus creates tax uncertainty from an international perspective, when the other jurisdictions may apply the approach of grouping/combining the transactions.
3.3.4. Limited comparability adjustments

296. Proving that the items under review are identical is already challenging for both the tax administration and taxpayers, even before considering comparability adjustments. For the application of the methods that allow comparability adjustments, the strict limitations as regards acceptable comparability adjustments constitute additional challenges.

Findings of the assessment

Prevention of BEPS risks

The restricted use of comparability adjustments is clearly motivated by the objective of preventing BEPS and possible inappropriate adjustments that could be made by taxpayers, and it could, in many cases, limit the BEPS risks resulting from inappropriate adjustments.

Prevention of double taxation

Comparability adjustments serve the purpose of improving the comparability of transactions. The Brazilian approach does not rely on comparables as much as the OECD approach so the relevance of comparability adjustments is already limited. On top of this, the adjustments that are permitted are also restricted, and where they would be considered reasonable in other jurisdictions, they may be strictly rejected under the Brazilian transfer pricing system. This effectively raises concerns around potential double taxation.

In the case of methods applied to commodity transactions, the limited adjustments could give an indication that there is a risk of potential double taxation; however, it appears that most of the necessary adjustments could be achieved also thanks to the possibility to apply potential premium or discount to reflect the specific facts and circumstances. It is however unlikely that the discount and premium, as currently foreseen in the relevant regulations, would also allow to reflect the functional and risk profiles of the parties to the transaction.

Ease of tax administration

Due to the restrictive approach to comparability adjustments, the tax administration will more easily be able to administer the application of the methods.

Ease of tax compliance

The taxpayers’ use of comparability adjustments is restricted to the comparability adjustments provided by the legislation, which makes it more difficult to use comparables in some cases.

Taxpayers that wish to apply CUP-like methods are typically required to present ideal internal or external comparables – identical or similar products in the strict sense for transactions performed at the same level. Some companies shared the view that difficulties may arise in the data presented when using the CUP like methods, because of the high threshold established by the law, and the concept of this threshold (i.e. “similar” or “identical” requirements).
Tax certainty

The limited and specific adjustments that can be made generally provide certainty as they are clear and objective. However, the practical aspects of making these adjustments might lead to uncertainty, especially from an international perspective.
The fourth chapter contains the analysis of Brazil’s rules and practices in relation to the guidance of Chapter IV of the OECD Guidelines, which examines a number of administrative procedures that can be applied in order to achieve two main purposes. The first purpose relates to minimising and preventing transfer pricing disputes between taxpayers and their tax administrations, and between different tax administrations. The second purpose is to help resolve such disputes if and when they do arise. The analysis identifies the transfer pricing compliance practices and dispute resolution mechanisms (MAPs and APAs) as areas where gaps and divergences exist. Other relevant aspects in relation to the guidance of Chapter IV are also discussed and assessed, including secondary adjustments and safe harbour rules. The analysis if followed by the assessment of effectiveness according to the policy objective of transfer pricing rules.
4.1. Avoiding and resolving transfer pricing disputes

4.1.1. Transfer pricing compliance practices

297. Transfer pricing compliance practices (and tax compliance practices in general) are a matter of domestic legislation and administrative practices. The OECD Guidelines identify three main policy objectives shared by many domestic tax compliance practices: a) to reduce opportunities for non-compliance; b) to provide positive assistance for compliance; and c) to provide disincentives for non-compliance. The Guidelines also recognise that countries have widely varying tax systems, the tax compliance practices of which need accommodate their particularities.

298. Appropriate and consistent application of the arm's length principle requires that countries develop and implement procedural rules to ensure adequate protection of the taxpayer and to make sure that tax revenue is not shifted to countries with overly harsh procedural rules. In addition, domestic compliance practices have implications beyond the borders of the country that has adopted them. This is particularly true when cross-border transfer pricing issues are concerned since an MNE group may be subject to double taxation if the same transfer pricing outcome is not accepted in different tax jurisdictions. For this reason, the Guidelines emphasise the importance of respecting the arm’s length principle for countries when following their domestic compliance practices with the ultimate objective of seeking to facilitate both the equitable allocation of taxes between jurisdictions and the prevention of double taxation for taxpayers.

299. The Guidelines provide general guidance on the types of problems that may arise and reasonable approaches for achieving a balance of interests of the taxpayers and tax administrations involved in a transfer pricing inquiry. In this context, the Guidelines focus on three key aspects that often have an impact on how tax administrations approach the mutual agreement procedure process and determine their administrative response to ensure compliance with their own transfer pricing rules. These three aspects are: examination practices, the burden of proof, and penalty systems. It is not possible to describe a uniform set of principles or issues that will be relevant in all cases because these aspects differ depending on the characteristics of the tax system involved. Therefore, the Guidelines provide general guidance on the types of problems that may arise and reasonable approaches for achieving a balance of the interests of the taxpayers and tax administrations involved in a transfer pricing inquiry.

Examination practices

300. The Guidelines recognise that examination practices and procedures vary widely among OECD member countries, and differences in procedures may be prompted by such factors as the system and the structure of the tax administration, the geographic size and population of the country, the level of domestic and international trade, and cultural and historical influences.

301. Transfer pricing cases can present special challenges to the normal audit or examination practices by both tax administration and taxpayer, since such cases are fact-intensive and may involve difficult evaluations of comparability, markets, and financial or other industry information. As a consequence, a number of tax administrations have examiners who specialise in transfer pricing and transfer pricing examinations themselves may take longer than other examinations and follow separate procedures.

302. Because transfer pricing is not an exact science, it will not always be possible to determine the single correct arm’s length price; rather, the correct price may have to be estimated within a range of acceptable figures, as recognised in Chapter III of the Guidelines. For example, taxpayers may experience particular difficulties when the tax administration proposes to use a methodology, such as the transactional profit split, that is not the same as that used by the taxpayer.  

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167 See paragraph 4.8 of the OECD Guidelines.
303. Additionally, tax administrations are encouraged to consider in conducting their transfer pricing examinations, that even the best-intentioned taxpayer can make an honest mistake, and even the best-intentioned tax examiner may draw the wrong conclusion from the facts. This involves two implications. First, tax examiners are encouraged to be flexible in their approach and not demand from taxpayers in their transfer pricing a precision that is unrealistic under all the facts and circumstances. Second, tax examiners are encouraged to take into account the taxpayer’s commercial judgment about the application of the arm’s length principle, so that the transfer pricing analysis is tied to business realities.

**Burden of proof**

304. The burden of proof for tax cases also differs among OECD member countries. In most jurisdictions, the tax administration bears the burden of proof both in its own internal dealings with the taxpayer (e.g., assessment and appeals) and in litigation. In some of these jurisdictions, the burden of proof can be reversed, which allows the tax administration to estimate taxable income, in case the taxpayer is found not to have acted in good faith, for example. In other countries the burden of proof is on the taxpayer.

305. It is stated in the Guidelines that the implication for the behaviour of the tax administration and the taxpayer of the rules governing burden of proof should be taken into account.\(^{168}\)

306. When transfer pricing issues are present, the divergent rules on the burden of proof among OECD member countries will present serious problems if the strict legal rights implied by those rules are used as a guide for appropriate behaviour.

307. The Guidelines present an example in which the controlled transaction under examination involves one jurisdiction in which the burden of proof is on the taxpayer and a second jurisdiction in which the burden of proof is on the tax administration. If the burden of proof is guiding behaviour, the tax administration in the first jurisdiction might make an unsubstantiated assertion about the transfer pricing, which the taxpayer might accept, and the tax administration in the second jurisdiction would have the burden of disproving the pricing. It could be that neither the taxpayer in the second jurisdiction nor the tax administration in the first jurisdiction would be making efforts to establish an acceptable arm’s length price. This type of behaviour would set the stage for significant conflict as well as double taxation.

308. Moreover, the Guidelines state that the burden of proof, as a matter of good practice, should not be misused, or be a justification for groundless or unverifiable assertions in respect to transfer pricing. A tax administration should be prepared to make a good faith showing that its determination of transfer pricing is consistent with the arm’s length principle even where the burden of proof is on the taxpayer, and taxpayer similarly should be prepared to make a good faith showing that their transfer pricing is consistent with the arm’s length principle, regardless of where the burden of proof lies.

309. In addition, the Guidelines refer to the Commentary on paragraph 2 of Article 9 of the OECD MTC, noting that in competent authority proceedings the State that has proposed the primary adjustment bears the burden of demonstrating to the other State that the adjustment “is justified both in principle and as regards the amount”.\(^{169}\) Both competent authorities are expected to take a co-operative approach in resolving mutual agreement cases.

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\(^{168}\) See paragraphs 4.12 and 4.13 of the OECD Guidelines.

\(^{169}\) See paragraph 4.17 of the OECD Guidelines.
Penalties

310. Penalties are generally designed to make tax underpayments and other types of non-compliance more costly than compliance. If a mutual agreement results in a withdrawal or reduction of an adjustment, it is important that there exist possibilities to cancel or mitigate a penalty imposed by the tax administration.\(^\text{170}\)

311. It is highlighted by the Guidelines that it is difficult to compare penalties practices and policies among countries. First, there may be different names used in the various countries for penalties that accomplish the same purpose. Second, the penalties should be judged within the context of a country’s overall compliance system.

312. National tax compliance practices depend on the basis of domestic need and balance, such as the choice between the use of taxation measures that remove or limit opportunities for non-compliance (e.g. imposing a duty on taxpayers to cooperate with the tax administration or reversing the burden of proof in situations where a taxpayer is found not to have acted in good faith) and the use if monetary obstacles (e.g. additional tax imposed as a consequence of underpayments of tax in addition to the amount of the underpayment).

313. Different types of penalties have been adopted by jurisdictions, and can involve either civil or criminal sanctions.\(^\text{171}\)

314. Civil penalties are more common and they typically involve a monetary sanction. Some civil penalties are directed towards procedural compliance, such as timely filing of returns and information reporting. Usually the amount of such penalties is small and based on a fixed amount that may be assessed, for instance, for each day in which the failure to file continues.

315. Some countries may classify “penalty” as “interest” or “additional tax”, for understatements which result in late payments of tax beyond the due date. This is often designed to ensure the revenue recovers at least the real time value of money lost.\(^\text{172}\) The Guidelines indicate that many OECD member countries impose civil monetary penalties for negligence or wilful intent, while only a few countries penalise “no-fault” understatements of tax liability.

316. Moreover, it is difficult to evaluate in abstract whether the amount of a civil monetary penalty is excessive. In OECD member countries the rate often ranges from 10% to 200%, considering the condition for imposing the penalty – for instance, higher penalties often can be imposed by showing a high degree of taxpayer culpability. The fairness of the penalty should be considered by reference to whether the penalties are proportionate to the offence committed.\(^\text{173}\)

317. The Guidelines state that a penalty should not be overly harsh, as it may give taxpayers an incentive to overstate the taxable income in that jurisdiction, which is contrary to Article 9 of the OECD MTC. In this case, the penalty system fails in its primary objective to promote compliance.

318. Finally, the Guidelines indicate that OECD member countries agree that conclusions can be drawn regardless of the aspects of the tax system in a particular country, and tax administrations are encouraged

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\(^{170}\) See Paragraph 4.18 of the OECD Guidelines.

\(^{171}\) Paragraph 4.20 of the OECD Guidelines states that criminal penalties are virtually always reserved for cases of very significant fraud, and they usually carry a very high burden of proof for the party asserting the penalty (i.e. the tax administration). Criminal penalties are not the principal means to promote compliance in any of the OECD member countries.

\(^{172}\) See paragraph 4.22 of the OECD Guidelines.

\(^{173}\) See paragraphs 4.24 and 4.27 of the OECD Guidelines.
to take the following observations into account in the implementation of their penalty provisions. First, the imposition of sizable “no-fault” penalty based on the mere existence of an understatement of a certain amount would be unduly harsh when it is attributable to good faith error rather than negligence or an actual intent to avoid tax. Second, it would be unfair to impose sizable penalties on taxpayers that made a reasonable effort in good faith to set the terms of their transactions with associated enterprises in a manner consistent with arm’s length principle. In particular, it would be inappropriate to impose a transfer pricing penalty on a taxpayer for failing to consider data to which it did not have access, or for failure to apply a transfer pricing method that would have required data that was not available to the taxpayer.174

4.1.2. Corresponding adjustments and the mutual agreement procedure: Articles 9 and 25 of the OECD Model Tax Convention

Corresponding adjustments: paragraph 2 of Article 9

319. The transfer pricing adjustments made by tax authorities leading to an increase of the tax base are called primary adjustments. These adjustments lead to a correction of the tax base where the profits were supposed to accrue but did not because the arm’s length principle was not applied appropriately. These adjustments may lead to double taxation, which can be further amplified by so-called “secondary adjustments” under certain circumstances, i.e. where the counterparty State does not recognize the tax levied on the secondary adjustment. Elimination of economic double taxation in such cases is foreseen through a so-called “corresponding adjustment”, enshrined in Article 9, paragraph 2 of the OECD MTC. The corresponding adjustment may be made by a Contracting State either by recalculating the profits subject to tax for the associated enterprise in that country using the relevant revised price or by letting the calculation stand and giving the associated enterprise relief against its own tax paid in that State for the additional tax charged to the associated enterprise by the adjusting State as a consequence of the revised transfer price. The former method is by far the more common among OECD member countries. In other words, the corresponding adjustment is a downward adjustment of the tax base of the associated enterprise in the other state to the amount corresponding to the upward “primary adjustment” made in the first state. The Guidelines provide that under paragraph 2 of Article 9, a tax administration should make a corresponding adjustment only insofar as it considers the primary adjustment to be justified both in principle and in amount. The nonmandatory nature of corresponding adjustments is necessary so that one tax administration is not forced to accept the consequences of an arbitrary or capricious adjustment by another State. It also is important to maintaining the fiscal sovereignty of each OECD member country.175

The mutual agreement procedure

320. The mutual agreement procedure (MAP) of Article 25 may also be used to consider requests for corresponding adjustments, as provided by paragraph 2 of Article 9. The Guidelines address this overlap and more particularly the case in which the bilateral income tax convention between two Contracting States does not contain a provision comparable to paragraph 2 of Article 9. Paragraph 11 of the Commentary on Article 25 states:

When the bilateral convention does not contain rules similar to those of paragraph 2 of Article 9 (as is usually the case for conventions signed before 1977) the mere fact that Contracting States inserted in the convention the text of Article 9, as limited to the text of paragraph 1 — which usually only confirms broadly similar rules existing in domestic laws — indicates that the intention was to have economic double taxation covered by the Convention. As a result, most member countries consider that economic double taxation

174 See paragraph 4.28 of the OECD Guidelines.

175 See paragraph 4.35 of the OECD Guidelines.
resulting from adjustments made to profits by reason of transfer pricing not in accordance with at least the spirit of the convention and falls within the scope of the mutual agreement procedure set up under Article 25.176 [Emphasis added]

321. Paragraph 12 of the same Commentary further states that most OECD member countries share the view that the MAP is considered to apply to transfer pricing adjustment cases, even in the absence of a provision comparable to paragraph 2 of Article 9 of the OECD MTC.177 It further notes that those States that do not agree with this view in practice find means of remediating economic double taxation in most cases involving bona fide companies by making use of provisions in their domestic laws.

322. The mutual agreement procedure (MAP) is a mechanism through which tax administrations consult to resolve disputes regarding the application of double tax conventions. This procedure, described and authorised by Article 25 of the OECD MTC, can be used to eliminate double taxation that could arise from a transfer pricing adjustment.

323. According to Article 25 of the OECD MTC, tax administrations can consult the MAP to resolve disputes regarding the application of double tax conventions in: a) instances of taxation not in accordance with the provisions of the convention (paragraphs 1 and 2); b) relation to questions of interpretation or application of the convention as well as the elimination of (both juridical and economic) double taxation in cases not otherwise provided for in the convention (paragraphs 3).

324. Paragraph 5 of Article 25 also provides that MAP cases for which no agreement was reached within two years will be resolved through an arbitration process upon request of the person who presented the case. This paragraph was incorporated in the OECD MTC in 2008 to ensure that where the competent authorities are unable to reach an agreement on one or more issues that prevent the resolution of a case, a resolution of the case will still be possible by submitting those issues to arbitration. The Guidelines indicate that even in the absence of a mandatory binding arbitration provision similar to paragraph 5 in a particular tax convention, the competent authorities may still establish a binding arbitration procedure by mutual agreement.

325. BEPS Action 14 developed 21 elements and 12 best practices, which assess a jurisdiction’s legal and administrative framework in the following four key areas: preventing disputes, availability and access to MAP, resolution of MAP cases, and implementation of MAP agreements.178 This minimum standard has been adopted by member countries of the Inclusive Framework on BEPS.

326. While the Guidelines do not provide an explanation of the minimum standard, but only include a reference in a footnote attached to the section discussing the mutual agreement procedure, it is highly relevant to restate the three general objectives of this minimum standard: (1) countries should ensure that treaty obligations related to the mutual agreement procedure are fully implemented in good faith and that MAP cases are resolved in a timely manner; (2) countries should ensure that administrative processes promote the prevention and timely resolution of treaty-related disputes; and (3) countries should ensure that taxpayers that meet the requirements of paragraph 1 of Article 25 can assess the mutual agreement procedure.179

176 Paragraph 11 of the Commentary on Article 25.
It is important to mention that, in this respect, the BEPS Action 14 minimum standard also comprises a number of other elements intended to address more generally concerns related to the denial of access to the mutual agreement procedure. These include: a commitment to provide access to MAP in divergences in respect to the conditions for the application of a treaty anti-abuse provision (element 1.2); a commitment to publish rules, guidelines and procedures related to MAP (element 2.1); to identify in that guidance the specific information and documentation needed to request a MAP (element 3.2); a commitment to clarify that audit settlements between tax authorities and taxpayers do not preclude access to the MAP (element 2.6); and a commitment to ensure that both competent authorities are made aware of requests for MAP assistance.

Addressing concerns with the mutual agreement procedure

The Guidelines recognise that although corresponding adjustments and MAP have proven efficient for resolving the majority of transfer pricing conflicts there are still serious concerns for taxpayers. Importantly, it is stressed in the Guidelines that tax administrations should take steps to assure taxpayers that they need not fear retaliatory action or offsetting adjustments (by the country from which the corresponding adjustment has been requested) and that, consistent with the arm’s length principle, each case is resolved on its own merits.

With respect to the concerns expressed by taxpayers, the Guidelines list and provide a detailed discussion of situations whereby: (1) taxpayers may be denied access to the MAP in transfer pricing cases; (2) time limits under domestic law for the amendments of tax assessments may make corresponding adjustments unavailable if the relevant tax treaty does not override those limits; (3) MAP cases may be time-consuming; (4) taxpayer participation may be limited; (5) published guidance may not be readily available to instruct taxpayers on how the MAP may be used; and (6) there may be no procedures to suspend the collection of tax deficiencies or the accrual of interest pending resolution of the MAP case.

Secondary adjustments

Primary transfer pricing adjustments and their corresponding adjustments change the allocation of taxable profits of an MNE group for tax purposes but they do not alter the fact that the excess profits represented by the adjustment are not consistent with the result that would have arisen if the controlled transactions had been undertaken on an arm’s length basis. To make the actual allocation of profits consistent with the primary transfer pricing adjustment, some countries have introduced into their domestic law a so-called “secondary” adjustment, which will assert under their domestic legislation a constructive transaction (a secondary transaction), whereby the excess profits resulting from a primary adjustment are treated as having been transferred in some other deemed form and taxed accordingly. Ordinarily, the secondary transactions will take the form of constructive dividends, constructive equity contributions, or constructive loan. The consequence of this secondary adjustment is that additional taxes are collected in the form of a withholding tax on dividends (in constructive dividend scenario), or additional corporate income tax is due on deemed accrued interest (in constructive loan scenario), or other types of taxes and duties (in constructive equity contribution scenario). These secondary adjustments are considered as a legitimate tax policy option, which is in line with Article 9. Introducing these measures allows for the collection of additional tax revenue. The potential secondary adjustment has also an additional deterrent function equivalent to additional penalty for taxpayers. The actual design and implementation of secondary adjustments is a matter of policy decision of each country. It should be however noted that the secondary adjustments create an additional tax burden and may also give rise to potential double taxation, which may also need to be addressed in the process of eliminating the double taxation resulting from both primary and secondary adjustments, including through MAP.

180 See paragraph 4.68 of the OECD Guidelines.
4.1.4. Simultaneous tax examinations

331. A simultaneous tax examination is a form of mutual assistance, used in a wide range of international issues, that allows two or more countries to co-operate in tax investigations. Simultaneous tax examinations can be particularly useful where information based in a third country is a key to a tax investigation, since they generally lead to more timely and more effective exchanges of information. It has also been suggested that simultaneous examinations could help reduce the possibilities for economic double taxation, reduce the compliance cost to taxpayers, and speed up the resolution of issues.\(^1\)

332. This mutual form of assistance may be a useful instrument to determine the correct tax liability of associated enterprises in case where, for instance, costs are shared or charged and profits are allocated between taxpayers in different tax jurisdictions. In other words, it promotes compliance with transfer pricing regulations, since it may be difficult for a tax administration, especially in cases where the taxpayer in its jurisdiction does not cooperate.

333. In addition, joint audits allow tax administrations to operate efficiently and effectively in an increasingly global environment, co-operating ever more closely and frequently with each other to ensure compliance, tackle base erosion and profit shifting, and minimise the probability of costly and time-consuming disputes.\(^2\)

4.1.5. Safe harbours

334. A safe harbour in a transfer pricing regime is a provision that applies to a defined category of taxpayers or transactions and that relieves eligible taxpayers from certain obligations otherwise imposed by a country’s general transfer pricing rules. The objective of safe harbours is to introduce simplified approaches for determining or approximating the arm’s length price and thus contribute towards reduced tax compliance costs for taxpayers, but also towards more efficient tax administration and tax certainty.

335. Guidance on safe harbours\(^3\) provides policy considerations for countries to design such measures with the objective of relieving some compliance burdens and to provide greater certainty for cases involving smaller taxpayers or less complex transactions. It also stresses the appropriateness of safe harbours when directed at taxpayers and/or transactions with low transfer pricing risks and when adopted on a bilateral or multilateral basis. In this regard, the guidance contained in Chapter IV provides a basis for countries to design a transfer pricing compliance framework that makes optimal use of the limited resources available.

4.1.6. Advance pricing arrangements

336. An advance pricing arrangement (APA) is an arrangement that determines, in advance of controlled transactions, an appropriate set of criteria (e.g. method, comparables and appropriate adjustments thereto, critical assumptions as to future events) for the determination of the transfer pricing for those transactions over a fixed period of time. It is formally initiated by a taxpayer and requires negotiations between the taxpayer, one or more associated enterprises, and one or more tax administrations.

\(^1\) See paragraph 4.79 of the OECD Guidelines.


\(^3\) Section E on safe harbours in Chapter IV of the Guidelines was revised to reformulate the recommendations against the use of transfer pricing safe harbours. The new recommendations are in favour of using safe harbours under appropriate circumstances and in consideration of the concerns they may raise. The revised guidance provides further details on how to mitigate some of the risks and concerns raised, notably by establishing bilateral or multilateral safe harbours.
administrations. APAs are intended to supplement the traditional administrative, judicial, and treaty mechanisms for resolving transfer pricing issues.

337. The Guidelines provide guidance to address some of the issues in relation to APAs, such as determining how specific they can be in prescribing a taxpayer’s transfer pricing over a period of years, the reliability considerations in terms of using predictions based on assumptions in an APA.

4.1.7. Arbitration

338. Arbitration is an extension and an integral part of the mutual agreement procedures that ensures that where the competent authorities cannot reach an agreement on one or more issues that prevent the resolution of a case, a resolution of the case will still be possible by submitting those issues to arbitration. The arbitration clause is provided in paragraph 5 of Article 25 since the 2008 update to the OECD MTC, which provides that, in the case where the competent authorities cannot reach an agreement within two years, the unresolved issues will, at the request of the person who presented the case, be solved through an arbitration process.

339. The existence of an arbitration provision in a particular bilateral treaty should make the mutual agreement procedure itself more effective even in cases where resort to arbitration is not necessary. The reason is that the MAP procedure does not require the parties to the tax treaty to resolve the dispute but only to use their best efforts to do so. The existence of an arbitration provision should encourage a more effective outcome of the mutual agreement procedure since both governments and taxpayers will know at the outset that the time and effort put into the mutual agreement procedure will be likely to produce a compromise result.

340. Arbitration as a dispute resolution mechanism is also a commitment that several countries have undertaken and expressed as a part of BEPS Action 14. These countries are Australia, Austria, Belgium, Canada, France, Germany, Ireland, Italy, Japan, Luxembourg, the Netherlands, New Zealand, Norway, Poland, Slovenia, Spain, Sweden, Switzerland, the United Kingdom and the United States.\textsuperscript{184}

341. Notwithstanding the number of existing tax treaties that contain the arbitration provision\textsuperscript{185} and the existence of the EU arbitration convention, which shows a certain international adherence to this dispute resolution mechanism, some OECD countries made reservation to paragraph 5 of Article 25 of the OECD MTC, such as Denmark, Israel, Korea, Mexico and Turkey.\textsuperscript{186}

342. In the context of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI), the arbitration provision will be introduced in over 150 existing treaties.\textsuperscript{187}

343. As of October 2019, a total of 30 out of 89 signatories have opted to include the MLI arbitration clause, 20 of which are OECD member countries.\textsuperscript{188}

\textsuperscript{184} Reference to p. 41 of BEPS Action 14 Making Dispute Resolution Mechanisms More Effective.

\textsuperscript{185} Arbitration as a dispute resolution mechanism is part of a set of best practices under BEPS Action 14.

\textsuperscript{186} Paragraph 97 of the Commentary on Article 25 of the OECD MTC.

\textsuperscript{187} An updated list of Signatories that chose to introduce the arbitration provision can be found on the OECD website at: \url{www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-beps.htm}.

\textsuperscript{188} Andorra, Australia, Austria, Barbados, Belgium, Canada, Curacao, Denmark, Fiji, Finland, France, Germany, Greece, Ireland, Italy, Japan, Liechtenstein, Luxembourg, Malta, Mauritius, Netherlands, New Zealand, Papua New Guinea, Portugal, Singapore, Slovenia, Spain, Sweden, Switzerland and United Kingdom.
4.2. Description of the existing rules and practices in Brazil and gap analysis

344. This section examines whether and how the administrative procedures outlined in Chapter IV of the OECD Guidelines have been adopted in the Brazilian transfer pricing framework.

4.2.1. Transfer pricing compliance practices

345. The OECD Guidelines do not provide for a specific set of examination practices that countries would need to implement with respect to transfer pricing. Instead, they recognise that practices vary widely among OECD member countries, and encourage tax examiners when dealing with transfer pricing cases to be flexible in their approach and to take into account the taxpayer’s commercial judgment about the application of the arm’s length principle.

346. The following paragraphs describe the current compliance practices in Brazil and highlight the differences and issues that may arise.

Examination practices

347. In Brazil, there is no special tax examination procedure dedicated to transfer pricing. Therefore, the general procedure provided by the legislation will apply. This general procedure needs to be followed by the tax authorities.

348. Taxpayers are required to present tax returns, accounting and commercial records in an electronic form, through its public system of digital bookkeeping. The tax returns contain a specific section dedicated to transfer pricing adjustments where taxpayers indicate the relevant adjustments that need to be made due to divergence of transaction prices from the parameter prices obtained according to one of the methods established by law. The tax authorities are able to make several types of cross-checking using such electronic systems and to use the information obtained to analyse the taxpayer’s activities. They may select companies if any irregularities are identified in these documents, or by using different criteria, such as type of business, amounts of income or deductions.

349. Taxpayers are required to keep documentation until the statute of limitation has expired. The statute of limitation is five years. However, it seems to be interpreted very strictly in practice, implying that the statute of limitation runs from the first day of the year in which the taxpayer was supposed to file a

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189 See the electronic Tax Accounting Bookkeeping (ECF) at: http://sped.rfb.gov.br/pagina/show/1285.

190 Article 150, paragraph 4, of the Brazilian Tax Code.
tax return. The practical consequence of such a short period of statute of limitation is that the audit must be completed and tax must be assessed within the five years.

350. Once a company is selected, the tax authorities need to follow the tax assessment procedure, generally governed by Decree 70,235/1972 (administrative fiscal procedure law). Procedures and rules are provided by RFB Ordinance 6,478/2017.

351. The tax administration must issue one of the following documents in order to initiate a tax examination procedure:\(^{191}\)

- Term of Distribution of Tax Inspection Procedure (TDPF-F) to initiate an inspection procedure;
- Term of Distribution of Tax Diligence Procedure (TDPT-D) to pursue a diligence;
- Term of Distribution of Special Tax Procedure (TDPF-E) to prevent the risk of hiding evidence.

352. These documents must contain the information listed by Article 5 of the RFB Ordinance, such as the name of the taxpayer, the names of the tax authorities in charge of the examination, the period being examined, the taxes being audited and the period prescribed for the duration of the audit, etc.

353. This framework allows tax authorities to examine tax returns, books and invoices, collect information about legal entities and its transactions. In addition, tax authorities are allowed to examine taxpayers’ information in documents, books, and registries of financial institutions, including information on deposit accounts and financial investments,\(^{192}\) provided that a tax audit is ongoing and such information is considered essential for the tax audit registries of financial.\(^{193}\) The next step is the notification of the taxpayer to present the requested documents and information. Taxpayers have the obligation to provide commercial, accounting and tax documents and information requested by the tax authorities during the audit, following Articles 971 and 972 of the Income Tax.\(^{194}\) On the other hand, the tax authorities have the obligation to audit taxpayers under the rules set forth by the law.

354. Following the presentation of the documents by the taxpayer, and if no further actions are requested by tax authorities, a term signalling the conclusion of the process is signed ("Termo de Encerramento de Fiscalização"). This term may state that the taxpayer has no further legal obligations, or that the examination resulted in a tax assessment (Auto de Infração).

355. The Brazilian framework has its particularities, but it does not necessarily mean that it deviates from the OECD Guidelines, since it is recognised therein that jurisdictions may have a different legal framework in respect to examination procedures. That said, the steps to conduct a tax examination in Brazil may make it difficult to conclude on complex transfer pricing issues within the period of the statute of limitation.

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\(^{191}\) Article 2, items I, II and II, of RFB Ordinance 6,478/2017.

\(^{192}\) The access by tax authorities to taxpayers’ information held by financial institutions for tax investigation purposes is regulated by Decree 3,724/2014.

\(^{193}\) Decree 3,724/2014 lists the situations in which the access to information is considered critical for the tax audit, such as in the case of lack of documentation justifying loans with non-financial institutions and transactions engaged with persons residing in low-tax jurisdictions.

\(^{194}\) Article 971 of Decree 9,580/2018 prescribes that individuals or legal entities, taxpayers or not, are obliged to provide the information and clarifications required by the Tax Auditors of the Federal Revenue Service of Brazil in the exercise of their functions. Additionally, Article 972 of Decree 9,580/2018 prescribes that no individuals or legal entities can refrain from providing the information or clarifications required by RFB within the specified time frame.
Burden of proof

356. For tax purposes, taxpayers are required to provide and substantiate information through tax returns and electronic filings, nevertheless, as a general rule, the tax authorities have the obligation to prove the reasons supporting a tax assessment.\footnote{Article 10 of Decree 70,235/72.}

357. For the purpose of tax law an administrative act to generate a presumption of validity and thereby reverse the burden of proof to the taxpayer, must be well founded and comply with the conditions established by the law.\footnote{Article 9 of Decree 79,235/72 establishes that the tax assessment must be formalized and instructed with all terms, statements, reports and other evidence necessary to prove the wrongful act. In addition, article 10 of the Decree established several information that need to be inserted in the tax assessment, such as e.g. the place, date and time of the tax assessment, the description of the facts, the legal provision that was violated, the penalty application, etc.} In the event of any administrative act being unduly founded, the taxpayer is not required to produce negative evidence, or any evidence of impossible production, it being enough to demonstrate that occurrence of the taxable event was unduly substantiated by the administration.

358. On the other hand, in the event that the nature of the claim is legitimate, it will be exclusively incumbent upon the taxpayer to produce evidence that their conduct did not violate the law. Thus, the burden of proof is reversed to the taxpayer. In respect to litigation disputes, as general rule the burden of proof lies with whoever asserts the claim, according to the provisions of Article 373 of the Code of Civil Procedure.\footnote{Law 13,105/2015.}

359. The Brazilian framework in regard to the burden of proof does not deviate from the OECD Guidelines, since it is recognised therein that jurisdictions may have a different legal framework in respect to examinations procedures.

Penalties

360. Transfer pricing adjustments in Brazil may affect the income tax (IRPJ) and the social contributions (CSLL), by changing their respective taxable base. If insufficient tax is collected, the taxpayer will be subject to the income tax and social contribution provisions on penalties and interest.

361. If an underpayment is proved and a tax debt is confirmed by the tax auditor, a tax assessment will be issued demanding the principal amounts, interest and penalties.

362. Penalties may vary from 20% to 225% on the tax amount due and not paid (as explained in the next paragraph),\footnote{Article 44 of Law 9,430/1996.} plus interest for late payment calculated on the base amount of underpaid tax (without penalties) with the interest rate based on SELIC, which is the Brazilian basic interest rate provided by the Central Bank.\footnote{SELIC table available at: \url{http://receita.economia.gov.br/orientacao/tributaria/pagamentos-e-parcelamentos/taxa-de-juros-selic}.} This interest is however significantly lower than the interest rate applicable on commercial credit,\footnote{The different rates are available at: \url{https://www.bcb.gov.br/estatisticas/tjuros}.} which can make it less effective as a compliance or motivation tool to ensure timely compliance of taxpayers and to discourage them from extending the litigation endlessly. It should also be noted that in the past laws have been introduced to provide \textit{ad hoc} possibilities for taxpayers’ penalties to be fully or partially forgiven as well as interest due as a result of special programmes aimed at enhancing the
collection of outstanding taxes due. The most recent development in this regard is a new law,\textsuperscript{201} which introduced the tax settlement mechanism, authorising the national attorneys in Brazil to negotiate with taxpayers the amounts of penalties as well as interest due. This could effectively mean that in practice the taxpayer could be fully or partially forgiven the penalties and interest due, which could further encourage the culture of challenging any assessment made and postponing the payment of the taxes due, relying on subsequent forgiveness of the accessories to the tax assessed.

363. The amount of the penalty depends on whether the assessment is made by the taxpayers themselves or by the tax authorities. In the case of voluntary self-correction, the penalty is only 0.33% per day limited to a maximum penalty of 20% on the underpaid amount. In the case of an assessment made by the tax authorities, as a general rule, the penalty for underpayment of federal taxes is 75%. This penalty is increased to 150% in cases involving fraud or sham. Both of these penalties may be increased by half (to 112.5% in the case of the general penalty or 225% in the case of penalty for fraud or sham) if the taxpayer does not co-operate with the tax authorities during a tax audit, i.e. where the taxpayer fails to meet deadlines to present files, documents, archives, or present any clarification.

364. The Brazilian framework does not necessarily deviate from the OECD Guidelines, since it is recognised therein that it is difficult to assess whether a particular penalty is fair or not.

365. Nevertheless, the Guidelines conclude that an imposition of a sizable “no-fault” penalty based on the mere existence of an understatement of a certain amount would be unduly harsh when it is attributable to good faith error rather than negligence or an actual intent to avoid tax. In this respect, the 75% penalty that is automatically applicable to a tax underpayment, irrespective of the reason, may be considered unduly harsh in some situations (e.g., good faith). This potential harshness may however be mitigated because the penalties resulting from an assessment by the tax authorities may be decreased by half if the taxpayer voluntarily pays the tax due, which also means that he gives up any administrative remedies. However, this does not preclude the taxpayer from challenging the assessment in court.

4.2.2. Concerns over resolution of transfer pricing disputes

366. In terms of avoiding and resolving transfer pricing disputes, a number of concerns have been raised in the case of Brazil. First, Brazil’s tax treaties do not include a provision equivalent to paragraph 2 of Article 9 of the OECD MTC to provide for corresponding adjustments between treaty partners. Although Brazil has put in place the legal framework, structure and resources in order to comply with the BEPS Action 14 minimum standard,\textsuperscript{202} concerns remain in relation to the implementation of MAP outcomes, notably because the domestic legislation does not provide for a mechanism to implement corresponding adjustments either.

367. Compliance with the minimum standard was reviewed as part of BEPS Action 14 peer review and monitoring.\textsuperscript{203}

\textsuperscript{201} See Provisional Measure (medida provisória) 899/2019, which was recently regulated by Ordinance PGFN 11.956/2019.


368. The Executive Summary of Brazil’s Stage 1 Peer Review Report states that:

Overall Brazil meets the majority of the elements of the Action 14 Minimum Standard. Where it has deficiencies, Brazil is working to address them.

(…)

In order to be fully compliant with all four key areas of an effective dispute resolution mechanism under the Action 14 Minimum Standard, Brazil needs to amend and update a significant number of its tax treaties. Brazil reported that it intends to update all of its tax treaties via bilateral negotiations to be compliant with the requirements under the Action 14 Minimum Standard and has already contacted all the relevant treaty partners to enter into bilateral negotiations. As Brazil has no bilateral APA programme in place, there were no elements to assess regarding the prevention of disputes.

Absence of paragraph 2 of Article 9 bilateral tax treaties

369. Brazil has not introduced paragraph 2 of Article 9 in any of its bilateral tax treaties. This means that there is an absence of explicit commitment and obligation to eliminate economic double taxation through corresponding adjustments.

370. However, in its position on Article 9 of the OECD MTC, Brazil states that “when Brazil’s Tax Treaties contain Article 9, paragraph 1 of the OECD and UN Model Tax Conventions and a case of double taxation arises that is captured by this Treaty provision, Brazil will provide access to MAP in line with the minimum standard of Action 14”.\(^\text{204}\) As Brazil committed to the Action 14 minimum standard, the absence of paragraph 2 of Article 9 in its tax treaties can thus be overcome should there be a will to ensure the elimination of double taxation, since a corresponding adjustment can be also agreed based on Article 25 of the OECD MTC.\(^\text{205}\)

371. All of Brazil’s tax treaties contain a provision relating to MAP and mostly follow paragraphs 1 through 3 of Article 25 of the OECD MTC. The outcome of the Brazil’s peer review is that its treaty network is partly consistent with the requirements of the Action 14 minimum standard, except mainly for the fact:

The majority (80%) of its tax treaties neither contain a provision stating that mutual agreements shall be implemented notwithstanding any time limits in domestic law (which is required under Article 25(2), second sentence), nor the alternative provisions for Article 9(1) and Article 7(2) to set a time limit for making transfer pricing adjustments.

More than half (51%) of its tax treaties do not contain the equivalent of Article 25(3), second sentence of the OECD Model Tax Convention stating that the competent authorities may consult together for the elimination of double taxation for cases not provided for in the tax treaty.

Less than a quarter (20%) of its tax treaties do not contain the equivalent of Article 25(1), as the timeline to file a MAP request is shorter than three years from the first notification of the action resulting in taxation not in accordance with the provision of the tax treaty.


According to the MAP guidance released by the tax administration in November 2018, it is clear that transfer pricing issues fall within the scope of the MAP. Availability and access to MAP is also confirmed in Brazil’s “Dispute Resolution Profile”.

Although not part of the BEPS Action 14 minimum standard, best practice 1 of BEPS Action 14 recommends that countries should include paragraph 2 of Article 9 in their tax treaties, with the understanding that such a change is not intended to create any negative inference with respect to treaties that do not currently contain a provision based on paragraph 2 of Article 9.

Almost all OECD members include paragraph 2 of Article 9 in their tax treaties with the exception of Czech Republic which reserves the right “not to include paragraph 2 in its conventions, but is prepared in the course of negotiations to accept this paragraph and at the same time to add a third paragraph limiting the potential corresponding adjustment to bona fide cases”. A number of other OECD members also expressed reservations on the Article.

**Box 4.1. Reservations on Article 9**

16. The Czech Republic reserves the right not to insert paragraph 2 in its conventions but is prepared in the course of negotiations to accept this paragraph and at the same time to add a third paragraph limiting the potential corresponding adjustment to bona fide cases.

17. [Deleted]

17.1 Italy reserves the right to insert in its treaties a provision according to which it will make adjustments under paragraph 2 of Article 9 only in accordance with the procedure provided for by the mutual agreement article of the relevant treaty.

18. Australia reserves the right to propose a provision to the effect that, if the information available to the competent authority of a Contracting State is inadequate to determine the profits to be attributed to an enterprise, the competent authority may apply to that enterprise for that purpose the provisions of the taxation law of that State, subject to the qualification that such law will be applied, as far as the information available to the competent authority permits, in accordance with the principles of this Article.

19. Hungary and Slovenia reserve the right to specify in paragraph 2 that a correlative adjustment will be made only if they consider that the primary adjustment is justified.


**MAP process**

The following paragraphs describe the MAP process in Brazil and highlight potential concerns.

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206 Normative Instruction 1,846/18 (superseded Normative Ruling 1,669 of 10 November 2016).

207 All members of the Inclusive Framework on BEPS commit to the implementation of the Action 14 minimum standard which includes publishing their MAP profiles pursuant to an agreed template. Brazil’s profile is available at: [www.oecd.org/tax/dispute/Brazil-Dispute-Resolution-Profile.pdf](http://www.oecd.org/tax/dispute/Brazil-Dispute-Resolution-Profile.pdf).


209 See OECD MTC 2017, Reservations on Article 9, p. 230.
Denial of access to the mutual agreement procedure in transfer pricing cases

376. Brazil formally introduced MAP guidance on 10 November 2016 through Normative Instruction 1,669/2016, which was recently superseded by Normative Instruction 1,846/2018. Prior to the issuance of this Normative Instruction, tax treaties concluded by Brazil contained MAP provisions, but there was no actual regulation or administrative guidance regarding MAP. As of March 2019, Brazil has 33 tax treaties in force and another four awaiting entry into force that contain provisions regarding MAP.

377. Additionally, in December 2018, RFB published an official MAP manual, which highlights some of the views and interpretations of the MAP provisions agreed to by Brazil in tax treaties, as well as the Normative Instruction 1,846/2018 that is currently in place and regulates the matter in Brazil.

378. Within this legal framework, Brazil has granted and continues to grant access to MAP for transfer pricing cases, according to the recently published MAP Peer Review Report. Therefore, as addressed by the BEPS Action 14 minimum standard, the fundamental concern with respect to the MAP, which is the failure to grant MAP access in transfer pricing cases, is not an issue in the Brazilian transfer pricing context.

379. Brazil’s MAP guidance also contains the list of documents and information that the taxpayer is required to provide to submit a MAP request, which is also in line with the BEPS Action 14 Final Report. In particular, documents in English and Spanish are accepted by Brazil’s competent authority but all documents in another language than Portuguese have to be translated. It also stipulates that Brazil’s competent authority will inform the other contracting state of any MAP requests it receives, even in cases where access to MAP was denied.

380. Brazil’s Peer Review Report concludes that the country meets some requirements regarding the availability and access to MAP under the Action 14 minimum standard, as clear and comprehensive guidance was published on the availability of MAP and how it applies this procedure in practice. It is noted that Brazil: “provides access to MAP in eligible cases, although it has since 1 January 2016 not received any MAP requests concerning cases where anti-abuse provisions are applied and it has no audit settlement process in place”.

Time limits

381. Further, the work on Action 14 of the BEPS Action Plan directly addresses the obstacle that domestic law time limits may present to effective mutual agreement procedures. Element 3.3 of the Action 14 minimum standard includes a recommendation that countries should include the second sentence of paragraph 2 of Article 25 in their tax treaties to ensure that domestic law time limits (1) do not prevent

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210 Argentina, Austria, Belgium, Canada, Chile, China (People’s Rep.), the Czech Republic, Denmark, Ecuador, Finland, France, Hungary, India, Israel, Italy, Japan, Korea (Rep.), Luxembourg, Mexico, the Netherlands, Norway, Peru, Philippines, Portugal, Russia, the Slovak Republic, South Africa, Spain, Sweden, Trinidad and Tobago, Turkey, Ukraine and Venezuela, and four tax treaties with Singapore, Switzerland, the United Arab Emirates, and Uruguay which had been signed but had yet to enter into force.


213 Element 1.1 of the BEPS Action 14 minimum standard.

214 “Any agreement reached shall be implemented notwithstanding any time limits in the domestic law of the Contracting States”.
the implementation of competent authority mutual agreements and (2) do not thereby frustrate the objective of resolving cases of taxation not in accordance with the Convention.\textsuperscript{215}

382. Where a country cannot include the second sentence of paragraph 2 of Article 25 in its tax treaties, element 3.3 of the Action 14 minimum standard states that it should be willing to accept an alternative treaty provision that limits the time during which a Contracting State may make an adjustment pursuant to Article 9, paragraph 1 or Article 7, paragraph 2, in order to avoid late adjustments with respect to which mutual agreement procedure relief will not be available.

383. Based on Brazil’s legal framework and current Supreme Court jurisprudence regarding hierarchy of tax treaties, implementation of MAP agreements can only be made within its domestic statute of limitation even when the relevant treaty contains the equivalent of Article 25, paragraph 2, second sentence of the OECD MTC, both for upward and downward adjustments that would result from a MAP agreement.

384. This situation has also been reflected in the Commentary on Article 25 of the 2014 OECD MTC, where Brazil’s position states that “implementation of reliefs and refunds following a mutual agreement ought to remain linked to time limits prescribed by domestic law”.\textsuperscript{216} This position is however no longer reflected in the 2017 OECD MTC, but due to remaining issues pertaining to the domestic law, the “Brazil Dispute Resolution Profile” still reflects that Brazilian conventions do not adopt the obligation of giving effect to the agreement reached irrespective of any time limits in its domestic law.\textsuperscript{217}

385. It is interesting to mention that some tax treaties concluded by Brazil, for example the tax treaties with India and Portugal, have the second sentence of Article 25, paragraph 2, of the OECD MTC, which states that “any agreement reached shall be implemented notwithstanding any time limits in the domestic law of the Contracting States”. However, as noted above, Brazil would not be able to implement an agreement reached in a MAP when the statute of limitation in domestic law has expired.

386. As established above, any implementation of MAP would be subject to the statute of limitations of five years provided by the Brazilian law. In order to mitigate this problem, where the mutual agreement procedure involves a tax credit in Brazil that can be refunded, the taxpayers and the competent authorities are instructed in the MAP manual to submit a formal request claiming for the reimbursement of the tax unduly paid (i.e. downward adjustment), which is a necessary condition for suspending the time limit foreseen in the domestic legislation.\textsuperscript{219}

387. Even though Brazil provides for a mechanism that suspends the counting down for the statute of limitation in respect to a MAP that involves a tax credit, it seems that the current framework does not yet fully comply with element 3.3 of the BEPS Action 14 minimum standard. This minimum standard states that in the absence of the second sentence of Article 25, paragraph 2, of the OECD MTC, a country should be willing to accept an alternative treaty provision that limits the time during which a Contracting State may make an adjustment pursuant to Article 9, paragraph 1, in order to avoid late adjustments with respect to which mutual agreement procedure relief will not be available.\textsuperscript{220}


\textsuperscript{218} The tax treaty with India was signed in April 1988 and entered into force in April 1992. The tax treaty with Portugal was signed in July 2001 and entered into force in October 2001.

\textsuperscript{219} See page 14 of the MAP manual.

\textsuperscript{220} See paragraphs 38 and 39 of the BEPS Action 14 Final Report.
The Peer Review Report also informs that Brazil does not fully meet the minimum standard because: "the absence of response from Brazil and the expiration of Brazil's domestic time limit have caused that some MAP cases could not be resolved in the past. Furthermore, Brazil does not have in place a documented notification process for those situations in which its competent authority considers the objection raised by taxpayers in a MAP request as not justified."

Implementation of a MAP agreements

As regards the implementation of MAP agreements, Brazil's MAP guidance indicates that MAP agreements are implemented once accepted by taxpayers. From a procedural standpoint, taxpayers have to submit an application for reimbursement at the same time as the MAP request (if not already submitted before) so that a downward adjustment can be made in case the MAP agreement requires Brazil to do so. In order to have MAP agreements implemented, taxpayers also have to commit that they will not pursue any administrative appeal or legal proceeding for the matter at stake.

It is not clear how a potential dispute related to transfer pricing would be resolved through a MAP procedure, especially given the peculiarities contained in the domestic law – e.g. fixed margins, lack of comparability analysis and limitations to the deductibility of certain expenses. There is also absence of clear guidance on how a MAP outcome involving a possible downward corresponding adjustment would be implemented in Brazil. Besides that, there is no specific mechanism under domestic law to implement corresponding adjustments.

The Peer Review Report also notes that Brazil does not fully meet the Action 14 minimum standard as regards the implementation of MAP agreements, "as Brazil has a domestic statute of limitation which impacts on the implementation of MAP agreements" and raises the following risk:

This leads to a risk that such agreements cannot be implemented where the applicable tax treaty does not contain the equivalent of Article 25(2), second sentence, of the OECD Model Tax Convention. Brazil has taken measures to mitigate this risk, mainly through a better communication with the relevant stakeholders. With respect to the agreements that could be reached, no issues have surfaced throughout the peer review process and Brazil monitors their implementation via a tracking system.

Concerns related to the differences between the Brazilian transfer pricing and international standards

In view of the above scenario, despite the current existent legal framework in Brazil related to MAP, practical challenges may arise for transfer pricing cases. The OECD Guidelines foresee the need to enter into MAPs in situations where different positions on the arm's length outcome are a reason of dispute. The differences between the Brazilian transfer pricing framework and the international standards may lead to disputes in respect of MAP, which may not be easily resolved due to the specificities of Brazilian transfer pricing rules.

In this context, although Brazil has committed itself to guaranteeing access to the mutual agreement procedure in cases involving the application of transfer pricing legislation, the adoption of a system of fixed margins under Brazilian law may in practice make resolution of a conflict challenging.

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221 Brazil seems to be willing to make changes in this area, as it stated in its MAP profile that “Under the DTAs signed by Brazil and the domestic legislation provisions, there may be limits to reach a solution in a transfer pricing case. Brazil is seeking improvement in that aspect in line with its participation in the BEPS Project”.

222 See paragraph 4.50 of the OECD Guidelines. See also the BEPS Action 14 Final Report and Article 25 of the OECD MTC.
4.2.3. Absence of secondary adjustments

393. Brazil currently does not foresee secondary adjustments.

4.2.4. Absence of simultaneous tax examination procedure in practice

394. Brazil could potentially engage in simultaneous tax examination procedures, but does not use this procedure in its administrative practice.

4.2.5. Weaknesses in and potential abuse of safe harbour rules

395. The Brazilian transfer pricing rules provide three safe harbour regimes (which are not applicable to commodity transactions):

- **De minimis** export amount:\(^{223}\) Brazilian taxpayers with export revenues of 5% or less of total revenue (in relation to both related and unrelated parties) do not have to adopt transfer pricing methods for export transactions. This test pertaining to the materiality of the export revenues is applicable to the company as a whole, and includes the export revenues in transactions undertaken with persons and legal entities domiciled in low-tax jurisdictions.

- **90% test:**\(^{224}\) This is a transaction-by-transaction test under which, if the export price represents at least 90% of the domestic market price, the export price adopted is deemed acceptable. It also applies to sales to low-tax jurisdictions and privileged tax regimes.

- **Profitability test:**\(^{225}\) Under this test, where a Brazilian exporter is able to demonstrate that, on an overall basis, exports to related parties generated a minimum 10% net profit margin, the transactional conditions are deemed to be acceptable. This safe harbour is not applicable to taxpayers entering into outbound intercompany transactions whose net revenue from related parties represents more than 20% of the total outbound transaction net revenue. It does not apply to sales to situations involving low-tax jurisdictions and privileged tax regimes. It is notable that in this case the strict item-per-item approach is not enforced.

396. The first type of safe harbour raises a concern regarding its appropriateness because it does not distinguish between different sizes of taxpayers (e.g., a small company or a huge conglomerate can take advantage of the same safe harbour). For example, a company with a turnover of EUR 100 million, which is part of a group whose turnover exceeds EUR 750 million, could apply the safe harbour, even if it is clearly a large company and a part of an even larger group which has the necessary capacity to apply transfer pricing rules. Furthermore, determination of the 5% threshold can be affected by mispricing because it would already be the actual transfer value that would be considered for the purposes of considering whether the threshold was met. Assuming an actual value of exported goods of EUR 30 million, but agreed transfer prices of EUR 5 million, the company could qualify for the safe harbour even though in substance it should not be eligible.

397. The second type of safe harbour raises a concern in terms of its appropriateness as it is based on a comparison between the prices on the domestic market in Brazil and the prices of the same goods or products on foreign markets. The profit potential may be significantly different in the foreign market, such as in a situation where foreign customers would have a different purchasing power or premium pricing would apply in foreign markets due to the scarcity or uniqueness of the particular products. This concern

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\(^{223}\) Article 49 of Normative Ruling 1,312/12.

\(^{224}\) Article 19 of Law 9,430/1996.

\(^{225}\) Article 48 of Normative Ruling 1,312/12. It is worth noting that prior to 1 January 2013 the safe harbour percentage was 5% and the 20% of total outbound net revenue requirement did not exist.
intensifies depending on the type of product and the type of economy targeted for exportation in the
eventuality that comparability factors (even though the standard of comparability is strict in principle) do
not take into account the specificity of the foreign markets in this safe harbour.

398. The third type of safe harbour also presents a concern in terms of its appropriateness. The safe
harbour assumes that out of the total export volume, not more than 20% is in relation to related parties.
This implies that 80% of the export volume should be in relation to unrelated parties. In the cases where
there are comparable transactions with unrelated parties, there should be sufficient information available
to apply the Brazilian version of the CUP method for exports (PEVEx method). In this respect, the
application of the safe harbour regime could lead to under-taxation, as all the taxpayer is required to do is
justify the minimum 10% net profit margin.

399. The fixed margins approach has been qualified as a safe harbour, or considered as an “adhesion
model” or “adhesion APA”. It should not, however, be confused with safe harbour regimes as described in
the OECD Guidelines,226 which are generally optional and only available under narrowly defined conditions.

4.2.6. Absence of advance pricing arrangements

400. Brazil does not have an APA programme in place, meaning there is currently no procedure under
which a taxpayer may enter into a unilateral, bilateral or multilateral APA with the tax authorities.

401. For Brazil to implement an APA programme, it would need to enact a specific legal provision
providing the limits and conditions under which the Brazilian tax authorities competent authorities can
negotiate APAs (unilateral, bilateral, or multilateral) with taxpayers.

402. In addition, even with the enactment of a specific legal provision, it would still be difficult to
conclude bilateral APAs considering that the effective jurisdictions will apply different standards and
principles in many cases.

403. Article 5, paragraph 2, of Normative Instruction 1,846/2018 states that the review to be performed
by RFB in the context of a MAP request may include analysis of foreign “advance pricing arrangements”
and the like, pointing to the relevance of APAs concluded with other tax administrations.227

4.2.7. Mechanism to challenge the fixed margins

404. It is possible to request a change of the fixed margins provided for the purposes of the methods
that incorporate them, i.e. those that are broadly equivalent to the resale price (PRL and PVA/PVV) and

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226 The country chapter on Brazil in the United Nations Practical Manual on Transfer Pricing for Developing Countries
(paragraph 10.1.1.5. of the November 2012 version) includes a statement that: “Brazil’s resale price and cost plus methods
with fixed margins are not ‘safe harbour’ methods. For these purposes, safe harbours mean provisions that apply to a defined
category of taxpayers or transactions that relieve eligible taxpayers, at their option, from certain obligations in pricing controlled
transactions otherwise applicable under the arm’s length standard.”

227 Article 5, paragraph 1, item XII, provides that the request for the opening of a MAP must be presented to the RFB
unit of the tax domicile of the applicant and must contain evidence that the matter has been submitted to judicial or
administrative review in Brazil or in the other Contracting State, together with a copy of the application and the
corresponding reply. In this context, paragraph 2 of Article 5 prescribes that the administrative review referred to in
item XII covers advance pricing arrangement (APA), tax consultation proceedings, specific interpretation by the foreign
tax administration, rulings or similar proceedings.
cost plus (CPL and CAP) methods. Ordinance 222/08 regulates the administrative aspects of the provision allowing taxpayers to request the use of different profit margins than those prescribed by these methods.

405. In particular, requests may generally be made by sector through a body representing an entire economic or professional sector at the national level or by an individual taxpayer. Requests are submitted to the tax authorities for examination, and they can propose a response pending ultimate approval by the Ministry of Finance. The decision taken is definitive and concerns only future transactions or transactions carried out in the same year as the request. The timeframe for the analysis of the request is not provided. If the request is denied, the only recourse for taxpayers is through legal proceedings. If granted, the tax authorities are obliged to propose a period of time of at least two years during which the new margin will be applicable. Other situations covered by Ordinance 222 include the situation where facts may alter the approved margin between the third and fifth year (for periods longer than three years), in which case the original margin will apply, as well as the situation where administrative rulings interpret the application of specific methods, which the taxpayer requesting the application of a different margin will give up the right to challenge. Finally, Ordinance 222 does not permit a request that claims a change in the margins that were already applied in past periods.

406. This mechanism, however, has not been used to any significant extent by taxpayers. To date, none of the requests submitted by taxpayers have been granted due to an insufficient level of supporting documentation.

407. It is suggested that if a taxpayer were in possession of the required level of supporting documentation, then it would be possible to apply the PIC or PVEx methods (CUP-like methods), and there would no longer be a need to challenge the fixed margin. Such information may be sensitive and translate to increased exposure to a tax audit – a risk that is certainly taken into consideration by taxpayers and reduces the incentive to use the mechanism.

4.2.8. Arbitration

408. There are no arbitration clauses in tax treaties entered into by Brazil. Moreover, Brazil has reserved the right not to include Article 25, paragraph 5, of the 2017 OECD MTC in their tax treaties.

409. The inability to start an arbitration procedure constitutes a gap in the Brazilian international tax framework, which could be addressed in the future. It may be an important consideration for Brazil to assure investors that potential double taxation will be effectively eliminated.

4.3. Assessment of effectiveness

410. The assessment of effectiveness in relation to the administrative approaches to avoiding and resolving transfer pricing disputes is most relevant for aspects of the Brazilian transfer pricing system that relate to MAP and the implementation of corresponding adjustments, which raise important concerns. In addition, the transfer pricing compliance practices, absence of corresponding adjustments, absence of...
secondary adjustments, safe harbours, absence of advance pricing arrangements, the mechanism to challenge the fixed margins and the absence of arbitration are assessed according to their effectiveness.

4.3.1. Transfer pricing compliance practices

411. Because of its peculiar transfer pricing regime, Brazil diverges significantly when considering the compliance practices seen in OECD member countries. The application of the fixed margins and the absence of a complete comparability analysis lead to a scenario where the existing examination practices are generally limited to assessing the formalistic compliance of taxpayers with prescriptive rules rather than assessing the reasonability of the transfer pricing outcomes. Tax examiners have limited ability to be flexible in their approach. They also cannot take into account the taxpayer’s commercial judgment about the application of the arm’s length principle.

412. Other features of Brazil’s existing tax system that have a bearing on the overall administration of transfer pricing should be considered as well, such as the penalty system and the statute of limitations.

413. The penalty system is currently based on a percentage of the tax due, with an interest element reflecting the time value of money, which is payable on the underpaid tax due. The penalty system also takes into account the misconduct of the taxpayer because penalties will be increased in the cases of non-cooperation of the taxpayer or refusal to provide the requested supporting documentation.

414. The existing penalty system however does not sufficiently distinguish between voluntary compliance and non-compliance determined on the basis of an assessment by the tax administration because the effective difference between the penalties applicable in the two different situations becomes insignificant. This is mainly because of the reduction of the penalties by half where the taxpayer voluntarily pays the assessed amount after his misconduct was determined through a tax audit. This outcome will not necessarily motivate taxpayers to ensure that they correctly self-assess the related-party transactions because they will rely on the possibility that in the case of detection, any penalty due can be subsequently significantly reduced.

415. In addition, there may not be sufficiently material penalties for failure to comply with transfer pricing documentation requirements, such as CbC Reporting, which may not create sufficient motivation for the taxpayer to prepare and complete the relevant information fully, truthfully, and correctly. This issue may be further exacerbated in cases of information being held abroad since the administration may not have sufficient tools to enforce such obligations, which may create difficulties in accessing information on foreign related parties. This could further create negative implications for Brazil, where Brazil is to comply with international standards and commitments because failure of the tax administration to receive or enforce collection of such information may be also interpreted as a systemic failure.

416. The statute of limitation may make it difficult to conclude all the necessary steps of the tax examination process (risk assessment, selection of taxpayer, exchange of information, obtaining information from abroad, as well as issuing the final tax assessment) for transfer pricing issues within the limited period of time due to the fact that the assessment needs to be fully concluded within a five-year period, which poses a risk that the audit will not be completed in time. The risk is already high under the current system because the risk assessment and audit proceedings are lengthy and administratively burdensome for tax examiners. Such risk may further increase under the application of transfer pricing rules in line with the OECD Guidelines, which require even more efforts to administer (in terms of risk assessment, collection of information, which may also require exchange of information, performance of the steps of the comparability analysis, etc.). In addition, a strict five-year period does not allow for the application of certain concepts of the OECD framework, such as the hard-to-value intangibles approach.

417. In general, the current compliance and examination framework provides weak incentives for self-compliance. If left as it stands, it could lead to a high degree of deliberate non-compliance.
Findings of the assessment

Prevention of BEPS risks
The current compliance framework does not provide sufficient protection against BEPS risks. Taxpayers may exploit the existing system and shift profits to low or no tax jurisdictions outside of Brazil, and they can also shift income to companies which benefit from exemptions or special regimes within Brazil. The existing framework does not provide tax examiners with sufficient tools and instruments to effectively identify and address those risks. Separately, the existing penalty practices do not provide sufficient disincentives for non-compliance, including BEPS.

Prevention of double taxation
Given that the current transfer pricing framework relies on prescriptive rules and does not allow much administrative consideration and flexibility, potential cases of double taxation may not be addressed or relieved through the existing administrative framework. In particular, for more complex transfer pricing issues, the existing procedures do not seem to provide sufficient safeguards against double taxation.

Ease of tax administration
Since there is no need to systematically perform a complete comparability analysis, the administrative burden is lighter than in other countries which follow OECD standards. In other words, it is easier for the tax administration to apply the transfer pricing methods or verify their appropriateness. However, the complexity of transfer pricing cases may make it difficult to conclude an audit within the statute of limitations, which may result in unsuccessful outcomes for tax authorities.

Ease of tax compliance
Similarly, the current compliance practices which are based on the application of the fixed margins also simplifies tax compliance for taxpayers. It can be argued that compliance is less time-consuming and less resource-intensive than in the context of the OECD Guidelines.

Tax certainty
The current compliance practices contribute towards more tax certainty from a domestic perspective, but there is significant cross-border tax uncertainty as a result of important differences affecting compliance requirements.

4.3.2. Concerns over resolution of transfer pricing disputes
418. Brazil does not include paragraph 2 of Article 9 of the OECD MTC in its tax treaties, which means there is an absence of obligatory corresponding adjustments. In addition, even though Brazil has issued administrative guidance in order to comply with the BEPS Action 14 minimum standard, concerns remain in relation to the implementation of MAP outcomes, notably because the domestic legislation does not provide for a mechanism to implement corresponding adjustments. Before 2016, Brazil lacked experience in resolving MAP cases and did not have a specific team to deal with them. However, since the publication of the BEPS Action 14 Final Report, Brazil took several steps in order to reduce these shortcomings, which consists of having more adequate resources and internal guidance to deal with MAP cases. Considering that Brazil’s MAP caseload has increased significantly since 2016, and could be expected to continue
increasing in particular in the case of transfer pricing cases, further capacity development and investment will be necessary in order to resolve MAP cases in a timely, efficient and effective manner.

Findings of the assessment

Prevention of BEPS risks

The potential lack of relevant capacities and resources to perform proper comparability analyses based on the arm’s length principle can put Brazil at risk that the assessment of Brazil’s position will not be accurately made and MAP outcomes will be negotiated in a way which may be detrimental to the tax base of Brazil.

Prevention of double taxation

Despite the fact that Brazil has expressed willingness to resolve transfer pricing disputes and provide corresponding adjustments based on Article 25 of the OECD MTC, the absence of an explicit mechanism for corresponding adjustment due to the absence of Article 9, paragraph 2, as well as limited evidence of resolved cases due to a low number of transfer pricing cases being submitted for MAP and the absence of mandatory arbitration may create concerns about the likelihood of effective resolution of double taxation in transfer pricing cases.

The absence of an additional dispute resolution mechanism, such as the arbitration procedure, may also reduce the effectiveness of the resolution of MAP cases, since the MAP procedure does not require the parties to the tax treaty to resolve the dispute but only to use their best efforts to do so. As a consequence, this might lead to a scenario where double taxation is not always effectively eliminated.

Ease of tax administration

The absence of mandatory corresponding adjustment mechanism as well as lack of clarity and guidance on the principles regulating the MAP process can create a potential additional burden for the tax administration (e.g., taxpayers will increasingly challenge outcomes through administrative appeals and in judicial procedures rather than MAP).

The absence of other dispute resolution mechanisms, such as the arbitration procedure, may also save resources and reduce the administration burden; however, there may be an indirect effect because taxpayers will seek to challenge the existing transfer pricing adjustments in courts and through administrative appeals rather than rely on effective dispute resolution in MAP by binding arbitration.

Ease of tax compliance

The absence of corresponding adjustment mechanism does not necessarily increase the tax compliance burden.

Tax certainty

The absence of a binding corresponding adjustment mechanism creates uncertainty from both a domestic and international perspective (i.e. Brazilian taxpayers not being granted corresponding adjustments). Issues associated with dispute resolution mechanisms constitute an important driver of uncertainty (i.e. foreign taxpayers will not get relief from double taxation).
The absence of another dispute resolution mechanism, such as the arbitration procedure, may undermine tax certainty for taxpayers, especially from the cross-border perspective.

4.3.3. Absence of secondary adjustments

419. Brazil's system does not provide for the possibility to perform secondary adjustments. Countries that have introduced this measure were motivated mainly by the objective of collecting additional tax revenue to ensure that the profits that have been shifted elsewhere have been probably accounted for from the perspective of taxes applicable on profit distribution. Countries may also take the alternative view that the shifted profit is capital provided to related parties as a loan, where this capital is to be returned to the party from which it was shifted, including the accrued interest. Finally, the countries which apply secondary adjustments would also see these adjustments as a way to motivate the compliance of taxpayers who may potentially face higher taxes and penalties as a consequence.

Findings of the assessment

Prevention of BEPS risks

The absence of secondary adjustments may raise BEPS issues, as there would be no mechanism to make the actual allocation of profits consistent with the primary transfer pricing adjustment. Brazil does not currently levy tax on dividends so there is no immediate loss of revenue, but this will change should the contemplated introduction of a withholding tax on profit distribution be implemented in the near future.

Prevention of double taxation

The absence of secondary adjustments under the current regime does not create additional problems with elimination of double taxation because should the primary adjustments be diverging from arm’s-length outcomes, secondary adjustments would further increase the burden of double taxation.

Ease of tax administration

The absence of secondary adjustments does not necessarily have a negative impact on tax administration.

Ease of tax compliance

The absence of secondary adjustments does not necessarily have a negative impact on tax compliance.

Tax certainty

The absence of secondary adjustments does not have a negative effect on tax certainty.

4.3.4. Safe harbour rules

420. As stated above, a safe harbour in a transfer pricing regime is a provision that applies to a defined category of taxpayers or transactions and that relieves eligible taxpayers (usually small and medium size enterprises which may lack the necessary resources to carry out full-fledge transfer pricing analysis) from
certain obligations otherwise imposed by a country’s general transfer pricing rules. In addition, the appropriateness of safe harbours is essential and a key element in order to lessen the likelihood of BEPS risks and double taxation, and to contribute to the ease of tax administration and tax certainty.

Findings of the assessment

Prevention of BEPS risks

As mentioned above, all three existing safe harbour regimes raise concerns as to their appropriateness and the potential BEPS risks that they may create.

The 5% de minimis rule does not distinguish between the taxpayers who may qualify and does not provide clear guidance on how the 5% threshold is to be determined, which means that mispriced revenues would be the basis for assessment. This creates a potential BEPS risk.

The 90% test safe harbour applies in cases where the export price represents 90% or more of the domestic market price. In such a case, the export price adopted is deemed acceptable, and this may also raise BEPS risks for the following reasons. This safe harbour is based on a comparison of prices applied in the domestic market in Brazil and the prices of the same goods or products in transactions in foreign markets. The profit potential may be significantly different in foreign markets. Differences in purchasing power or premium pricing due to scarcity or uniqueness of the particular products, and the specificity of the market may create outcomes that will present BEPS risks for Brazil.

Further, the profitability test safe harbour also may lead to concerns of appropriateness as well as potential loss of revenue for Brazil. Under this test, where a Brazilian exporter is able to demonstrate that, on an overall basis, exports to related parties generated a minimum 10% net profit margin, the transactional conditions are deemed to be acceptable. In addition, the provision also states that 80% of export volume should be in relation to unrelated parties. In the cases where are comparable transactions with unrelated parties, there should be sufficient information available to apply the Brazilian version of the CUP method for exports (PEVEx). Accordingly, the application of the safe harbour regime could lead to under-taxation, as all the taxpayer is required to do is justify the minimum 10% net profit margin.

Prevention of double taxation

The existence of the current safe harbours may lessen the likelihood of double taxation because the existing transfer pricing will not apply in most cases. Therefore, the current negative effects of existing rules resulting in double taxation may not arise or they may be mitigated to a certain extent.

Ease of tax administration

The safe harbours in Brazil reduce the potential burden for the tax administration because they do not have to analyse compliance with the existing transfer pricing rules for the situations covered by the safe harbours.

Ease of tax compliance

Taxpayers qualifying for the safe harbour have a significantly lighter compliance burden because it eliminates the need for data collection and compliance with associated documentation requirement.
Tax certainty
The existence of the safe harbours contributes towards more tax certainty, as the eligible taxpayers will have their price charged or paid on qualifying controlled transactions accepted by the tax administrations. The tax administration would accept, with limited or no scrutiny, transfer prices within the safe harbour parameters which would contribute toward tax certainty in both domestic and cross-border situations. There may be limited instances where the existing safe harbours may not achieve tax certainty in cross-border situations, which could be cases where taxpayers wrongly determine the arm’s-length price and this is not accepted by the other tax administration that could still challenge the outcome of the application of the safe harbour.

4.3.5. Absence of advance pricing arrangements – inability to prevent double taxation

421. APAs may be most useful when traditional mechanisms fail or are difficult to apply. In particular, it is recognised that bilateral APAs provide a greater level of certainty in both treaty partner jurisdictions, lessen the likelihood of double taxation and may proactively prevent transfer pricing disputes.\(^{231}\)

Findings of the assessment

Prevention of BEPS risks
The absence of APA programmes does not allow for horizontal monitoring and scrutiny of transactions until they become visible to tax authorities, thereby reducing the opportunities for early identification of BEPS risks.

Prevention of double taxation
Bilateral APAs lessen the likelihood and thus contribute towards prevention of double taxation. The lack of APA mechanism in Brazil means there is no prevention mechanism in place, which contributes to higher likelihood of double taxation.

Ease of tax administration
APAs provide an opportunity for ongoing horizontal monitoring of taxpayer practices and it thus may proactively prevent transfer pricing disputes and contribute to effectiveness of tax administration.

Ease of tax compliance
Taxpayers need to determine transfer pricing approaches in absence of horizontal monitoring and guidance/dialogue with tax authorities, which tends to increase tax compliance costs.

\(^{231}\) Work pursuant to BEPS Action 14 to ensure the timely, effective and efficient resolution of treaty-related disputes recommended, as non-binding best practice 4, that countries should implement bilateral APA programmes.
**Tax certainty**

APA programmes generally provide a greater level of certainty. Existence of a functional and effective APA programme contributes towards more tax certainty. Absence of APAs means that this positive effect on tax certainty is absent, which is even more critical from a cross-border perspective.

Bilateral or multilateral APA programmes provide a greater level of certainty in the relevant treaty partner jurisdictions, because they ensure that the APA results are acceptable in all the jurisdictions involved. Such programmes are currently absent. This is a missed opportunity for tax certainty in Brazil.
The fifth chapter contains the analysis of Brazil’s relevant transfer pricing rules in respect of transfer pricing documentation as compared with the guidance in Chapter V of the OECD Guidelines, which is intended to provide guidance for tax administrations in developing rules and/or procedures on documentation to be obtained from taxpayers in connection with a transfer pricing enquiry or risk assessment. Brazil’s system has specific transfer pricing documentation-requirements corresponding to the information needs for the application of its transfer pricing methods. The differences are highlighted and assessed according to the policy objectives of transfer pricing rules.
5.1. A three-tiered approach to transfer pricing documentation

422. Chapter V of the OECD Guidelines is intended to provide guidance for tax administrations in developing rules and/or procedures on documentation to be obtained from taxpayers in connection with a transfer pricing enquiry or risk assessment. This chapter also serves the purpose of providing guidance to assist taxpayers in identifying relevant documentation to show that their transfer pricing is consistent with the arm’s length principle and thus prove helpful in resolving transfer pricing issues as well as satisfying tax examinations. The Guidelines contain a discussion of the objectives of transfer pricing documentation rules, which also provides guidance for the development of such rules so that transfer pricing compliance is more straightforward and more consistent among countries. At the same time, it is meant to ensure that tax administrations are provided with more focused and useful information for transfer pricing risk assessments and audits. Further, it should be noted that an important overarching consideration in developing these rules is to balance the usefulness of the data to tax administrations for transfer pricing risk assessment and other purposes with any increased compliance burdens placed on taxpayers.

423. The Guidelines list three main objectives of transfer pricing documentation rules, which are attainable through the recommended three-tiered approach, namely (i) to ensure that taxpayers give appropriate consideration to transfer pricing requirements in establishing prices and other conditions for transactions between associated enterprises and in reporting the income derived from such transactions in their tax returns; (ii) to provide tax administrations with the information necessary to conduct an informed transfer pricing risk assessment; and (iii) to provide tax administrations with useful information to employ in conducting an appropriately thorough audit of the transfer pricing practices of entities subject to tax in their jurisdiction, although it may be necessary to supplement the documentation with additional information as the audit progress.

424. These three objectives related to the taxpayer’s own compliance with the arm’s length principle, transfer pricing risk assessment and transfer pricing audits form the underlying objectives of the documentation rules. In this respect, the design of appropriate domestic transfer pricing documentation requirements should take into account these three objectives. Further information on each objective is provided in the Guidelines.

425. The three-tiered approach to transfer pricing documentation consist of (i) a master file containing standardised information relevant for all MNE group members; (ii) a local file referring specifically to material transactions of the local taxpayer; and (iii) a Country-by-Country Report containing certain information relating to the global allocation of the MNE’s income and taxes paid together with certain indicators of the location of economic activity within the MNE group.

5.1.1. Master file

426. The master file should provide an overview of the MNE group business, including the nature of its global business operations, its overall transfer pricing policies, and its global allocation of income and economic activity. In producing the master file, information is considered important if its omission would affect the reliability of the transfer pricing outcomes.

427. The information required in the master file provides a high-level overview of the whole MNE group and contains relevant information that can be grouped in the following five categories: a) the MNE group’s organisational structure; b) a description of the MNE’s business or businesses; c) the MNE’s intangibles; d) the MNE’s intercompany financial activities; and e) the MNE’s financial and tax positions.\textsuperscript{232}

\textsuperscript{232} See paragraph 5.19 of the OECD Guidelines.
5.1.2. Local file

428. The local file provides more detailed information relating to specific intercompany transactions. This information supplements the master file and focuses on information relevant to the transfer pricing analysis related to transactions taking place between a local country affiliate and associated enterprises in different countries and which are material in the context of the local country’s tax system, including relevant financial information regarding those specific transactions, a comparability analysis, and the selection and application of the most appropriate transfer pricing method. Items of information to be included in the local file are included in an annex to the Guidelines.\textsuperscript{233}

5.1.3. Country-by-Country report

429. The Country-by-Country report (CbCR) requires aggregate tax jurisdiction-wide information relating to the global allocation of the income, the taxes paid, and certain indicators of the location of economic activity among tax jurisdictions in which the MNE group operates. In addition, the report requires a listing of all the constituent entities for which financial information is reported, including the tax jurisdiction of incorporation, where different from the tax jurisdiction of residence, as well as the nature of the main business activities carried out by that Constituent Entity. CbCR is useful for high-level transfer pricing risk assessment purposes and may be used by tax authorities in evaluating other BEPS related risks and, where appropriate, for economic and statistical analysis.

430. A model template of the report is included as an annex to the Guidelines.\textsuperscript{234}

431. The Guidelines importantly note that the Country-by-Country report should not be used as a substitute for a detailed transfer pricing analysis of individual transactions and prices based on a full functional analysis and comparability analysis.

5.2. Description of existing rules and practices in Brazil and gap analysis

432. The existing documentation requirements under the Brazilian transfer pricing system do not request the same level of detailed information from taxpayers as the OECD Guidelines. The information required to perform a complete transfer pricing analysis and apply OECD-recognised transfer pricing methods based on the Guidelines is more comprehensive than would be needed to perform a transfer pricing analysis in Brazil, which may explain lighter documentation requirements imposed on Brazilian taxpayers.

433. As far as the application of the transfer pricing methods is concerned in Brazil, the required documentation includes purchase and sale documents (e.g., invoices and receipts) and accounting and tax books containing information related to costs of production as well as documents supporting the

\textsuperscript{233} Annex II in Chapter V of the OECD Guidelines.

\textsuperscript{234} Annex III in Chapter V of the OECD Guidelines.
calculation of average costs and prices, and other complementary elements of proof.\textsuperscript{235} In addition to that, reports on quoted prices must be presented for transactions involving commodities.\textsuperscript{236}

Nevertheless, transfer pricing documentation may also be used for other purposes such as risk assessment beyond verification and control of transactions for transfer pricing purposes.

5.2.1. Master file

Brazil does not require the filing of the master file as developed under BEPS Action 13 and does not require any of the elements contained therein as part of its transfer pricing documentation rules. It is however a matter of fact that most countries around the world where MNEs operate require preparation of the master file. This means that both Brazilian-headquartered and foreign-headquartered MNEs prepare the master file for the purposes of complying with the documentation rules of foreign jurisdictions, but tax administration in Brazil is not able to benefit from the information contained therein, because it requires neither preparation nor submission of a master file. Brazil is thus missing out on important information that would provide the global economic, legal, financial and tax context of the MNE group’s transfer pricing practices as well as a high-level overview of the MNE group’s global operations and policies, which would be relevant for risk assessment, audit purposes, and supporting documentation for MAP cases.

5.2.2. Local file

Brazil does not require the filing of the local file as developed under BEPS Action 13.

However, documentation requirements found in the Brazilian transfer pricing rules include some elements of the local file (that must be filed together with the annual corporate tax return).

The following main elements need to be provided for transfer pricing purposes:\textsuperscript{237}

- Type of transaction: taxpayers need to indicate if the transaction undertaken involves goods, services, rights, financial transactions or indicate “non-specified”;
- Description of the transaction: identification of the elements, such as brand, model, etc.
- The amount of the transaction;
- The selected method used for the calculation of the parameter price;
- The parameter price and the practiced price (price charged);
- The amount of the adjustments.

\textsuperscript{235} As a complementary element of proof, the taxpayer can support its documentation requirements with “government publications or reports of the buyer’s or seller’s country, or a statement issued by the tax administration of the same country, provided that Brazil has entered into an agreement with that country to avoid double taxation of income or to exchange information” and “research done by a company or institution well-known for its technical expertise or technical publications which specify the sector, period, companies researched and margins found, and identify data collected and reviewed per company”, as stated Article 43 of Normative Instruction 1,312/12.

\textsuperscript{236} For the application of the methods designed for commodity transactions (PCI and PVEx methods).

\textsuperscript{237} See the Electronic Tax Accounting bookkeeping (ECF) at: \url{http://sped.rfb.gov.br/pagina/show/1285}.
5.2.3. Country-by-Country report

439. Brazil implemented Country-by-Country Reporting (Declaração País-a-País) by issuing Normative Ruling 1,681/16 of 28 December 2016.\(^{238}\) The template for the report is nearly identical to the model template included in Annex III of Chapter V of the Guidelines.

440. According to the first phase of the Country-by-Country Reporting peer review,\(^{239}\) Brazil meets all the terms of reference relating to the domestic legal and administrative framework. There was one exception, which led to a recommendation to ensure that the annual consolidated group revenue threshold is applied in a manner consistent with the OECD guidance on currency fluctuations. Brazil has now clarified the application of the threshold rule in its internal guidance, as confirmed at the outcome of the next round of peer review.\(^{240}\)

5.3. Assessment of effectiveness

Transfer pricing documentation requirements

441. The transfer pricing legislation in Brazil was designed with the intent of being simple and practical, a feature that is most noticeable in the area of transfer pricing documentation. For the application of the transfer pricing rules in Brazil, it appears that the information contained in the master file and the local file is less relevant. This information becomes useful for foreign tax authorities when considering the other side of transactions – i.e. entities located in foreign jurisdictions –, where transfer pricing rules and approaches more closely aligned with the OECD Guidelines are followed, but such considerations are not necessarily relevant for the application of some of the Brazilian transfer pricing methods. In the particular case of performing corresponding adjustments (should this become relevant in the future), the information contained in these files would become especially relevant.

Findings of the assessment

Prevention of BEPS risks

Important information contained in the master file and local file is missing from the documentation requirements under the Brazilian transfer pricing system, including the nature of the MNE group’s global business operations, its overall transfer pricing policies, and its global allocation of income and economic activity. Such information would be of great value in order to assist tax administrations in evaluating the presence of significant transfer pricing risk. Additional requirements on the basis of the master file and local file templates could therefore improve the risk assessment process. The current level and nature of information required may not be sufficient to identify and effectively audit BEPS risks.

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\(^{238}\) Available at: [http://normas.receita.fazenda.gov.br/sijut2consulta/link.action?idAto=79444](http://normas.receita.fazenda.gov.br/sijut2consulta/link.action?idAto=79444).


Prevention of double taxation

Should Brazil contemplate and attempt to effectively eliminate double taxation, it will be necessary for the Brazilian tax authorities to be able to have the same level of transfer pricing information as their foreign counterparts have available in the process of approving a corresponding adjustment or negotiating a MAP. Current information submitted by MNEs in Brazil would not be sufficient for this purpose.

Ease of tax administration

The efforts required to receive and process additional information, that may or may not be useful for tax authorities, could be perceived as greater and conducive to a heavier burden for the tax administration. If, however, efficient and appropriate use of the information is made, notably for risk assessment purposes, the collection of supplementary information through a master file and local file could work in favour of the tax administration.

Ease of tax compliance

The absence of local file and master file eases the tax compliance burden for taxpayers under the current system as they are not required to prepare the relevant documentation and comply with additional requirements. If adopted, additional requirements would foreseeably increase the burden and compliance costs for taxpayers.

Preparing two sets of documentation, one specifically for Brazil and other standardised documentation for other countries creates potential duplicity and extra compliance costs.

In some cases, some of the transfer pricing documentation (namely the master file) is already being prepared at the global level for other MNEs that are part of the MNE group, meaning that no extra significant compliance burden would be generated if Brazil were to require taxpayers who are of certain size that they submit master file in line with BEPS Action 13, since they are in most cases already preparing and submitting the master file abroad. Such burden could however increase if Brazil were to require that taxpayers prepare the master file differently than prescribed by the OECD Guidelines.

Tax certainty

The absence of the master file and local file has only limited impact on tax certainty from a domestic perspective, although it could result in a further discrepancy in terms of alignment with internationally accepted approaches. The absence of standardised master file and local file and the obligation to prepare specific types of documentation only for Brazilian purposes can create uncertainty concerns by foreign MNEs that may not be familiar with the specificities of Brazilian transfer pricing documentation requirements and can make mistakes or insufficiently prepare documentation which may be then refused by the Brazilian tax administration and this can have consequence that the selected method will be refused. This leads to higher tax uncertainty.
The sixth chapter contains the analysis of Brazil’s relevant transfer pricing rules for transactions involving the use or transfer of intangibles as compared with the guidance contained in Chapter VI of the OECD Guidelines. The main findings of the analysis include the differences in the definition of intangibles used for transfer pricing purposes, the absence of specific transfer pricing rules and lack of guidance for intangibles. This chapter also addresses the treatment of certain outbound payments involving intangibles. The implications of these divergences are assessed according to the policy objectives of transfer pricing rules.
6.1. Determining arm’s length conditions for the use or transfer of intangibles

442. Chapter VI provides special considerations for intangibles in order to determine arm’s length conditions for transactions that involve the use or transfer of intangibles and refine the execution of the comparability and functional analysis in accordance with Section D.1 of Chapter I. The guidance was principally developed to prevent BEPS by moving intangibles among group members by “(i) adopting a broad and clearly delineated definition of intangibles; (ii) ensuring that profits associated with the transfer and use of intangibles are appropriately allocated in accordance with (rather than divorced from) value creation; (iii) developing transfer pricing rules or special measures for transfers of hard-to-value intangibles”.241

443. Because the Chapters I - III analyses have already addressed the gaps or issues related to the guidance contained in these chapters, the analysis in this chapter will focus on the absence of special considerations for intangibles as the key gap identified in the Brazilian transfer pricing system.

444. In order to determine arm’s length conditions for the use or transfer of intangibles, it is first necessary to identify intangibles, based on a broad and clearly delineated definition. Further, the guidance contained in this chapter is intended to ensure that transfer pricing outcomes are in line with value creation and promotes the development of rules to prevent BEPS by moving intangibles among group members.

6.1.1. Identifying intangibles

445. According to the OECD Guidelines, an important consideration to be addressed at the outset is the definition of the term intangible. This definition should be neither too narrow nor too broad. On the one hand, a definition that is too narrow could result in arguments raised by taxpayers that certain items do not fall within the scope of the definition. On the other hand, if the definition is too broad, tax administrations or taxpayers alike may argue that the use or transfer of an intangible requires a compensation where no such compensation would exist between independent enterprises.

446. The definition focusses on the comparability analysis at the heart of the application of the arm’s length principle:

In these Guidelines, therefore, the word “intangible” is intended to address something which is not a physical asset or a financial asset, which is capable of being owned or controlled for use in commercial activities, and whose use or transfer would be compensated had it occurred in a transaction between independent parties in comparable circumstances. Rather than focusing on accounting or legal definitions, the thrust of a transfer pricing analysis in a case involving intangibles should be the determination of the conditions that would be agreed upon between independent parties for a comparable transaction.242

447. Rather than focussing on accounting or legal definitions, the thrust of a transfer pricing analysis in a case involving intangibles should be the determination of the conditions that would be agreed upon between independent parties for a comparable transaction. In other words, the use or transfer of an intangible asset would be compensated in transactions between independent parties.

448. Further elements required to qualify an intangible are its capacity of being owned or controlled and its capacity of being used in commercial activities. Items which cannot be controlled by the enterprise, such as local weather conditions, local market conditions or MNE group synergies, are not considered to be


intangibles, but they are considered as relevant comparability factors that should be considered during the comparability analysis. An intangible need not be a physical asset or a financial asset, it also need not meet the definition of an intangible for accounting purposes, or need not qualify as an intangible for general tax or treaty withholding tax purposes (Article 12 of the OECD MTC), or to be legally protected or separately transferable.

**Table 6.1. Illustrations: whether items should be considered as intangibles or comparability factors**

<table>
<thead>
<tr>
<th>Items often considered as intangibles</th>
<th>Items which are not considered to be intangibles, but constitute important comparability factors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Patents</td>
<td>Group synergies</td>
</tr>
<tr>
<td>Know-how and trade secrets</td>
<td>Market specific characteristics</td>
</tr>
<tr>
<td>Trademarks, trade names and brands, customer lists</td>
<td>Location savings</td>
</tr>
<tr>
<td>Rights under contracts and government licences</td>
<td>Workforce</td>
</tr>
<tr>
<td>Licences and similar limited rights in intangibles</td>
<td></td>
</tr>
<tr>
<td>Goodwill and ongoing concern value</td>
<td></td>
</tr>
</tbody>
</table>

Source: Paragraphs 6.18 and subsequent of the OECD Guidelines.

**6.1.2. Ensuring that profits associated with the transfer and use of intangibles are appropriately allocated in accordance with value creation**

449. The guidance provided in Chapter VI describes the analytical framework for a transfer pricing analysis involving intangibles. This specific guidance is needed because intangibles are an increasingly dominant feature of the modern and increasingly digitalised economy. The challenges related to intangibles are partially derived from the fact that intangibles are often some of the most valuable assets in the MNE group, but they are not physical assets so the ownership of intangibles can be easily transferred within the MNE group, which have an impact on income allocation and makes it one of the most risky areas in transfer pricing. The transfer pricing analysis of intangibles may start with the identification of the legal owner. This step is followed by the identification of the parties performing functions, using assets, and assuming risks related to the development, enhancement, maintenance, protection and exploitation of intangibles (the so-called DEMPE functions). Next, the analysis entails to cross-check the consistency of the agreements based on the conduct of the parties. Upon the identification of the relevant controlled transaction, an arm’s length price for the relevant transactions identified will be established, where possible. In exceptional cases, transactions may have to be re-characterised as would be necessary to reflect arm’s length conditions.

**Ownership of intangibles and DEMPE functions**

450. While determining legal ownership and contractual arrangements is an important first step in the analysis, these determinations are separate and distinct from the question of remuneration under the arm’s length principle. For transfer pricing purposes, legal ownership of intangibles, by itself, does not confer any right ultimately to retain returns derived by the MNE group from exploiting the intangible, even though such returns may initially accrue to the legal owner as a result of its legal or contractual right to exploit the intangible. The return ultimately retained by or attributed to the legal owner depends upon the functions it
performs, the assets it uses, and the risks it assumes, and upon the contributions made by other MNE group members through their functions performed, assets used, and risks assumed. In other words, legal ownership of intangibles by an associated enterprise alone does not determine entitlement to returns from the exploitation of intangibles.

451. Further, the legal owner would generally be expected to perform important functions at arm’s length, including design and control of R&D, management and control over budgets, control over strategic decisions related to intangible development, decisions regarding defence and protection of intangibles, ongoing quality control. If outsourced to associated enterprises, the party performing such important functions should not generally be treated as the tested party in applying one-sided methods for pricing transactions related to the development of intangibles. Associated enterprises performing important value-creating functions related to the development, maintenance, enhancement, protection and exploitation of the intangibles can therefore expect appropriate remuneration. An associated enterprise assuming risk in relation to the development, maintenance, enhancement, protection and exploitation of the intangibles must exercise control over the risks and have the financial capacity to assume the risks, including the very specific and meaningful control requirement.

452. The entitlement of any member of the MNE group to profit or loss relating to differences between actual (ex post) and a proper estimation of anticipated (ex ante) profitability will depend on which entity or entities in the MNE group in fact assumes the risks as identified when delineating the actual transaction (see Section D.1 of Chapter I). It will also depend on the entity or entities which are performing the important functions in relation to the development, enhancement, maintenance, protection or exploitation of the intangibles or contributing to the control over the economically significant risks and for which it is determined that arm’s length remuneration of these functions would include a profit sharing element.

453. In terms of the contribution of assets (including funds), appropriate compensation should be provided. In the specific case of funding, it is important to differentiate between the financial risk, which relates to funding the investment, and the operational risk, which relates to the activities for which the funding is provided. For example, an entity merely providing funding but not performing functions or assuming the financial risk should receive lower remuneration (not more than a risk-free return) than a funder that performs the relevant functions and assumes the financial risks. Accordingly, an associated enterprise providing funding and assuming the related financial risks, but not performing any functions relating to the intangible, could generally only expect a risk-adjusted return on its funding. In addition, it is to be expected that the higher the development risk and the closer the financial risk is related to the development risk, the more the funder will need to have the capability to assess the progress of the development of the intangible and its consequences.

Framework for analysing transactions involving intangibles

454. As stated above, the general principles of Chapters I - III of the OECD Guidelines apply to transactions involving both (i) transactions involving transfers of intangibles or rights in intangibles, and (ii) transactions involving the use of intangibles in connection with the sale of goods or the provision of services. Realistic alternatives for each of the parties need to be taken into account in these transactions, from the perspective of both parties to the transaction.

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243 See paragraph 6.42 of the OECD Guidelines.

244 The framework for analysing risks contained in Chapter I depends on a very specific and meaningful control requirement, which takes into account the capability to perform relevant decision-making functions together with the actual performance of such functions.

245 See paragraph 6.72 of the OECD Guidelines.
The framework for analysing transactions involving intangibles between associated enterprises requires taking the following steps, consistent with the guidance for identifying the commercial or financial relations provided in Section D.1 of Chapter I:

- Identify the intangibles used or transferred in the transaction with specificity and the specific, economically significant risks associated with the development, enhancement, maintenance, protection, and exploitation of the intangibles;
- Identify the full contractual arrangements, with special emphasis on determining legal ownership of intangibles based on the terms and conditions of legal arrangements, including relevant registrations, licence agreements, other relevant contracts, and other indicia of legal ownership, and the contractual rights and obligations, including contractual assumption of risks in the relations between the associated enterprises;
- Identify the parties performing functions, using assets, and managing risks related to developing, enhancing, maintaining, protecting, and exploiting the intangibles by means of the functional analysis, and in particular which parties control any outsourced functions, and control specific, economically significant risks;
- Confirm the consistency between the terms of the relevant contractual arrangements and the conduct of the parties, and determine whether the party assuming economically significant risks controls the risks and has the financial capacity to assume the risks relating to the development, enhancement, maintenance, protection, and exploitation of the intangibles;
- Delineate the actual controlled transactions related to the development, enhancement, maintenance, protection, and exploitation of intangibles in light of the legal ownership of the intangibles, the other relevant contractual relations under relevant registrations and contracts, and the conduct of the parties, including their relevant contributions of functions, assets and risks, taking into account the framework for analysing and allocating risk under Section D.1.2.1 of Chapter I;
- Where possible, determine arm’s length prices for these transactions consistent with each party’s contributions of functions performed, assets used, and risks assumed, unless the guidance in Section D.2 of Chapter I applies.

Comparability

In applying the principles of Chapters I - III, comparability of the transactions being examined is a critical concern. Because intangibles often have unique features, the comparability analysis is especially important in matters involving intangibles.

Some comparability factors are especially relevant for intangibles, including exclusivity, geographic scope, useful life, stage of development, rights to enhancements, revisions and updates, and expectation of future benefits.

Important risks to be considered concern those related to future development of intangibles, to product obsolescence and intangible devaluation, to infringement of intangible rights, product liability and similar risks.

Other comparability concerns involve reliability of any proposed adjustments to comparable intangibles and the use of comparables drawn from databases.

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246 Including specifically the important functions described in paragraph 6.56 of the OECD Guidelines.
Transfer pricing methods

460. Selection of the transfer pricing method should follow the general principles of Chapter II. Guidance on aggregation of transactions and the use of more than one method is particularly relevant. Any of the OECD-recognised methods may be used in appropriate circumstances. Valuation techniques are also useful tools.

461. The selection of the most appropriate transfer pricing method should be based on a functional analysis that provides a clear understanding of the MNE group’s global business processes and how the transferred intangibles interact with other functions, assets and risks that comprise the global business. The functional analysis should identify all factors that contribute to value creation, which may include risks borne, specific market characteristics, location, business strategies, and MNE group synergies among others.

462. The transfer pricing method selected, and any adjustments incorporated in that method based on the comparability analysis, should take into account all of the relevant factors materially contributing to the creation of value, not only intangibles and routine functions.

463. The transfer pricing methods most likely to prove useful in matters involving transfers of one or more intangibles are the CUP method and the transactional profit split method. Valuation techniques can be useful tools.

464. Caution regarding the use of some methods is recommended. In particular, the use of cost-based methods is discouraged, since there is rarely any correlation between the cost of developing intangibles and their value or pricing once the intangibles are developed. Their after-development value is most likely significantly higher. In some limited circumstances methods based on the estimated cost of reproducing or replacing the intangible may be used. For instance, the development of intangibles used for internal business operations (e.g., internal software systems). One-sided methods (i.e. the TNMM and RPM methods) are not typically useful to directly value intangibles, but may be used in some residual valuation approaches.

6.1.3. Transfer pricing rules for transfers of hard-to-value intangibles

465. A rigorous transfer pricing analysis by taxpayers is required to ensure that the transfer or use of hard-to-value intangibles are priced at arm’s length. The term hard-to-value intangibles (HTVI) covers intangibles or rights in intangibles for which, at the time of their transfer between associated enterprises, (i) no reliable comparables exist, and (ii) at the time the transactions was entered into, the projections of future cash flows or income expected to be derived from the transferred intangible, or the assumptions used in valuing the intangible are highly uncertain, making it difficult to predict the level of ultimate success of the intangible at the time of the transfer.

466. Under this approach, if the taxpayer cannot demonstrate that its pricing is based on a rigorous transfer pricing analysis, tax administrations are permitted to consider ex post outcomes as presumptive

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247 See paragraph 6.136 of the OECD Guidelines.

248 Supplemental guidance on the transfer pricing methods most likely to be useful in connection with transfers of intangibles is provided in Section D.2.6 of Chapter VI of the OECD Guidelines. The revised guidance on the application of the transactional profit split method, while not being prescriptive, clarifies and significantly expands the guidance on when a profit split method may be the most appropriate method. OECD (2018), Revised Guidance on the Application of the Transactional Profit Split Method, www.oecd.org/tax/transfer-pricing/revised-guidance-on-the-application-of-the-transactional-profit-split-method-beps-action-10.pdf.

249 See paragraphs 6.142 and 6.143 of the OECD Guidelines.
evidence about the appropriateness of ex ante pricing arrangements. Exemptions may apply based on unforeseeable developments, materiality, time period and advance price arrangements.

6.2. Description of existing rules and practices in Brazil and gap analysis

467. There appears to be no legislation, guidance or case law regarding the transfer pricing aspects of intangibles in Brazil. In the absence of special rules, the general transfer pricing rules apply to intangibles. However, the concepts of development, enhancement, maintenance, protection, and exploitation (DEMPE) functions and risk control are not reflected therein. Further, the available transfer pricing methods may potentially prove difficult to apply to transactions involving the use or transfer of intangibles.

6.2.1. Definition of intangibles for transfer pricing purposes

468. Brazilian transfer pricing rules are applicable to transactions involving “goods, services and rights”. As there is no specific definition of these terms in the transfer pricing legislation, the definitional elements contained in private law are used to inform their meaning.

    Definition derived from company law

469. There is also no express definition of an intangible asset under private law in Brazil. Under private law jurisprudence and doctrines, goods may be classified as tangible or intangible, also called corporeal or incorporeal goods respectively. In this context, company law, when classifying the accounts for the purpose of the balance sheet of companies, indicates that the rights related to incorporeal assets which are “used in the maintenance of the company or are used within this purpose”, should be classified as intangibles.

470. Moreover, the interpretative rules contained in pronouncement nº 04 of the Brazilian Accounting Committee (Comitê de Pronunciamentos Contábeis, CPC) define the accounting treatment of intangible assets. The pronouncement states that an intangible asset is a non-monetary asset without physical substance, identifiable, controllable and capable of generating future economic benefits.

471. While the existing definitions of intangibles could be also interpreted broadly to cover most types of intangible assets, it is not entirely clear how the accounting rules and principles (e.g. recognition of assets, measurability, transferability and controllability), for the purposes of which the company law contains the definition of intangibles, would interact with the types of intangibles that are not necessarily separately transferable or measurable. Due to these reasons, the definition of intangibles contained in the current rules may not be as broad as the one put forward in the OECD Guidelines because the strict legal interpretation and potential accounting recognition rules may not reflect all intangible assets for the purposes of transfer pricing. This narrow definition currently present in Brazil may prevent the recognition of intangible assets for transfer pricing purposes and thus prevent appropriate allocation of income under the current transfer pricing framework.

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250 Articles 18 and 19 of Law 9,430/1996 refer to imports and exports of goods, services or rights.

251 Article 179, items IV and VI, of Law 6,404/76.

252 See the “integral pronouncements” of the Comitê de Pronunciamentos Contábeis at: www.cpc.org.br/CPC/Documentos-Emitidos/Pronunciamentos.

253 For example, the accounting standards generally would not allow the recognition of internally generated intangibles.
Royalty payments and different types of fees

472. Outbound royalty payments and outbound payments for technical, scientific, administrative or similar assistance are excluded from the scope of transfer pricing rules in Brazil. In cases where these exclusions apply, the relevant payments are subject to special measures – deductibility limitation rules, which limit the amount of deduction in respect of such payments. On the other hand, where the exclusions do not apply, the general transfer pricing rules remain applicable.

473. The term “royalties” refers to the income arising from the use, fruition or exploitation of rights, such as (a) the right to collect or extract vegetal resources; (b) the right to research and extract mineral resources; (c) rights relating to inventions, processes, manufacturing formulae, trademarks and industry intellectual property; (d) the author’s right, unless the income is earned by the author himself.

474. Moreover, payments for technical, scientific, administrative or similar assistance, are treated as payments for services in which the transfer of technology is implied (i.e. know-how).

6.2.2. Risk of inappropriate allocation of profits associated with the transfer and use of intangibles in accordance with value creation

475. Brazil has not issued any special rules or guidance in relation to the transfer or use of intangibles. The general transfer pricing rules are applicable to transactions involving intangibles, except for outbound royalty payments and payments for technical, scientific, administrative or similar assistance.

476. Other aspects of the existing transfer pricing system, which arise in relation to Chapters I - III of the OECD Guidelines, create further difficulties and challenges in addressing transactions involving the transfer or use of intangibles for transfer pricing purposes. Among others, the absence of a complete comparability (including functional and risk) analysis, absence of accurate delineation of the actual transactions, unavailability of some methods – especially the profit split method and other (valuation) methods – make it extremely challenging, if not impossible, to arrive at a reasonable outcome from a transfer pricing perspective.

6.2.3. Absence of transfer pricing rules for hard-to-value intangibles

477. The concept of hard-to-value intangibles does not exist under the Brazilian transfer pricing system. Accordingly, there are no transfer pricing rules for hard-to-value intangibles. This further limits the ability to collect tax revenue from value generated in Brazil, where these hard-to-value intangibles are developed and transferred out of the jurisdiction. Based on the existing methods, it would be sufficient to use the cost of development and a relatively small gross profit margin of 15% on the costs, to obtain a value of the intangible for transfer pricing purposes which may widely differ from the actual value transferred.

254 Article 18, paragraph 9, of Law 9,430/1996 and Article 55 of Normative Instruction 1,312/12.

255 Note that the term “royalty” may not encompass some types of payments, as indicated in Decree 9,580/2018.

256 Article 22 of Law 4,506/64.

257 Law 9,279/1996 presents the general provisions on technology transfer agreements (in Article 211), which are further regulated by Normative Act no 135 of 15 April 1997 of the National Institute of Industrial Property (INPI), which is the patent and trademark office in Brazil.

258 Article 19, paragraph 3, of Law 9,430/1996.
6.2.4. Treatment of certain outbound payments (limited deductibility)

478. Brazil has a regulatory framework which allows only limited deductibility of certain outbound payments, i.e. companies can deduct outbound royalty payments and other payments involving technical scientific, administrative and similar assistance only up to a certain percentage limit.

479. The objective limitation on the deduction of outbound royalty and assistance (i.e. technical, scientific, administrative and related) payments is up to 5% of the net revenue gross revenue of the product manufactured or sold. Moreover, the percentage range “up to 5%” mentioned above shall be established and periodically reviewed by the Minister of Finance, according to the degree of essentiality. In this sense, the Ordinance provided by the Minister of Finance establishes, for instance, that the deductible amount for royalties related to trademarks is 1% of the net sales. In addition, this limit is higher for royalties related to other intangibles, depending on the economic sector, for royalties related to patents, industrial processes and manufacturing formulas, and the corresponding technical, scientific, administrative or similar assistance payments.

Table 6.2. Deductibility limitations depending on type of transaction

<table>
<thead>
<tr>
<th>Types of transactions</th>
<th>Rate</th>
<th>Activity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trademarks</td>
<td>1%</td>
<td>Any activity</td>
</tr>
<tr>
<td>Patents</td>
<td>5%</td>
<td>First Group (basic industry): Energy (production and distribution), Fuel (oil, petroleum products), Transports (urban railways), communication, Transportation products (automobiles, trucks and similar vehicles, auto parts, Pneumatics); fertilizers, basic chemicals; Heavy metallurgy; iron, steel and aluminium; electric products; other products (Tractors and Combinations for Agriculture, Equipment, Parts for Road Construction, parts for Extraction and Processing Industries) Shipbuilding.</td>
</tr>
<tr>
<td>Industrial processes</td>
<td>4%</td>
<td>Second Group (transformation industry): (i) Conditioning materials and packaging; (ii) food products; (iii) chemical products; (iv) pharmaceutical products; (v) fabrics, wire and lines.</td>
</tr>
<tr>
<td>Manufacturing formulas</td>
<td>3.5%</td>
<td>(i) Footwear and similar products; (ii) metal products; (iii) cement and asbestos products.</td>
</tr>
<tr>
<td>Corresponding technical, scientific, administrative or similar assistance payments</td>
<td>3%</td>
<td>(i) Electric material; (ii) machinery and tools (machinery and apparatus of domestic use not considered superfluous, office machines and equipment, devices destined for scientific purposes).</td>
</tr>
<tr>
<td></td>
<td>2%</td>
<td>(i) Rubber products and plastic materials; (ii) hygiene and personal care products.</td>
</tr>
<tr>
<td></td>
<td>1%</td>
<td>Other transformation industries.</td>
</tr>
</tbody>
</table>

480. Due to the application of these deductibility limits, the transfer pricing methods are specifically not applicable in respect to outbound payments of royalties as well as in respect to the outbound payments in relation to services involving administrative, technical, scientific and similar types of assistance. It should be noted that for services involving administrative, technical, scientific and similar types of assistance, the

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260 Article 74, paragraph 1, of Law 3,470/1958.


262 Article 18, paragraph 9, of Law 9,430/1996 and Article 55 of Normative Instruction 1,312/2012.
income tax law provides for another layer of limitation. The law establishes that the expenses derived from the outbound payments of such services may only be deducted in the first five years of the company’s operation or the introduction of a special production process, and that this period may be extended by the competent authority up to five more.\textsuperscript{263}

481. These outbound payments (royalty and assistance i.e. technical, scientific, administrative and related) are only deductible upon meeting the registration obligation with the National Industrial Property Institute (INPI)\textsuperscript{264} and the Brazilian Central Bank. Such payments are thus subject not only to tax but also to special registration and exchange control rules. These administrative requirements have also been highlighted as an additional compliance burden by the business community.\textsuperscript{265}

482. Therefore, these special measures setting out fixed deductibility limitations on outbound royalty and technical, scientific, administrative or similar assistance payments, which are not discussed in the OECD Guidelines, are clearly out of the scope of transfer pricing regulations in Brazil. The Guidelines, however, provide the principles that may allow for the scrutiny of royalty and technical services payments through the perspective of the appropriate delineation of the actual transaction and the benefits test, as well as the arm’s-length pricing test. These principles do not currently apply to royalty and technical, scientific, administrative or similar assistance payments under the Brazilian transfer pricing rules, and these special measures apply instead.

\section*{6.3. Assessment of effectiveness}

\subsection*{6.3.1. Absence of definition of intangibles for transfer pricing purposes}

483. The transfer or use of intangibles needs to be compensated, either separately or together with other assets. Intangibles may also affect the arm’s length price of other transactions. Comparability may affect the arm’s length price of other transactions so they should be taken into account when pricing these other transactions. According to the OECD Guidelines, the fact that an item is not an intangible does not mean it can be ignored in a transfer pricing analysis or that a taxpayer can claim to transfer that item without compensation.

484. Adopting a broad and clearly delineated definition of intangibles is necessary to apprehend transactions involving the use or transfer of intangibles. However, this is only one element of the comprehensive transfer pricing guidance contained in the Guidelines. Brazil does not have any specific definition of intangibles for transfer pricing purposes. Instead, company law and accounting definitions are the only notions that are currently used for the purposes of transfer pricing analysis involving intangibles.

\textsuperscript{263} Article 12, paragraph 3, of Law 4,131/1962.

\textsuperscript{264} The INPI is the patent and trademark office in Brazil.

\textsuperscript{265} See Annex A of this report for further details.
Findings of the assessment

Prevention of BEPS risks
The fact that Brazilian transfer pricing rules do not contain a definition of intangibles leads to a scenario in which it is unlikely that intangible assets which are not recognised in the accounting records of the company would be considered as intangibles for transfer pricing purposes. This exposes the Brazilian tax base to risks of base erosion and profit shifting because intangibles assets developed in Brazil, if not reflected in the accounting records, may be easily transferred without any compensation to reflect their arm’s-length value.

Prevention of double taxation
In the absence of a definition of intangibles for transfer pricing purposes, differences in the apprehension of intangibles between Brazil and other jurisdictions may arise, which could in some cases negatively affect the prevention of double taxation.

Ease of tax administration
The use of narrow accounting definitions of intangibles can make the tax administration procedures simpler and more straightforward, compared to the administration of transactions based on the principle-based definition of intangibles used in OECD Guidelines, which may require further and deeper analysis to identify the presence of intangibles. The ease of tax administration, however, clearly comes at the cost of loss of revenues.

Ease of tax compliance
The tax compliance burden, following the same rationale as above, is also potentially reduced by the narrower definition of intangibles for transfer pricing purposes.

Tax certainty
Taxpayers can derive a degree of domestic certainty from the application of the strict legal and accounting definition. Nonetheless, tax certainty is undermined in the international context, where the divergent treatment of intangibles between Brazil and other jurisdictions creates potential uncertainty.

6.3.2. Absence of transfer pricing rules for intangibles, including hard-to-value intangibles
The guidance contained in Chapter VI addresses the opportunities for base erosion and profit shifting resulting from the transfer of intangibles among members of an MNE group. Under this guidance, members of the MNE group are to be compensated based on the value they create through functions performed, assets used and risks assumed in the development, enhancement, maintenance, protection and exploitation of intangibles. New tools to tackle the problem of information asymmetry in determining the appropriate pricing arrangements for intangibles were introduced. Valuation techniques, for instance, were recognised as useful tools for pricing transactions involving intangibles.
Findings of the assessment

Prevention of BEPS risks
Special guidance was developed in order to prevent BEPS risks by moving intangibles among group members. Further guidance clarifying the application of the rules or special measures was developed especially for hard-to-value intangibles. The development of this guidance is intended to palliate the opportunities for BEPS.

Therefore, the fact that Brazilian transfer pricing rules do not address situations involving the use or transfer of intangibles exposes the tax base to abuse.

Prevention of double taxation
Another objective of the new guidance on intangibles was to ensure that profits associated with intangibles are appropriately allocated in accordance with value creation. In the absence of application of the same rules and principles to the transactions involving intangibles, differences in the apprehension of intangibles remain between the two systems and thus, the probability of creating double taxation cases is high.

Ease of tax administration
The tax administration requirements are reduced and focus only on the application of the deductibility limitations and the review of the limited methods. Detailed analysis of transactions involving intangibles is not required and thus, the corresponding efforts are less burdensome than the full-fledged transfer pricing analysis based on the OECD Guidelines.

Ease of tax compliance
In parallel, the tax compliance burden is potentially reduced by the application of the deductibility limitations and the methods involving fixed margins. Detailed analysis of transactions involving intangibles is not required and thus the corresponding efforts are less burdensome than the full-fledged transfer pricing analysis based on OECD Guidelines.

Tax certainty
A degree of tax certainty is established from the domestic perspective as taxpayers can either derive certainty from the application of the deductibility limitations or from the use of the fixed margins in the existing methods. However, this notion of tax certainty disappears in the international context, where the divergent treatment of intangibles between Brazil and other countries creates significant uncertainty.

6.3.3. Treatment of certain outbound payments (limited deductibility)

Brazil has a regulatory framework that excludes outbound payments of royalties and other payments involving technical assistance services from the application of the transfer pricing legislation. Instead, the law determines that such transactions will be particularly subject to specific deductibility conditions and limitations (up to 5%). Therefore, even under these conditions and limitations, the fact that these transactions are not scrutinised from the perspective of transfer pricing rules raises concerns.
Findings of the assessment

Prevention of BEPS risks
The motivation behind this Brazilian rule is likely to be the objective of preventing base erosion and profit shifting. This approach involves the use of measures which are not part of transfer pricing regulations, but can provide a degree of protection from BEPS risks. When applied in conjunction with general rules for deductibility of expenses which require the expenses to be necessary, usual and normal in the taxpayer’s activities, this approach could prevent BEPS risks resulting from deductibility of outbound payments.

However, since royalty payments are not scrutinised from the same perspective as under the OECD Guidelines (through accurate delineation, the benefits test, and the arm’s-length test), and the royalty payments may still be deductible under the Brazilian rules as long as they are within the limits, the deductibility limitation rules may not offer the same efficiency in terms of preventing BEPS risks.

Prevention of double taxation
The interaction of transfer pricing rules as applied in foreign jurisdictions and the ceilings for deductibility may lead to cases of double taxation. Such deductibility ceilings may result in double taxation since the income in some cases may still be included into the tax base abroad based on the application of the arm’s length principle. The resulting double taxation may be difficult to resolve, since the relief under Article 9, paragraph 2 (corresponding adjustment), may not be available due to the fact that these special measures used in Brazil are outside the scope of Article 9.

Ease of tax administration
Tax administration requirements are reduced because the transfer pricing rules are substituted by more prescriptive rules, which are more straightforward and easier to administer.

Ease of tax compliance
The limitation on the deductibility is not significantly burdensome as it derives from prescriptive provisions found in the income tax law. However, in order to claim deduction for payments of royalty or payments related to technical, scientific, administrative or similar assistance taxpayers are subject to special registration and exchange control rules. These administrative requirements have been highlighted as an additional compliance burden by the business community.

Tax certainty
Tax certainty may be provided from a domestic perspective, but tax uncertainty arises from the international perspective, where the approach adopted by Brazil is different from the approach adopted in any other jurisdiction that applies transfer pricing rules in line with the OECD standard, and double taxation is likely to arise as a result.
The seventh chapter contains the analysis of Brazil’s relevant transfer pricing rules as compared with Chapter VII of the OECD Guidelines, which contains the guidance addressing specific issues that may arise in relation to activities taking place between entities within an MNE group, some of which may constitute services for which an arm’s-length compensation needs to be determined. The guidance contains considerations relevant for determining whether these activities should be for transfer pricing purposes considered services for which arm’s-length compensation is due or whether such activities are to be considered as something else – e.g., shareholder activities, incidental benefits for which no charge is appropriate. The guidance then elaborates on suitable approaches for establishing arm’s length compensation for those activities that constitute intra-group services. The main findings of the analysis are the absence of special considerations in order to establish the arm’s length price for intra-group services and the absence of the benefits test in the transfer pricing rules. The simplified approach for low-value intra-group services is also discussed. The analysis is followed by the assessment of effectiveness for these three gaps according to the policy objectives of transfer pricing rules.
7.1. Two main issues in the analysis of transfer pricing of intra-group services

487. The two main issues in the analysis of transfer pricing for intra-group services addressed in this chapter are whether the activities carried out constitute the intra-group services and what the intra-group charge for such services for tax purposes should be in accordance with the arm’s length principle.266

7.1.1. Determining whether intra-group services have been rendered

Benefits test

488. The OECD Guidelines provide that under the arm’s length principle, the question of determining whether intra-group services have been rendered should depend on whether the activity provides a respective group member with economic or commercial value to enhance or maintain its business position. This can be determined by considering whether an independent enterprise in comparable circumstances would have been willing to pay for the activity if performed for it by an independent enterprise or would have performed the activity in-house for itself. This analysis depends on the actual facts and circumstances, and it is not possible in the abstract to determine which activities constitute the rendering of intra-group services.

Special guidance on common types of services

489. Although the analysis for the purpose of the benefits test clearly depends on the actual facts and circumstances, and the Guidelines do not set forth categorically the activities that do or do not constitute the rendering of intra-group services, some guidance is also provided in respect of some common types of activities undertaken within the context of MNE groups, such as shareholder activities, duplicated services, incidental benefits, and centralised services. These activities are described in the paragraphs below.

490. The Guidelines provide that when a shareholder activity is performed solely because of the interest ownership of the parent company in one or more other group members, i.e. in its capacity as a shareholder, this activity would not be considered to be an intra-group service, and therefore, would not justify a charge to other group members. Instead, the costs associated with this type of activity should be borne and allocated at the level of the shareholder.267 Some examples of costs associated with shareholder activities are provided by the Guidelines, such as:

- Costs relating to the juridical structure of the parent company itself;
- Costs relating to the reporting requirements of the parent company;
- Cost of raising funds for the acquisition of its participations and costs relating to the parent company’s investor relations;
- Costs relating to compliance of the parent company with the relevant tax laws;
- Costs which are ancillary to the corporate governance of the MNEs as a whole.

491. On the other hand, the Guidelines indicate that if, for instance, a parent company raises funds on behalf of another group member which uses them to acquire a new company, the parent company would generally be regarded as providing a service to the group member.

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267 See paragraph 7.9 of the OECD Guidelines.
492. With respect to duplication, the Guidelines provide that, in general, no intra-group service should be found for activities undertaken by one group member that merely duplicate a service that another group member is performing itself, or that is being performed for such other group member by a third party. Exceptions to this general rule may happen where the duplication of services is only temporary and where the duplication of services is undertaken to reduce the risk of a wrong business decision.

493. As regards incidental benefits, are cases where an intra-group service performed by a group member such as a shareholder or coordinating centre relates only to some group members but incidentally provides benefits to other group members. Examples could be analysing the question whether to reorganise the group, to acquire new members, or to terminate a division. These activities could constitute intra-group services to the particular group members involved, but they may also produce economic benefits for other group members not directly involved in the potential decision since the analysis could provide useful information about their own business operations. The incidental benefits ordinarily would not cause these other group members to be treated as receiving an intra-group service because the activities producing the benefits would not be ones for which an independent enterprise ordinarily would be willing to pay.

494. Similarly, an associated enterprise should not be considered to receive an intra-group service when it obtains incidental benefits attributable solely to its being part of a larger concern, and not to any specific activity being performed.

495. Finally, centralised services in the parent company or one or more group service centres (such as headquarters company), which may relate to the group as a whole (e.g., administrative services, planning co-ordination, financial advice, accounting, etc.), will generally be considered intra-group services, because they are the type of activities that independent enterprises would have been willing to pay for.

Form of the compensation

496. When considering whether a charge for the provision of services would be made between independent enterprises, it is also relevant to consider the form that an arm’s length consideration would take if the transaction had occurred between independent enterprises.

497. The compensation for intra-group services may be carried out in different forms. The compensation can be directly identifiable or the compensation can be included into other arrangements. One important consideration addressed by the guidance is thus the possibility that the compensation for services rendered to an associated enterprise may be included in the price for other transfers (e.g., the price for licensing a patent or know-how may include a payment for technical assistance services or centralised services performed for the licensee or for managerial advice on the marketing of the goods produced under the license). In such cases where the compensation is included in other forms, the tax administration and the taxpayers would have to check that there is no additional service fee charged and that there is no double deduction.

7.1.2. Determining an arm’s length charge

498. Once it is determined that an intra-group service has been rendered, it is necessary, as for other types of intra-group transfers, to determine whether the amount of the charge, if any, is in accordance with the arm’s length principle. This means that the charge for intra-group services should be that which would have been made and accepted between independent enterprises in comparable circumstances.

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268 See paragraph 7.12 of the OECD Guidelines.
Charging for intra-group services

499. In order to identify the amount (if any) charged for services, a tax administration will need to identify the arrangements that have actually been put in place between the associated enterprises to facilitate charges being made for the provision of services between them.

Direct-charge method

500. In certain cases, the arrangements made for charging for intra-group services can be readily identified. These cases are where the MNE group uses a direct-charge method, i.e. where the associated enterprises are charged for specific services. This approach allows clear identification of the service provided as well as the corresponding charges made for that service and therefore facilitates easier determination of whether the compensation is carried out in line with the arm’s length principle.

Indirect-charge method

501. Some MNE groups have developed other methods for charging for services provided by parent companies or group service centres. In such cases, MNE groups use cost allocation and apportionment methods which often necessitate some degree of estimation or approximation, as a basis for calculating an arm’s-length charge (the so-called indirect-charge methods). In some cases, an indirect-charge method may be necessary due to the nature of the service being provided. One example is where the proportion of the value of the services rendered to the various relevant entities of the group cannot be quantified except on an approximate or estimated basis.

Calculating the arm’s length compensation

502. In terms of the calculation of the arm’s length compensation, the Guidelines make it clear that in trying to determine the arm’s-length price in relation to intragroup services, the matter should be considered both from the perspective of the service provider and from the perspective of the recipient of the service.269

Methods

503. The OECD Guidelines prescribe that the applicable transfer pricing methods should be determined in line with the principles established in Chapters I - III of the Guidelines. In general, the most appropriate method for pricing intra-group services will be determined to be a CUP or cost-based method (cost plus method or cost-based TNMM):

- A CUP method is likely to be the most appropriate method where there is a comparable service provided between independent enterprises in the recipient's market, or by the associated enterprise providing the services to an independent enterprise in comparable circumstances;
- A cost based method would likely be the most appropriate method in the absence of a CUP where the nature of the activities involved, assets used, and risks assumed are comparable to those undertaken by independent enterprises;270
- In exceptional cases, it may be helpful to take account of more than one method.

504. Further, the guidance specifies that it may be necessary to perform a functional analysis of the various members of the group to establish the relationship between the relevant services and the members'...
activities and performance. In addition, the service could have a long-term effect, which should also be taken into account.

Including a profit element

505. In an arm’s length transaction, an independent enterprise normally would seek to charge for services in such a way as to generate profit, rather than providing the services merely at cost. Therefore, the charge may be such that it results in a profit for the service provider. However, there are circumstances in which an independent enterprise may not realise a profit from the performance of services alone based on specific business strategies. As an example, it may be the case that the market value of intra-group services is not greater than the costs incurred by the service provider. This could occur where the service is not an ordinary or recurrent activity of the service provider but is offered incidentally as a convenience to the MNE group.271

7.1.3. Low value-adding intra-group services

506. Resulting from the implementation of the outcomes of Action 10 of the BEPS Project,272 Chapter VII of the OECD Guidelines was revised with the publication of the 2017 edition to include an elective simplified approach for low value-adding intra-group services.

507. This elective simplified approach for low value-adding intra-group services (LVAS) was developed with the objectives of (i) reducing compliance efforts with respect to meeting the benefits test; (ii) providing greater certainty for MNE groups; and (iii) providing tax administrations with targeted documentation in order to enable the efficient review of compliance risks.

508. The first step of this approach consists of the determination of the pool of expenses incurred by all members of the group in performing each category of low value-adding intra-group services. This cost pool is, in a subsequent step, apportioned/allocated among the individual entities of the MNE based on an appropriate allocation key with a mark-up of 5%.

509. The guidance contains:

- The definition of low value-adding intra-group services;
- A description of the elective, simplified approach for the determination of arm’s length charges for low value-adding intra-group services, including a simplified benefits test;
- Guidance on documentation and reporting requirements that should be met by an MNE group electing to apply this simplified approach;
- The possibility of limiting the application of this simplified approach on a threshold basis;
- A discussion of some issues with regard to the levying of withholding taxes on charges for low value-adding intra-group services.

7.2. Description of existing rules and practices in Brazil and gap analysis

510. The transfer pricing rules in Brazil appear to have been designed mainly for transactions involving tangible property and there is no specific guidance for the treatment of intra-group services, so the relevant general rules apply in respect to services. In the absence of special rules, intra-group services are also not

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271 See paragraphs 7.35 to 7.37 of the OECD Guidelines.

defined for transfer pricing purposes and there is no special transfer pricing guidance to determine whether intra-group services have been rendered and to obtain the arm’s length charge for intra-group services.

511. There is not a specific definition for services in the transfer pricing legislation in Brazil. In this context, the tax administration and taxpayers may need to use definitions of services in other sources to identify whether a transaction is a provision of service. For instance, the list established in the complementary law 116/2003, which provides for a comprehensive list of services subject to the service tax (ISS), case law and private law may be used as potential definition.

512. More importantly, it should be noted that the general and special rules related to the deductibility of service payments are applicable, including the provisions limiting the deductibility of outbound payments related to technical, scientific, administrative or similar assistance. Where these special rules apply to limit deductibility, the concerned intra-group services are not subject to the transfer pricing rules.

7.2.1. Absence of benefits test in the transfer pricing rules

513. The Brazilian transfer pricing rules do not provide special transfer pricing guidance to establish whether the activity provides a respective group member with economic or commercial value to enhance or maintain its business position. In principle, the approach would be to follow the general deductibility rules which require that the expenses be necessary, usual and normal in the taxpayer’s activities, including intra-group service payments. This approach seemingly leads to outcomes similar to the application of the benefits test under the OECD Guidelines, except for those cases where it is not possible to identify the intra-group service in question based on written contracts and accounting records. This is because the analysis in Brazil is typically limited to the legal perspective, based on the contracts and to some extent the conduct of the parties, besides the accounting and tax records.

514. Therefore, the existing rules do not fully encompass the notion of transfer of economic or commercial value which does not only consider the form of the remuneration, but more broadly the form that an arm’s length consideration would take had the transaction occurred between independent enterprises. In other words, if the compensation is not reflected on a legal obligation or on the accounting books of the Brazilian entity, it will be more difficult for the tax authorities to determine that the service has actually been provided.

515. The necessary, usual and normal criteria, as mentioned above, may not always lead to the same outcome as the benefits test set out in the OECD Guidelines as it may not always take into account the specificity of the functional and risk profile as well as the enhancement of the commercial position of different MNE group members. For example, suppose one MNE group member abroad carries out a successful marketing/advertising campaign that clearly benefits another group member in Brazil,


274 See for instance Resp nº 222.246/MG (Special Court Appeal, STJ), which indicated that the provision of services encompasses services that reveal an economic content. In addition, Resp nº 190.771 stated that an entity which obtains as a result of its activity the mere reimbursement of costs is not considered a taxpayer for the purpose of services tax (in this context, see also Resp 411.590/SP and Resp nº 224.813/SP). Further, the Supreme Court (STF), notably through REx (Supreme Court appeal, STF) nº 116.121, has stated that a provision of service is “an obligation to do something”.

275 Article 18, paragraph 9, of Law 9.430/1996.


277 The deduction will consequently not be allowed. An exception could potentially be found in the context of a MAP, where a deemed deduction could be recognised for the purpose of performing a transfer pricing adjustment.
evidenced through the visible deployment of advertising means and increased sales in the country, without any cost incurred by the Brazilian entity. In this case, the foreign jurisdiction could establish that an intra-group service has been provided between the two entities based on the approach set forth in the OECD Guidelines, which may not be recognised in Brazil if the Brazilian entity has not a legal obligation to compensate the other party, and the expense is not reflected in the accounting records or other forms of documentation. 278

516. Moreover, there is also no special guidance on the application of the benefits test (or of a similar approach) to common types of intra-group services, such as shareholder activities, duplicated services, and incidental benefits. In the absence of such guidance, disputes are likely to arise.

7.2.2. Absence of special considerations in order to establish the arm's-length price for intra-group services

517. As previously stated, there are no special considerations for intra-group services in the Brazilian transfer pricing framework – no special legal provisions, instructions or guidance specifically regarding controlled services transactions. Therefore, with the exception of transactions that are covered by the deductibility limitation rules, the treatment of services from a transfer pricing perspective is governed by the general transfer pricing rules.

518. Several areas or issues constitute gaps or divergences. First, the implications related to the definition of a service may hinder the ability to determine an arm’s length charge if the economic or commercial value transferred is not reflected in a legal obligation or the accounting books of the Brazilian company in some cases. Second, although both direct-charge and indirect-charge methods are acceptable in practice, there is no clear guidance on the use of allocation keys. 279 Third, the methods incorporating fixed margins, if applicable, may not necessarily reflect the economic reality of the economic and commercial value created through the provision of the services, notably in the case of low value-adding services and high value-adding services. Finally, the unavailability of transactional profit methods may also lead to the inappropriate remuneration of certain types of services, such as high value-added services rendered in relation to DEMPE functions, where the profit split method would most likely be the selected method under the OECD Guidelines.

519. The peculiarities of the Brazilian transfer pricing system have repercussions on the treatment of intra-group services for transfer pricing purposes. Such treatment is often inconsistent between import and export service transactions.

Determining an arm’s-length charge

520. In principle, if a related party located in a foreign jurisdiction is the beneficiary of a service rendered by a Brazilian company, which is clearly reflected in the legal and accounting records, the Brazilian company will be under the obligation to charge the related party for this service and comply with one of the transfer pricing methods available in Brazil. Similarly, the Brazilian company will be required to comply with the transfer pricing rules if the related party abroad charges the Brazilian company for services. Therefore, the Brazilian transfer pricing rules will be applicable to transactions where there is a legal obligation to compensate the other party. However, there may be situations where the Brazilian transfer pricing rules do not properly address the transfer of economic or commercial values.

278 In addition, if the intra-group service would otherwise be subject to the deductibility limitation rules, then the decision not to charge it to the Brazilian entity could be motivated by the opportunity to achieve tax benefits.

279 Business reported that disputes arise in this area (see Annex A of this report for a summary of business comments).
In terms of the identification of the amount charged for services, even though there is no clear guidance on the question, the Brazilian system generally allows the use of both direct-charge and indirect-charge methods. Allocation keys may be challenged by the tax authorities on a case-by-case basis if they are considered to be unreasonable.

**Methods**

A Brazilian taxpayer may in principle select any of the available methods (if appropriate) to prove that service charges are in accordance with Brazilian transfer pricing rules, as provided by the freedom of selection of the method.

Often, the methods that will be applicable to intra-group services will be limited to the methods broadly equivalent to the CUP method (PIC or PVEx methods) or those broadly equivalent to the cost plus method (CPL or CAP methods). For the application of the PIC method, broadly equivalent to the CUP method, finding acceptable comparables (i.e. comparable services in the recipient's market in comparables circumstances) may prove challenging.

The application of transactional profit methods (e.g., the TNMM or the profit split method) is not foreseen under the Brazilian transfer pricing rules.

In contrast to the OECD Guidelines that recognise the potential relevance of a functional analysis of the members of the group to establish the relationship between the relevant services and the members’ activities and performance, no such consideration is given in the Brazilian context.

The inclusion of a profit element (i.e. relevant fixed margins) depends on the applicable method. Under the fixed margins approach, Brazilian taxpayers must comply with the statutory margins set forth in the provisions of the applicable transfer pricing method. Accordingly, it is not possible to distinguish between more routine or low value-added services and services that add higher value. Further, the available transfer pricing methods do not take into account the effective net profit of the Brazilian company.

In the methods that broadly correspond to the cost plus method (CPL and CAP methods), a profit element will be required for the outbound provision of services by a Brazilian company (CAP method), which will be determined based on the mandatory fixed margin of 15%. A profit element will not be required for the importation of services (as a result of the ceiling of maximum deductible expenses provided for in the caput of Article 18 of the Law 9,430/96) and no transfer pricing adjustment will be performed unless the charge for the intra-group service exceeds the price calculated by applying the CPL method (i.e. the effective profit margin must be less than the fixed profit margin, i.e. 20%, which could also make it possible to have a 0% profit mark-up).

**7.2.3. Absence of simplified approach for low value-adding intra-group services**

The simplified approach for low value-adding intra-group services has not been implemented in Brazil, meaning that the general rules discussed in the foregoing paragraphs apply to low value-adding services (as they are described in the OECD Guidelines) in the same manner as any other types of services. Again, this may lead to divergences between the two systems, notably as a result of the application of the fixed margins, especially in cases of outbound provision of services by Brazilian companies.

Under the current system, the absence of the simplified approach creates difficulties. For example, the 15% mark-up applied in the method broadly equivalent to the OECD-recognised cost plus method for

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280 See paragraphs 7.31 and 7.32 of the OECD Guidelines.
the outbound provision of services (CAP method) could in many cases be too high for low value-adding services. This could lead to the mark-up being rejected by the tax administration of the country where the company paying for the services provided by the Brazilian company is located.

530. Brazil expressed its intention to implement the simplified approach with a domestic threshold and other conditions. The threshold that will be studied should limit the applicability of the approach when the low value-adding intra-group service payments represent a risk of BEPS (e.g., based on the fixed value of the total amount of payments, percentage of all intra-group service payments, percentage of total revenues, or a combination thereof).

7.3. Assessment of effectiveness

531. The guidance in Chapter VII of the Guidelines is based on the key principles developed in Chapters I - III. Therefore, the previously identified gaps have an impact on the effectiveness of the rules. The assessment of effectiveness is carried out on that basis, but these gaps are not restated.

532. By way of introduction, the first issue with the existing definition of a service that is used for transfer pricing purposes in Brazil lies in the fact that it does not fully embrace (although it may come close) the principle-based approach of recognising the transfer of economic and commercial value resulting from activities carried out within an MNE group. The consequence may be that a deduction will not be allowed unless it can be proven that a service was rendered and that there was an obligation, from a legal perspective, to compensate the related party, which should be reflected in the accounting books.

533. Since there is no benefits test established in the Brazilian transfer pricing framework, the assessment focusses on the effectiveness of the general deductibility rules for determining whether intra-group services can be deducted. The effectiveness of the general transfer pricing rules is then assessed with respect to the ability to determine the arm’s length charge, including the identification of the actual arrangement for charging for intra-group services and the calculation of the arm’s length compensation. Finally, the effectiveness of the general transfer pricing rules is assessed in terms of their application to low value-adding intra-group services in consideration of the simplified approach developed in the Guidelines.

7.3.1. Absence of benefits test in the transfer pricing rules

534. Since there is no special guidance to deal with intra-group services, the approach to determine whether a service has actually been rendered is to apply the general deductibility limitation rules, according to which the service must be necessary, usual and normal.282

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281 Taxpayers should provide documentation, declarations or clarifications in good faith in order to demonstrate that a service was rendered. If there is omission or if the information is not provided in good faith, tax authorities are allowed to deem the service (in)existent and its price (see Articles 116 and 148 of the Tax Code and Article 167 of the Civil Code). In addition, case law shows that the substance-over-form principle has relied on the old civil law concepts of simulation and abuse of law, and, in particular, administrative decisions of CARF have relied on the substance-over-form approach in the context of tax planning matters.

282 In comparison, the OECD Guidelines state that “whether an intra-group service has been rendered when an activity is performed for one or more group members by another group member should depend on whether the activity provides a respective group member with economic or commercial value to enhance or maintain its business position”, in paragraph 7.6 of the OECD Guidelines.
Findings of the assessment

Prevention of BEPS risks
This requirement found in the general deductibility rules seemingly allows the necessary degree of scrutiny to accept or deny deductions related to intra-group service expenses. Therefore, it should provide some protection against BEPS risks, but it does not contain a specific and clear principle as foreseen in the OECD Guidelines and also does not distinguish between different types of intra-group activities (e.g., shareholder activities, incidental benefits, etc.). Besides that, this rule is only applicable to the provision of inbound services, which means that there is not a similar benefits test applicable to outbound situations (services provided by a Brazilian entity). Therefore, the absence of the benefits test potentially gives rise to BEPS risks.

Prevention of double taxation
The lack of alignment with the OECD Guidelines due to the absence of the benefits test can give rise to situations where activities which would not normally pass the benefits test and would not be considered as services (e.g., incidental benefits or shareholder services) may be treated as a provision of services and charged in one jurisdiction while the other jurisdiction may not allow its deduction.

Ease of tax administration
The absence of the benefits test does not seem to reduce tax administration costs or to make tax administration more effective since a significant degree of scrutiny is seemingly required under the test according to the general deductibility rules and the tax administration actually pay detailed attention to specific intra-group service charges.

Ease of tax compliance
Taxpayers will have to demonstrate that the service was usual, necessary and normal for the purpose of deducting the expenses. The compliance burden for the taxpayer is broadly similar to that of the benefits test.

Tax certainty
The application of the benefits test and the application of the general deductibility rules lead to similar outcomes as the business expenses incurred by taxpayers may become non-deductible. The two tests differ in some aspects, but may create potential uncertainty in the way tax authorities would apply them in practice. The OECD guidance is more elaborated and applied by most countries around the world. On the other hand, the notions of “normal, necessary and usual”, which are used in Brazil, are also found in other countries’ tax systems. It is difficult to establish which of these two concepts create more or less uncertainty for taxpayers.
7.3.2. Absence of special considerations in order to establish the arm’s length price for intra-group services

535. In terms of the absence of special considerations in order to establish the arm’s length price for intra-group services, the assessment of effectiveness focuses on the determination of the arm’s length charge. This determination includes the identification of the actual arrangement and the calculation of the arm’s length compensation. Since not all intra-group services are subject to the transfer pricing rules, the assessment also considers the effects of the deductibility ceilings.

Findings of the assessment

Prevention of BEPS risks

BEPS risks may arise in situations involving intra-group services. In inbound situations, MNEs groups operating in Brazil can take advantage of the system by charging services from abroad based on the fixed margins, which may significantly exceed the margins considered acceptable under the OECD guidance, where very small or no mark-up is applicable. As a consequence the deductions that may be claimed by taxpayer in Brazil will exceed the amount that would have been accepted under the OECD standard.

In these situations of inbound service provision, deductibility limitation rules are designed to prevent BEPS risks and could be effective for the services that are covered (services involving technical, scientific, administrative or similar assistance).

With respect to outbound situations, the issue is especially prominent in the case of high value-adding services, where the Brazilian entity is the service provider and the value of the services it provides is significant – and may even qualify for the application of the profit split method, or has a high profit margin, but the application of the equivalent of the cost plus method (CAP method) with a fixed margin allows the taxpayer to satisfy the rules with a gross mark-up of 15%.

The issue can be demonstrated in scenarios involving high value added services which could entail a mark-up, significantly higher than the applicable fixed margin under the Brazilian rules.

Prevention of double taxation

The risk of double taxation may arise in both inbound and outbound situations, especially when the methods that rely on fixed margins are used and a discrepancy between jurisdictions arises. For example, in outbound situations, the rules may force the Brazilian resident to charge out more than what is the arm’s length price of the service provided while, the foreign jurisdiction only allows the deduction of the arm’s-length amount. In inbound situations, the rules may force the Brazilian resident to limit the deduction to the fixed margin’s amount, while the value of the service actually provided may be significantly higher and in the foreign jurisdiction the service provider will be charged tax on the full arm’s-length value of the service provided.

For services involving technical, scientific or similar assistance subject to the deductibility limitations, the possible double taxation outcomes will be further amplified because of the special deductibility ceilings.
Ease of tax administration
The existing rules contain elements which may provide simplification, especially rules that involve the application of fixed margins regardless of the nature of the service so the system may be easier to apply. The deductibility limitation rules are prescriptive so they are also easy to administer and apply.

Ease of tax compliance
Deductibility limitation rules and the fixed margins may provide some degree of simplification unless additional documentation requirements are imposed (e.g., due to the item-per-item approach or if preparation of documentation requires information from foreign service providers).

Tax certainty
The absence of special guidance creates uncertainty in some situations where divergences may arise in relation to the OECD Guidelines, which can potentially result in double taxation. From a purely domestic perspective, the existing rules provide a degree of certainty, where compliance with the Brazilian rules is made easier for taxpayers.

7.3.3. Absence of simplified approach for low value-adding intra-group services
536. The main issue concerns the outbound provision of low value-adding services, where the fixed margins require higher profit margins than would be acceptable according to the OECD Guidelines. Another issue is the interaction with the deductibility limitation rules, where a Brazilian entity is the beneficiary of services in a cross-border situation and the payment exceeds the deductibility limitation, even if the price was considered to be arm’s-length in the other jurisdiction.

Findings of the assessment

Prevention of BEPS risks
The absence of the concept of low value-adding services does not seem to give a rise to BEPS risks.

Prevention of double taxation
Margins are often too high for services that would be qualified as low value-adding services, which means that the transfer pricing outcome will often be misaligned in the case of the application of the simplified approach (applying a 5% mark-up), and this may trigger double taxation, especially in outbound situations. However, on the inbound side, double taxation does not arise because of the application of the “generous” fixed margin.

Ease of tax administration
The tax administration aspects of controlling intra-group services are not more burdensome than the OECD simplified approach for low value-adding intra-group services, which has some complexities (e.g., it requires the pooling of costs and implies a thorough verification process).
Ease of tax compliance
In terms of tax compliance burden, the implications are similar for taxpayers. The fixed margins and deductibility limitations may provide a comparable degree of simplification to that provided by the OECD Guidelines.

Tax certainty
From a purely domestic perspective, the existing rules seem to provide a reasonable degree of certainty. However, there is some degree of tax uncertainty from an international perspective because of different approaches and outcomes in other jurisdictions compared to Brazil.
The eighth chapter contains the analysis of Brazil’s relevant transfer pricing rules as compared with Chapter VIII of the OECD Guidelines, which provides guidance to determine whether the conditions established by associated enterprises in transactions covered by a cost contribution arrangement (CCA) are in line with the arm’s length principle. If contributions to and benefits of the CCA are not valued appropriately, this will lead to profits being shifted away from the location where the value is created through the economic activities performed. The Guidelines provide that CCAs have specific characteristics that warrant special consideration. However, as set forth in Section D.1 of Chapter I of the Guidelines, no differences exist for a transfer pricing analysis between a CCA and any other kind of contractual arrangement where the division of responsibilities, risks, and anticipated outcomes as determined by the functional analysis of the transactions is the same. Therefore, a number of issues identified in the analysis conducted for previous chapters are also relevant for the analysis of this chapter. The main finding of the analysis is the limited guidance on CCAs in Brazil, in addition to the implications of the other issues previously identified in this context, and the assessment of effectiveness according to the policy objectives of transfer pricing rules focuses on this gap.
8.1. Concept of a CCA

537. A cost contribution arrangement is defined as a contractual arrangement between business enterprises to share the contributions and risks involved in the joint development, production or the obtaining of intangibles, tangible assets or services with the understanding that such intangibles, tangible assets or services are expected to create benefits for the individual business of each of the participants.283

538. The referred sharing of contributions, risks as well as the corresponding benefits, is a key feature of a CCA.284 As noted in the OECD Guidelines, in accordance with the arm’s length principle, at the time of entering into a CCA, each participant’s proportionate share of the overall contributions to a CCA must be consistent with its proportionate share of the overall expected benefits. In any case, each participant must be entitled to benefit from the CCA assets produced/services provided with no need of paying additional consideration, except in case of a balancing payment and the contributions described in Section C.4 of that Chapter VIII.

539. CCAs can provide helpful simplification of multiple transactions, for instance, in a situation where associated enterprises perform activities for other group members and simultaneously benefit from activities performed by other group members, a CCA can provide a mechanism for replacing a web of separate intra-group arm’s-length payments with a more streamlined system of netter payments, based on aggregated benefits and aggregated contributions associated with all the covered activities.285

8.1.1. Types of CCAs

540. The OECD Guidelines specify that the CCAs to jointly develop intangible or tangible assets (development CCAs, e.g. R&D, marketing) and the CCAs for obtaining services (services CCAs) are the most common types of CCAs encountered. In this context, each particular CCA should be considered on its own facts and circumstances, but the key differences between these two types of CCAs will generally be that development CCAs are expected to create ongoing, future benefits for participants, and often involve significant risks. On the other hand, services CCAs will create only current benefits and often offer more certain and less risky benefits.286

541. Detailed consideration is made under the development CCA. It is indicated that for this type of CCA, each participant has an entitlement to rights in the developed intangible(s) or tangible asset(s). In relation to intangibles, such rights often take the form of separate rights to exploit the intangible in a specific geographic location of for a particular application.287

8.1.2. Applying the arm’s length principle

542. According to the OECD Guidelines, for a CCA to satisfy the arm’s length principle the participants’ contributions and reasonably expected benefits must be consistent with what unrelated parties would agree to contribute under comparable circumstances. In addition, what differentiates contributions to a CCA from any other intra-group transfer of property or services is that in a CCA part of or all the

284 See paragraph 8.5 of the OECD Guidelines.
285 See paragraph 8.7 of the OECD Guidelines.
286 See paragraph 8.10 of the OECD Guidelines.
287 See paragraph 8.11 of the OECD Guidelines.
compensation intended by the participants is the expected mutual and proportionate benefit from the pooling of resources and skills.\textsuperscript{288}

543. Accordingly, to apply the arm’s length principle, it is essential to identify the expectation of a proportionate mutual benefit. This is fundamental to the acceptance by independent enterprises of an arrangement for sharing the consequences of risks materialising and pooling resources and skills. The next step is to calculate the value of each participant’s contribution to the joint activity, and then to determine whether the allocation of CCA contributions accords with their respective share of expected benefits. It is necessary that the value of each participant’s contribution is valued and matched against their expected benefits.

**Determining participants**

544. According to the OECD Guidelines, a party without an expected benefit from the CCA, or who cannot exploit its CCA benefits in its own business may not be considered a participant to the CCA, but a service provider, and as such should be compensated for the services it provides on an arm’s length basis (external to the CCA). Similarly, a party would not be a participant in a CCA if it is not capable of exploiting the output of the CCA in its own business in any manner.

545. A party is also not a participant if it does not control the CCA risk assumed, or it does not have the sufficient financial capacity to bear those risks, as it would not be entitled to a share in the output that is the objective of the CCA based on the functions it actually performs. In such situations, the Guidelines establish that the guidance of Chapter I on assessing whether a party providing funding has the functional capability to exercise control over the financial risk attached to its contributions to the CCA and on delineating the actual transaction would apply.\textsuperscript{289}

546. The CCA participants are not required to perform all the CCA activities through their own personnel. It may be that the CCA participants decide to outsource certain functions related to the subject activity to a separate entity that is not a participant. In this case, the participants to the CCA should individually meet the requirements on exercising control over the specific risks they assume under the CCA. As stated in the Guidelines, such requirements include exercising control over the outsourced functions by at least one of the participants to the CCA. Where the entity is an associated enterprise of one or more of the CCA participants, the arm’s length charge would be determined under the general principles of Chapter I - III, VI and VII.\textsuperscript{290}

**Expected benefits from the CCA**

547. The relative shares of expected benefits might be estimated based on the anticipated additional income generated or costs saved or other benefits received by each participant as a result of the arrangement. An approach that is frequently used in practice, most typically for services CCAs, would be to reflect the participants’ proportionate shares of expected benefits using a relevant allocation key. The possibilities for allocation keys include sales (turnover), profits, units used, produced, or sold, number of employees, and so forth.\textsuperscript{291}

548. Moreover, the OECD Guidelines indicate that projections about the participant’s shares of benefits are needed when part or all of the benefits of a CCA activity are expected to be realised in the future.

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\textsuperscript{288} See paragraph 8.12 of the OECD Guidelines.

\textsuperscript{289} See paragraph 8.15 of the OECD Guidelines.

\textsuperscript{290} See paragraph 8.18 of the OECD Guidelines.

\textsuperscript{291} See paragraph 8.19 of the OECD Guidelines.
(typically for development CCAs). This may raise problems for tax administrations in verifying the assumptions based on the projections, and therefore, it may be appropriate for a CCA to provide for possible adjustments of proportionate shares of contributions that reflect changes in relevant circumstances that lead to changes in relative shares of benefits.

549. If an arrangement covers multiple activities, it will be important to take this into account in choosing an allocation method, since not all participants participate in an equal manner in all activities. One approach suggested by the Guidelines is to use different sets of allocation keys for each activity. The Guidelines also indicate that prospective adjustments may be needed to account for differences among expected and actual benefits received by the participants. The CCA should require periodic reassessment of contributions vis-à-vis the revised share of benefits to determine whether the future contributions of participants should be adjusted accordingly. Thus, the allocation key(s) most relevant to any particular CCA may change over time leading to prospective adjustments. Such adjustments may reflect either the fact that the parties will have more reliable information about foreseeable (but uncertain) events as time passes, or the occurrence of unforeseeable events.

The value of each participant’s contribution

550. The objective for measuring the value of each participant’s contribution is to determine whether a CCA satisfies the arm’s length principle – i.e. that the proportionate share of contributions is consistent with the share of expected benefits. This value should be consistent with the value that independent enterprises in comparable circumstances would have assigned to that contribution.

551. The OECD Guidelines establish that in valuing contributions, distinctions should be drawn between contributions of pre-existing value (e.g., existing tangible assets or intangibles) and current contributions. For instance, in a CCA for the development of an intangible, the contribution of patented technology by one of the participants reflects a contribution of pre-existing value, which is useful towards the development of the intangible that is the objective of the CCA. The value of the technology should be determined using the guidance provided by Chapter I - III and Chapter VI. The value of the current R&D activity under the development CCA must be based on the value of functions performed rather than on the potential value of the resulting further application of the technology. Comprehensive guidance on evaluating each participant’s contribution is also provided in the Guidelines.

Balancing payments

552. Where the value of a participant’s share of overall contributions under a CCA at the time the contributions are made is not consistent with that participant’s share of expected benefits under the CCA, the contributions made by at least one of the participants will be inadequate, and the contributions made by at least one other participant will be excessive. In such a case, the arm’s length principle would generally require that an adjustment be made. Such adjustment may result upon the entering into the CCA, or may be the result of periodic re-evaluation of the share of the expected benefits and/or the value of the contributions. Tax administrations may also require balancing payments where the value at the time the

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292 See the following example provided in paragraph 8.21 of the OECD Guidelines: “If there are five participants in a CCA, one of which cannot benefit from certain services activities undertaken within the CCA, then in the absence of some form of set-off or reduction in contribution, the contributions associated with those activities might be allocated only to the other four participants. In this case, two allocation keys might be used to allocate the contributions. Whether any particular allocation key or keys are appropriate depends on the exact nature of the CCA activity and the relationship between the allocation key(s) and the expected benefits.”

293 See paragraph 8.22 of the OECD Guidelines.

294 See paragraphs 8.24 to 8.26 of the OECD Guidelines.
contribution was made has been incorrectly determined, or where the participant’s proportionate expected benefits have been incorrectly assessed.\textsuperscript{295}

\textit{Accurately delineating the actual transaction}

553. Economically relevant characteristics of the arrangement identified under the guidance in Section D of Chapter I may indicate that the actual transaction differs from the terms of the CCA. For example, one or more of the alleged participants may not have any reasonable expectation of benefit from the CCA activity. Although in principle the size, no matter how small, of a participant’s share of expected benefits is no bar to eligibility, if a participant that is performing all of the subject activity is expected to have only a small fraction of the overall expected benefits, it may be questioned whether the reality of the arrangements for that party is to pool resources and share risks or whether the appearance of sharing in mutual benefits has been constructed to obtain more favourable tax results. The existence of significant balancing payments arising from a material difference between the parties’ proportionate shares of contributions and benefits may also give rise to questions about whether mutual benefits exist or whether the arrangements should be accurately delineated, taking into account all the economically relevant characteristics, as a funding transaction. Consequently, CCAs may be disregarded where the arrangements lack commercial rationality.\textsuperscript{296}

\textit{Tax treatment of contributions and balancing payments}

554. The OECD Guidelines provide that the contribution, including any balancing payments, by a participant to a CCA should be treated for tax purposes in the same manner as would apply under the general rules of the tax systems(s) applicable to that participant if the contributions were made outside a CCA, to carry on the activity that is the subject of the CCA.\textsuperscript{297}

555. In services CCAs, a participant’s contribution to the CCA will often give rise to benefits in the form of cost savings, and in development CCAs, the expected benefits to participants may not occur until some time after the contributions are made, which means no immediate recognition of income to the participants on their contribution at the time they are made. Finally, the Guidelines state that balancing payments should be treated as an additional contribution by the payer and a reduction in the contribution of the payee.

\subsection*{8.1.3. CCA entry, withdrawal or termination}

556. Changes in the membership of a CCA will trigger a reassessment of a participant’s proportionate shares. A new entity that becomes a participant in an active CCA might obtain an interest in any result of prior CCA activity, such as completed or work-in-progress intangibles or tangible assets. The participants must receive an arm’s length compensation – i.e. a buy-in payment. The payment should consider the entrant’s share in the overall expected benefits and value of any of its pre-existing contribution.\textsuperscript{298}

557. In a withdrawal, i.e. when a participant leaves a CCA, the departing participant disposes of its interest in the result of past CCA activity and could demand an arm’s length buy-out payment. The guidance in Chapters I - III and Chapter VI is fully applicable to determining the arm’s length amount of any buy-in, buy-out or balancing payment required.

\textsuperscript{295} See paragraphs 8.34 to 8.38 of the OECD Guidelines.

\textsuperscript{296} See paragraph 8.39 of the OECD Guidelines.

\textsuperscript{297} See paragraph 8.41 of the OECD Guidelines.

\textsuperscript{298} See paragraph 8.44 of the OECD Guidelines.
558. Finally, when a CCA is terminated, each participant retains an interest in the results of the CCA activity or is appropriately compensated for any transfer of that interest to other participants.

8.1.4. Recommendations for structuring and documenting CCAs

559. The OECD Guidelines establish that a CCA generally should meet the following conditions, emphasising that the list is neither a minimum compliance standard nor an exhaustive list of the information that a tax administration may be entitled to request:

- Must be between enterprises that expect to derive mutual and proportionate benefits from the CCA;
- The arrangement would specify the nature and extent of each participant’s interest in the results of the CCA activity;
- No payment other than the CCA contributions (also include appropriate balancing payments and buy-in payments made for the particular interest or rights in intangibles, tangibles assets or services obtained through the CCA);
- Determination of the value of the participant’s contribution in accordance with the Guidelines;
- The arrangement may specify provisions for balancing payments and/or changes in the allocation of contributions prospectively after a reasonable period of time to reflect material changes in proportionate shares of expected benefits among the participants;
- Adjustment would be made as necessary (buy-in or buy-out inclusive) upon the entrance or withdrawal of a participant and upon termination of the CCA.

560. Further, the Guidelines provide that the documentation standard set out in Chapter V requires reporting under the master file of important service arrangements and important agreements related to intangibles, including CCAs. The local file requires transaction information including a description of the transactions, the amounts of payments and receipts, copies of material intercompany agreements, and pricing information, including description of reasons for concluding that the transactions were priced on an arm’s-length basis. If not included in the master file or local file, taxpayers should be prepared to provide it upon request. Finally, a list with information that would be relevant and useful concerning the initial terms and over the duration of the CCA term is presented (e.g., a list of participants, scope of activities and how they are managed and controlled, duration, etc.).

8.2. Description of existing rules and practices in Brazil and gap analysis

561. The absence of special measures and clear guidance with respect to CCAs, which is also confirmed by Brazil’s country profile, is the main gap identified in the Brazilian transfer pricing framework in relation to Chapter VIII. Despite the absence of formal legal framework and guidance with respect to CCAs, some administrative guidance was issued in the past by RFB. This guidance may to some extent

299 For the list of the relevant information concerning the initial terms of a CCA, see paragraph 8.52 of the OECD Guidelines.

300 For the list of relevant information that could be useful concerning the duration of a CCA, see paragraph 8.52 of the OECD Guidelines.


302 After the issuance of Private Ruling 08/2012, which provides some guidance on CCAs, the new rulings discussed to some extent CCAs did not provide further details, or any guidance on the treatment of CCAs under the
reiterate the principles set out in the Guidelines, but it is not always consistent and also may suffer from the lack of legal framework, which may lead to questions in respect of the legality of such guidance in the absence of principles that would be established in the primary or secondary law.  

8.2.1. Limited guidance on cost contribution arrangements

562. The absence of transfer pricing provisions in the primary and secondary law dealing with the transfer pricing aspects of CCAs at the domestic level raises concerns as to whether the treatment of CCAs for transfer pricing purposes is in line with the OECD Guidelines.

563. Despite the complete absence of specific provisions on CCAs in the domestic law, academic literature has been used as a reference and been frequently cited by administrative and judicial bodies. Among the 17 Private Rulings issued by RFB on the topic, references to this literature are made in at least seven Rulings. Such rulings, especially the ones issued by the General Coordination Office for the Federal Revenue Taxation (COSIT) after the entry into force of Normative Instruction 1,396/2013, are of great relevance because they have binding effect on all tax officials and on taxpayers under the same factual circumstances, regardless of which taxpayer initiated the administrative procedure. Theses rulings, notably Private Ruling 08/2012, are the sole administrative guidance on the topic.

564. The following paragraphs describe the existing treatment of CCAs for transfer pricing purposes, based on the limited administrative guidance available, and to what extent the Brazilian scenario deviates from the guidance contained in the Guidelines.

Concept of a CCA

565. There is no definition of CCAs in the Brazilian transfer pricing legislation. The most relevant Private Ruling to delineate the concept of CCA is COSIT 08/2012, in which the tax administration made particular reference to the 2009 edition of the OECD Guidelines:

According to the OECD, the Cost Contribution Arrangement is a contractual agreement between companies with the objective to share costs and risks involved on the development, production or the obtaining of assets, services and rights, and to determine the nature and the extension of the benefits received in a consistency manner with the participation of each of company of the group.

Brazillian legal framework. Most of the rulings that were issued after 2012 discuss only the domestic tax treatment of CCAs (i.e. whether the transaction would be subject to CIDE, IRRF, and social contribution payments).

303 Members of the business community confirmed the lack of comprehensive guidance on CCAs and the difficulties for the application of the existing CCA guidance issued by the tax administration. See the summary of business comments in Annex A of this report.

304 See Alberto Xavier in “Direito Tributário Internacional do Brasil” (International Tax Law in Brazil), PG. Forense, 8ª edition, 2016.


306 Article 9 of Normative Instruction 1,396/2013.


308 Private Ruling (Solução de Consulta) COSIT nº 08/2012, pp. 5-6, item 11.
In the conclusion of Private Ruling COSIT 8/2012 a definition of what constitutes a CCA is provided, namely a “legal agreement in which one company of the group undertakes expenses in the benefit of all or part of other companies which are parties of the group, by means of reimbursement of the costs incurred”.

However, the concept of CCA as indicated in the Private Ruling does not fully match the current definition of a CCA as stated in the Guidelines. The lack of a comprehensive definition in the private ruling and the lack of any definition of CCAs in the Brazilian transfer pricing legislation, may lead to uncertainty regarding the characterisation of a CCA.

Types of CCAs

Notwithstanding the lack of an express provision, the academic literature, which is notably quoted in Private Ruling 50/2016, identifies three different types of CCAs:

- The CCA (cost sharing or “contrato de compartilhamento de custos”) that is used in the context of back-office activities and for the use of rights and assets owned by one group member company and put at the disposal of the others – which broadly corresponds to the services CCAs in the Guidelines;
- The CCA (“contrato de contribuição para os custos”) that aims to share the costs and risks on the development, production and obtaining of tangible or intangible assets, services and rights, as well as to define the extent of the interests of each participant. These agreements aim to form a pool of resources and technologies for the share of the costs with R&D, which means an entitlement to a portion of the intangible rights produced – they correspond to development CCAs in the Guidelines;
- The intra-group service (“serviço intra-grupo”) that is the actual provision of a service, which corresponds to the concept of intra-group service described in Chapter VII of the Guidelines.

These terminologies, even though used inconsistently by different ruling and authors, refer to both services and development CCAs. Nevertheless, the private rulings and case law reveal that these terms were used in the context of a typical service CCA related to back-office activities.

Even though the concept and types of CCA (services/development) exist in Brazil in the academic literature and Private Rulings, it is not fully aligned with the notions in the Guidelines, which means that the classification under the literature, combined with the different terminologies used, may lead to misunderstandings for both taxpayers and tax authorities.

Consequently, it can be stated that the legal framework in Brazil has not been developed to a large extent and fails to provide clarity and certainty.

Shortcomings as regards the application of the arm’s length principle

There are no special considerations for CCAs in the Brazilian transfer pricing framework – no legal provisions, instructions or guidance. In consequence, the current framework raises questions as to whether CCAs are apprehended by the transfer pricing rules in Brazil.

Private Ruling 08/2012, with reference to the arm’s length principle and the 2009 edition of the Guidelines, established a number of conditions and requirements for a CCA:

- Clear allocation of costs and risks inherent in the development, production or obtaining of goods, services or rights;
- The contribution of each company must be consistent with the benefits which are expected or effectively received on an individual basis;

309 Private Ruling (Solução de Consulta) COSIT nº 08/2012, p. 15, item 51.
Forecasting of each individual benefit to each company of the group;\(^{310}\)

- Negotiation of the reimbursement, understood as the reimbursement of the costs corresponding to the efforts expended in the realisation of an activity, without the addition of a profit margin;
- Collective character of the benefits offered to all companies belonging to the group;
- Remuneration for the activities, regardless of their effective use. In this regard, it is sufficient that the activities be made available to and for the benefit of the other companies of the group;
- The provision of conditions that any company, under the same circumstances, would be interested in entering the arrangement.

574. It seems that RFB attempted, to some extent, to apply some of the principles and concepts established in the 2009 edition of the Guidelines. However, it is unclear how RFB would perform the analysis of the foregoing conditions and requirements when facing a CCA scenario, especially because of the fact that the law does not foresee the application of the arm’s length principle, or any functional or economic analysis.

575. However, according to the private ruling, if the requirements are met, payments abroad in connection with a CCA would not be subject to transfer pricing control – no transfer pricing provision would be applicable, and profits should be deductible for the Brazilian entity.

576. Therefore, the effect of following this Ruling, would be the de-activation of the transfer pricing rules in the context of CCAs in Brazil.

577. Moreover, the limited guidance in the current scenario and the issues previously reported in this report, especially related to Chapters I - III, VI and VII, jeopardise the efficiency of the Brazilian approach with respect to CCAs. In consequence, the absence of clear guidance and the conclusions provided by the aforementioned Private Ruling, lead to high uncertainty for taxpayers and the tax administration on how to deal with CCAs, and whether this types of contracts are apprehended by the transfer pricing rules.

**Determining participants**

578. There is no specific guidance on CCA participants. The only reference to the topic is made in COSIT 08/2012 in the sense that if it is not possible to assume that the company can expect any benefit from the activity developed according to the CCA, and if the costs do not correspond to the payment for goods effectively received or services effectively rendered, such company cannot be considered a party to the contract.

579. The rationale provided by the Ruling generally reflects the fundamental concept of mutual benefit as established by the Guidelines.

580. However, others relevant considerations developed in the Guidelines to determine a participant to a CCA are absent from the Brazilian transfer pricing framework. The existing guidance does not provide considerations with respect to a participant that is not capable of exploiting the outcomes of the CCA in its own business in any manner, or that does not exercise control over the specific risk it assumed under the CCA and does not have the financial capacity to assume these risks. All these situations would disqualify a party from being a participant to the CCA.

**Expected benefits from CCA**

581. No guidance is provided on how to assess the expected benefits from a CCA. As stated before, according to the Guidelines, the relative shares of expected benefits might be estimated based on the

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\(^{310}\) If it is not possible to show that the company will have any benefit by undertaking such activity, the company should not be considered as a part of the contract.
anticipated additional income generated or costs saved or other benefits received by each participant as a result of the arrangement. An approach frequently used in practice, typically for services CCAs, would be to use relevant allocations keys, such as sales (turnover), profits, units used, produces, or sold; number of employees, and so forth.

582. In addition, no specific guidance is provided regarding the periodic reassessment of contributions vis-à-vis the revised share of benefits to determine whether the future contributions of participants should be adjusted.

Value of each participant’s contribution

583. One indication on the value of each participant’s contribution is given by Private Ruling 08/2012, which states that a CCA should entail conditions that any company, under the same circumstances, would be interested in entering into the arrangement. However, no further indication on how to assess the actual value of each participant’s contribution is provided.

Balancing payments

584. No guidance for balancing payments to CCAs is provided under the Brazilian framework. It is unclear if Brazil would foresee an adjustment to be made when the participant’s share of overall contributions under a CCA at the time the contributions are made is not consistent with that participant’s share of expected benefits under the CCA.

Accurately delineating the actual transaction

585. The only consideration stated in Private Ruling 08/2012 is that if an agreement presented as a CCA, is actually an authentic service agreement, the general transfer pricing rules will be applicable.

Tax treatment

586. Brazil does not have comprehensive legislative guidance but only some limited administrative guidance with respect to the tax treatment of payments undertaken under a CCA, and in consequence of this gap in the legislation, there is a potential tax uncertainty surrounding CCAs.

587. The only guidance available to taxpayers are the Private Rulings issued by RFB, which do address various issues concerning CCAs raised by taxpayers.

588. The main rulings (issued by COSIT) are further explained below with a view to demonstrating that Brazil lacks clear guidance on the tax treatment of transactions carried out under a CCA.

589. Private Ruling 08/2012 was issued in the context of an international CCA in which the lead company assumed the financial expenses related to some activities that were shared among other companies in the group, and subsequently, the expenses were reimbursed by these companies, in proportion to their benefits.

590. Through this Ruling, the tax administration confirmed the existence, validity and the nature of the CCA and established conditions in order to qualify a contract as a CCA, while providing that if all the conditions are satisfied, the amount becomes deductible and no transfer pricing legislation is applicable.311 More importantly, it was established that if the payment under a CCA is a mere reimbursement, without profit margin, among other conditions, the payments made by the beneficiaries to the leader would not correspond to a compensation for services rendered.

311 Private Ruling (Solução de Consulta) COSIT nº 08/2012, p. 16, item 17.
Additionally, this Private Ruling also made an important distinction stressing that for external cost-sharing agreements, in which the services centralised at the level of the parent company are outsourced to third parties, the amounts remitted are subject to withholding tax, which is levied on the services actually rendered by the third parties. Therefore, in such cases, this private ruling indicated that these agreements, differently from a CCA, would be treated as a typical service provision contract, indicating that the tax treatment would follow accordingly.

A year later, Private Ruling 23/2013 analysed a query from the taxpayer concerning a domestic CCA in which the company intended to organise a structure in order to concentrate specific departments for administrative support. It was stressed in the Ruling that the payments for reimbursement do not constitute revenue, because they lack the potential to generate a capital increase. The consequence was the non-inclusion of these costs in the social contribution taxable base.

Furthermore, RFB issued Private Ruling 21/2015. This ruling deals with international cost sharing agreement signed by a Brazilian subsidiary and other companies from the group with the head office situated in Germany. The taxpayer questioned whether there was an obligation to insert the transactions performed under the CCA in the SISCOSERV (electronic system developed by the Brazilian government to monitor cross-border transactions involving services and intangibles). It was established that CCAs are to be included in the SISCOSERV, as the reimbursement offered in return for the activity represents an expense, which would lead to a variation in the companies’ equity. Nevertheless, it was indicated that CCAs are guided by a collaborative principle in which the purpose of obtaining profit is not present, indicating that the provision of services occurs in a competitive, free-market economy based on external price pressure and with the objective of generating profits.

Further, RFB issued Private Ruling 43/2015 in which the tax authorities analysed whether “CIDE-technology” (tax levied on remittances abroad for technical services, technical assistance and administrative assistance – 10%) would be levied on reimbursements of costs to a foreign company in the context of a CCA. According to this Ruling, the reimbursement of payments are remunerating, although indirectly and even without obtaining a profit, the services form which the Brazilian subsidiary benefits. The conclusion in the Ruling stated that CIDE is applicable in cost contribution arrangements even when the amounts correspond to the cost of services that are directly provided through the employees of the group company domiciled abroad (internal costs), and also when the amounts are paid by the group company domiciled abroad to third-party external services provider (external costs).

On the one hand, it seems that through Private Ruling 08/2012, 23/2013 and 21/2015, tax authorities would accept that amounts received as reimbursement of expenses under a CCA would not be taxed by withholding income tax and other taxes on remittance, such as IRRF, CIDE, PIS and COFINS, because they would not conform with the concept of taxable revenue for the purpose of income. And on the other hand, based on Private Ruling 43/2015, tax authorities would classify payments under a “legitimate” CCA as being an actual provision of service, and would charge “CIDE-Technology” on amounts remitted to non-residents even where there is the mere reimbursement of expenses.

In addition to above, considering that the material scope of the Brazilian transfer pricing rules is restricted to transactions with goods, services and rights, if the activities carried out under CCA are not characterized as the provision of services, the application of transfer pricing rules would not be triggered.

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313 Private Ruling (Solução de Consulta) COSIT nº 21/2015, p. 6, item 19.1.
314 Private Ruling (Solução de Consulta) COSIT nº 43/2015, p. 11, item 35.
CCA entry, withdrawal or termination

597. It is uncertain whether or how the Brazilian rules would be applicable in the context of entry, withdrawal or termination of a CCA.

Recommendations for structuring and documenting CCAs

598. The Private Rulings, notably COSIT 08/2012, provided some conditions for structuring a CCA. However, no other guidance in this respect and related to transfer pricing documentation is provided.

8.3. Assessment of effectiveness

Limited guidance on cost contribution arrangements

599. Limited guidance on CCAs creates confusion and significant uncertainty as regards the treatment of transactions in connection to a CCA for transfer pricing purposes, or even whether they would be subject to transfer pricing control in some cases. The issues related to Chapters I - III, VI and VII also undermine the effectiveness of the transfer pricing rules in Brazil with respect to CCAs. In this context, the proper application of the arm’s length principle is highly unlikely.

600. In practice, the experience with CCAs is limited to service CCAs, as demonstrated from the rulings issued so far by the tax administration. There is also no special guidance for distinguishing between the different types of CCAs (service vs. development CCAs), and also no consistent guidance for determining whether an agreement is an actual CCA or whether it should be considered as something else (e.g. a provision of service).

Findings of the assessment

Prevention of BEPS risks

The lack of clear guidance on how transactions are assessed in the context of a CCA, i.e. how to determine the participants, the contributions and benefits, how to delineate the transaction and balancing payments, undermines the capacity of Brazil to prevent BEPS.

There is also an indication that, based on the administrative rulings, the transfer pricing legislation may not be applicable to actual CCA transactions if all the conditions established in Private Ruling 08/2012 are fulfilled. BEPS risks may arise in scenarios involving high-value transactions, especially where such CCA arrangements may be used to shift the economic benefits resulting from the development of intangible assets in Brazil to foreign entities for the mere contribution to the costs of such development; or similarly, where valuable services are being provided for a mere cost contribution. Further, in situations which would constitute a genuine CCA involving the provision of services and where a Brazilian entity is a mere participant who is expected to contribute towards the costs (cost reimbursement), the absence of existing rules would actually allow such costs to be deducted with mark-up in Brazil. It also appears that the CCA concept is being used to avoid other types of taxes, which may create BEPS risks also in areas such as withholding taxes and other duties and levies.

Accordingly, the existing transfer pricing legislation in Brazil clearly does not address such BEPS risks. The absence of regulations or guiding principles on how to assess CCAs constitutes a significant BEPS risk.
**Prevention of double taxation**

The absence of guidance on CCAs combined with the absence of a complete comparability analysis (including functional analysis, risk analysis, considerations as to financial capacity to bear a risk, etc.), lead to an approach that may produce outcomes which differ from the outcomes that would be obtained based on the OECD Guidelines, and accordingly, may give rise to double taxation.

**Ease of tax administration**

The tax administration is not made simpler in the absence of clear rules or principles that regulate CCAs. The tax authorities currently have to navigate through a set of mutually conflicting principles resulting from prior private rulings.

**Ease of tax compliance**

The limited guidance to deal with CCAs under the transfer pricing system makes it unclear for taxpayers what rules are to be followed, i.e. whether they should follow the general transfer pricing rules or whether they should take a position based on the published private rulings.

**Tax certainty**

The absence of clear rules and inconsistencies in the scarce existing administrative guidance result in tax uncertainty from a domestic and international perspective. From a domestic point of view, this is explained because no clarity in the treatment of a CCA is provided. Besides that, it is uncertain whether an attempt to enter in a CCA under the current guidance will actually be treated accordingly or if it will be treated as a provision of service.

From an international perspective, the uncertainty is explained by the fact that a majority of jurisdictions, including all OECD member countries, follow the guidance on CCAs. The absence of similar guidance means that a different, inconsistent approach must be followed.
The ninth chapter contains the analysis of Brazil’s relevant transfer pricing rules as compared with Chapter IX of the OECD Guidelines, which contains guidance on the transfer pricing aspects of business restructurings. Business restructuring refers to the cross-border reorganisation of the commercial or financial relations between associated enterprises, including the termination or substantial renegotiation of existing arrangements. The analysis includes both the arm’s length compensation for the business restructuring itself and for the remuneration of post-restructuring controlled transactions. The findings show that the Brazilian rules are not adequate to deal with these transactions and the situation is assessed according to the policy objectives of transfer pricing rules.
INTRODUCTION

Different types of business restructurings

601. Business restructurings may often involve the centralisation of intangibles, risks, or functions with the profit potential attached to them. In particular, business restructurings may typically consist of:

- Conversion of full-fledged distributors (that is, enterprises with a relatively higher level of functions and risks and correspondingly higher profit and loss potential) into limited-risk distributors, marketers, sales agents, or commissionaires (that is, enterprises with a relatively lower level of functions and risks and correspondingly lower profit and loss potential) for a foreign associated enterprise that may operate as a principal;
- Conversion of full-fledged manufacturers (that is, enterprises with a relatively higher level of functions and risks and correspondingly higher profit and loss potential) into contract manufacturers or toll manufacturers (that is, enterprises with a relatively lower level of functions and risks and correspondingly lower profit and loss potential) for a foreign associated enterprise that may operate as a principal;
- Transfers of intangibles or rights in intangibles to a central entity (e.g. a so-called “IP company”) within the group;
- The concentration of functions in a regional or central entity, with a corresponding reduction in scope or scale of functions carried out locally; examples may include procurement, sales support, supply chain logistics.

602. There are also business restructurings whereby more intangibles or risks are allocated to operational entities (e.g., to manufacturers or distributors). Business restructurings can also consist of the rationalisation, specialisation or de-specialisation of operations (manufacturing sites and/or processes, research and development activities, sales, services), including the downsizing or closing of operations.

603. This guidance is intended to be applied in the same way to all types of transactions comprising a business restructuring, irrespective of whether they lead to a more centralised or less centralised business model.

Issues

604. Business restructurings are typically accompanied by a reallocation of profit potential among the members of the MNE group, either immediately after the restructuring or over a few years. One major objective of this Chapter IX is to discuss the extent to which such a reallocation of profit potential is consistent with the arm’s length principle and more generally how the arm’s length principle applies to business restructurings. The implementation of integrated business models and the development of global organisations may complicate the application of the arm’s length principle, which determines the profit of members of an MNE group by reference to the conditions which would have been made between independent enterprises in comparable transactions and comparable circumstances. This complexity in applying the arm’s length principle in practice is acknowledged in the OECD Guidelines (see paragraphs 1.10-1.11). When discussing the issues that arise in the context of business restructurings, the OECD has kept this complexity in mind in an attempt to develop approaches that are realistic and reasonably pragmatic.

Theoretical framework

605. The relevant question under Article 9 of the OECD Model Tax Convention and the arm’s length principle is whether there are conditions made or imposed in a business restructuring that differ from the
conditions that would be made between independent enterprises. This is the theoretical framework in which all the guidance in this chapter should be read.

**ARM’S LENGTH COMPENSATION FOR THE RESTRUCTURING ITSELF**

606. The first part of Chapter IX provides guidance on the determination of the arm’s length compensation for the restructuring itself. It is centred on concepts that have been developed consistently with other chapters of the OECD Guidelines. Therefore, many of the conclusions of previous chapters are also relevant, especially Chapter I and notion of the accurate delineation of the transactions (functions, assets and risks before and after the restructuring).

9.1. Applying the arm’s length principle to business restructurings

607. The application of the arm’s length principle to a business restructuring must start, as for any controlled transaction, with the identification of the commercial or financial relations between the associated enterprises involved in the business restructuring and the conditions and economically relevant circumstances attaching to those relations so that the controlled transactions comprising the business restructuring are accurately delineated. In this regard, the general guidance in Section D.1 of Chapter I is applicable.

9.1.1. Accurate delineation of the actual transaction and focus on allocation of risk in the context of a business restructuring

608. The notion of accurate delineation of the actual transaction requires the examination of the economically relevant characteristics of the commercial or financial relations between the associated enterprises, and in particular the contractual terms of the business restructuring, the functions performed by each party to the restructuring, before and after the restructuring, taking into account assets used and risks assumed, the economic circumstances of the parties and business strategies.

609. Risks are of critical importance in the context of business restructurings. The assumption of risk associated with a commercial opportunity affects the profit potential of that opportunity, and the allocation of risk assumed between the parties to the arrangement affects how profits or losses resulting from the transaction are allocated through the arm’s length pricing of the transaction.

610. Business restructurings often result in local operations being converted into low risk operations (e.g. “low risk distributors”, or “low risk contract manufacturers”) and being remunerated with a relatively low (but generally stable) return on the grounds that the economically significant risks are assumed by another party to which the profits or losses associated with those risks are allocated.

9.1.2. Reallocation of profit potential as a result of a business restructuring

611. When applying the arm’s length principle to business restructurings, the question is whether there is a transfer of something of value (an asset or an ongoing concern) or a termination or substantial renegotiation of existing arrangements and that transfer, termination or substantial renegotiation would be compensated between independent parties in comparable circumstances. The Guidelines provide detailed guidance applicable to both scenarios.

612. It is important to determine whether risks contractually transferred as part of the business restructuring are assumed by the foreign associated enterprise in accordance with the guidance in Section D.1 of Chapter I. At arm’s length, the response is likely to depend on the rights and other assets of the
parties, on the profit potential\textsuperscript{315} of the associated enterprise in relation to the different business models as well as the expected duration of the new arrangement.

613. In particular, in evaluating profit potential, it is necessary to evaluate whether historic profits (determined in accordance with the arm's length principle) are an indicator of future profit potential, or whether there have been changes in the business environment around the time of the restructuring that mean that past performance is not an indicator of profit potential.

\textbf{9.1.3. Commercial rationale}

614. The transfer pricing analysis of transactions comprising a business restructuring involves an understanding of the business reasons for and the expected benefits from the restructuring, including the role of synergies.

615. The Guidelines specify that where anticipated synergies are put forward by a taxpayer as an important business reason for the restructuring, it would be a good practice for the taxpayer to document, at the time the restructuring is decided upon or implemented, what these anticipated synergies are and on what assumptions they are anticipated. For Article 9 purposes, it would also be a good practice for the taxpayer to document the source of these synergies and how these anticipated synergies impact at the entity level in applying the arm's length principle.

616. While at arm's length there are also situations where an entity would have had one or more options realistically available to it that would clearly offer more attractive opportunities to meet their objectives than to accept the conditions of the restructuring, there are also situations where the restructured entity would have had no clearly more attractive option realistically available to it than to accept the conditions of the restructuring.

\textbf{9.2. Description of existing rules and practices in Brazil and gap analysis}

617. The transfer pricing system in Brazil does not provide any special measure or guidance on business restructurings. Therefore, the general transfer pricing rules apply to each transaction comprising the business restructuring, as separately considered and formalised, and without regard to the functions, risks and assets at play.

\textbf{9.2.1. Functional analysis and risk control}

618. Brazilian transfer pricing rules do not incorporate the notion of accurate delineation of the transactions; therefore, the transactions comprising the business restructuring will not be assessed through the perspective of performing a functional analysis that seeks to identify the economically significant activities and responsibilities undertaken, assets used or contributed, and risks assumed before and after the restructuring by the parties involved.

619. As previously explained under the Chapter I analysis, the concept of risk allocation and risk control is ignored in the Brazilian transfer pricing legislation. Thus, no effort is required to determine which party assumes specific risks before the restructuring and which party assumes specific risks following the restructuring.

\textsuperscript{315} In the OECD Guidelines, "profit potential" typically means "expected future profits". Profit potential could also materialise in a loss.
9.2.2. Transfer pricing analysis of conversions

620. The main issue in relation to these differences is that the transfer pricing analysis will lead to completely different outcomes under the Brazilian system.

621. For example, the conversion of full-fledged distributors (that is, enterprises with a relatively higher level of functions and risks) into limited-risk distributors will have limited transfer pricing impact because the statutory margins applied would remain the same for the distributor, e.g., in the case of the resale price method (PRL method), regardless of its functional profile (either full-fledged or limited).

622. As another example, the conversion of full-fledged manufacturers (that is, enterprises with a relatively higher level of functions and risks) into toll (that is, enterprises with a relatively lower level of functions and risks), whereby all functions, risks and assets, including intangible assets (e.g., distribution agreements) would be transferred, would result in the application of one of the available methods to the transfer of intangibles (with difficulty), whereas the treatment of the transfer of other assets would be undetermined/uncertain if the price of the transaction is adjusted and the transfer of functions (through the relocation of personnel) would not be addressed.

623. In conclusion, the actual transactions comprising the common types of business restructurings would not be accurately delineated and would not trigger any transfer pricing risks or have a significant transfer pricing impact beyond the usual application of the transfer pricing rules.

9.2.3. Commercial rationale

624. A company is not required to present to the tax authorities with the reasons for a restructuring. As a result, it is unlikely that the restructuring will be challenged by the tax authorities as long as compliance with the transfer pricing methods is ensured.

625. It is however suggested that the reasons for the company’s profit being reduced drastically could be challenged as part of an audit, where the tax authorities may invoke the sham theory or substance-over-form arguments. Such arguments would be likely to be successful only in cases of blatant abuse or situations lacking economic substance.

9.3. Assessment of effectiveness

Absence of special considerations for the transfer pricing aspects of business restructurings (arm’s length compensation for the restructuring itself)

626. The Brazilian transfer pricing rules are inefficient in terms of apprehending transactions comprising a business restructuring. The current methodology in the Brazilian transfer pricing legislation does not take into consideration this kind of operation since potential changes of the functional profile of the company do not affect the transfer pricing analysis in Brazil, i.e. the profit margins will not change if the risk or functional profile of the company is modified. Further, the transfer of valuable assets (especially intangibles) is unlikely to be subject to application of transfer pricing rules unless there is a clear formalisation of such transactions. However, even in such cases, the existing rules are unlikely to appropriately remunerate the resident entity, which has transferred its profit potential through the transfer of functions, assets and risks. Likewise, where the resident entity has the functional profile of a principal or full-fledged entrepreneur, the existing framework is unlikely to reward the Brazilian entity for its profit potential and there could be significant loss of revenue also in these situations, which can be also an important factor that will need to be considered in possible transition of the current system, which could trigger such significant conversions to reduce the existing functional and risk profiles, when taxpayers may seek to move the existing profit potential out of Brazil, should such a change occur.
Findings of the assessment

Prevention of BEPS risks

Significant BEPS risks and loss of revenue for Brazil occur as a consequence of the absence of special considerations for the transfer pricing aspects of business restructurings and the diverging approach. The issues identified under Chapter I-III resurface in the context of business restructurings. Combined with the absence of a complete comparability analysis, including a functional analysis and a risk analysis, the absence of guidance on the transfer pricing aspects of business restructurings creates important BEPS concerns.

Importantly, transfers of valuable intangibles, which may not always be duly recognised in the accounting and legal framework as separate assets, since the definition of intangibles contained in the current rules may not be as broad as the one contained in the OECD Guidelines, and/or transfer of profit potential out of Brazil are likely to occur. It is suggested that Brazil is already losing revenue because if a company has significant profit potential, its transfer is not recognised as part of the restructuring. In the reverse situation, where functions, risks and assets are transferred to Brazil, there will be in most cases no additional revenue recognised and allocated for the functions performed, risk assumed and assets owned to Brazil because only the minimum amount of tax as prescribed by law would be paid. The common tax planning structures would assure that the corresponding profit potential including assets, functions and risks are allocated to the entities in low or no tax jurisdictions so that the corresponding profits end up offshore.

Prevention of double taxation

There may be on the other hand situations where legitimate transactions take place between a foreign entity of the MNE group, which has the functional and risk profile of a principal entity established in a normal or high tax jurisdiction, while the Brazilian entity performs legitimate low risk functions. In such a case, the current system with fixed margins can create situations of double taxation, where the fixed margin exceed the arm’s length compensation, which would be appropriate in such instances.

Ease of tax administration

The absence of guidance for special considerations in cases of restructuring combined with absence of functional and risk analysis significantly reduces the complexity and fact intensity required under the OECD guidance. This simplicity however comes at the cost of loss of revenue for Brazil.

Ease of tax compliance

The absence of guidance for special considerations in cases of restructuring combined with absence of functional and risk analysis significantly reduces the tax compliance burden for taxpayers and the features of the system allow the taxpayers to reduce the tax burden.

Tax certainty

The absence of guidance for special considerations for business restructurings can create certainty for taxpayers who seek to exploit the weaknesses of the current system, which can enhance the opportunities for BEPS behaviour of some MNEs.
REMUNERATION OF POST-RESTRUCTURING CONTROLLED TRANSACTIONS

627. The second part of Chapter IX addresses the remuneration of post-restructuring controlled transactions. It is concerned with ensuring that the arm’s length principle applies in the same manner to post-restructuring transactions as opposed to transactions that were structured as such from the beginning.

9.4. Applying the arm’s length principle to post-restructuring controlled transactions

628. This part of the guidance focusses on:

- Possible factual differences between situations that result from a restructuring and situations that were structured as such from the beginning;
- Selection and application of a transfer pricing method for the post-restructuring controlled transactions;
- The relationship between compensation for the restructuring and post-restructuring remuneration;
- Comparing the pre- and post-restructuring situations; and
- Location savings.

9.5. Description of existing rules and practices in Brazil and gap analysis

629. For the reasons discussed in the previous section, the conclusions of the gap analysis are similar, namely, Brazilian transfer pricing rules are not concerned with the appropriate remuneration of pre- nor post-restructuring controlled transactions. The general transfer pricing rules would continue to apply to transactions within the scope of the existing legislation, according to the available transfer pricing methods. This means that most of the transactions occurring as part of the restructuring may not be addressed under existing rules and therefore also outside of the scrutiny of the tax administration.

9.6. Assessment of effectiveness

Absence of special considerations for the transfer pricing aspects of business restructurings (remuneration of post-restructuring controlled transactions)

630. The outcomes of the assessment of effectiveness are also similar, though it is worth highlighting some nuances.

Findings of the assessment

Prevention of BEPS risks

The main concern regarding BEPS is the potential transfer of functions and risks out of Brazil, which are not currently covered by the existing transfer pricing legislation. This risk is also potentially relevant in the case of the intangible assets that do not meet the narrow definition of intangibles and transfers of assets where the fixed margins would prevent application of the actual market value. This could be especially an issue in the transitional period, when the companies may seek to reduce the functional and risk profiles of the Brazilian entities to assure lower returns based on arm’s length principle. This
concern could be addressed in the transitional period by effective exit tax rules, which could be designed based on international best practices.\(^{316}\)

Concerns are also present in the context of current inbound restructuring which involves shifting functions, risks and assets to Brazil, and whereby under the OECD Guidelines, Brazilian entities would have higher profit potential. This profit potential would not be properly addressed under the current system and this can give rise to risk of significant under-taxation.

In some cases, the fixed margins could be considered as protective element as they would be indifferent to the change of the functional/risk profile and would still require minimum amount of income recognised even in cases, where the functional and risk profile is intentionally adjusted and manipulated with tax motivated restructuring arrangements. This protection is however limited by the fixed margins themselves, which would only require the recognition of the minimum income and it do not enable Brazil to fully protect the potential of the Brazilian entities.

**Prevention of double taxation**

The risk of double taxation remains due to the potential application of the fixed margins in the post-restructuring situations, especially in cases where the restructuring is motivated by legitimate commercial reasons and the profit potential is transferred and materialised in the tax base recognised in the tax jurisdictions, where it is subject to a reasonable level of corporate income tax. The fixed margins requiring the minimum level of income can thus also create a risk of double taxation, as discussed in previous sections.

**Ease of tax administration**

The absence of guidance for special considerations in cases of restructurings combined with the absence of functional and risk analysis significantly reduces the complexity and fact intensity required under the OECD guidance. The application of fixed margins in post-restructuring situations reduces the tax administration burden.

**Ease of tax compliance**

The absence of guidance for special considerations in cases of restructuring combined with absence of functional and risk analysis significantly reduces the tax compliance burden for taxpayers and the features of fixed margins allow the taxpayers to reduce the tax burden.

**Tax certainty**

There is a potential for increased tax certainty as a consequence of the application of the fixed margins in post-restructuring situations. This impact on tax certainty from a domestic perspective is however limited. The absence of special considerations for business restructurings does not provide tax certainty from an international perspective.

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Transfer pricing aspects of financial transactions / intra-group financing

The tenth chapter contains the analysis of Brazil’s relevant transfer pricing rules in respect of financial transactions based on the OECD Guidelines and the specific OECD draft guidance (which has yet to be finalised), the purpose of which is to provide guidance for determining whether the conditions of certain financial transactions between associated enterprises are consistent with the arm’s length principle. The chapter starts by providing the status of OECD guidance on intra-group financing, before describing the current situation in Brazil and the gaps and divergences identified by the analysis. The analysis is followed by the assessment of effectiveness according to the policy objectives of transfer pricing rules.

631. Another key area where special considerations and guidance on the application of the arm’s length principle may be needed is the area of financial transactions carried out within an MNE group. Such transactions may take a variety of forms and can include provision of capital – either in the form of debt or equity –, but they can also take more complex forms, such as intra-group guarantees, hedging, cash pooling, captive insurance arrangements and others.

632. These types of transactions have been a concern for policymakers and tax administrations already for a long time, but attempts to formulate specific guidance have failed in the past and that is why there is currently no specific guidance contained in the OECD Guidelines. One of the reasons why it was difficult to reach consensus was the difficulty to determine the hypothetical arm’s-length capital structure of an entity within an MNE group. Some countries were of the view that the arm’s length principle can provide reasonable guidance in this area, while other countries were of the view that the arm’s length principle cannot provide reasonably accurate guidance, especially due to the fact that the notion of arm’s-length capital structure is flawed as it would imply a comparison of the capital structure of the entity with that of an independent enterprise, but the principle of independent parties generally precludes the existence of a capital/shareholder relationship.

633. Nevertheless, significant concerns related to both BEPS risks and potential double taxation exist in the area of financial transactions and countries have been adopting various measures to deal with such challenges. These measures include thin-capitalisation rules, interest deductibility limitations or caps on interest rates. The OECD reviewed these practices in the 1980s and analysed their compliance with tax treaty obligations. The findings of this analysis are contained in the Thin Capitalisation report,317 which identifies the key limitations to the application of special measures to address the challenges related to financial transactions that may be found in the non-discrimination provisions of bilateral tax treaties. The report also identifies that the arm’s length principle and Article 9 remain relevant for determining the pricing of financial transactions and elimination of double taxation. These findings have been also reflected in the Commentaries on Article 9 and Article 24 the OECD MTC, which may also be further clarified in the near future.

634. The BEPS risks however remained and continued to be a prevalent challenge for policymakers. Therefore, BEPS Action 4 mandated work on the transfer pricing aspects of financial transactions,318 which was to be closely co-ordinated with the other transfer pricing work on BEPS Actions 8-10 and namely BEPS Action 9.319 The BEPS Action 4 mandate has identified ongoing BEPS risks presented by various

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318 Action 4 of the BEPS Action Plan called for the development of recommendations regarding best practices in the design of rules to prevent base erosion through the use of interest expense, for example through the use of related-party and third-party debt to achieve excessive interest deductions or to finance the production of exempt or deferred income, and other financial payments that are economically equivalent to interest payments. As stated in the BEPS Action Plan (BEPS Action Plan, OECD, 2013) “the work will evaluate the effectiveness of different types of limitations. In connection with and in support of the foregoing work, transfer pricing guidance will also be developed regarding the pricing of related party financial transactions, including financial and performance guarantees, derivatives (including internal derivatives used in intra-bank dealings), and captive and other insurance arrangements. The work will be co-ordinated with the work on hybrids and CFC rules”.

319 The mandate on Action 9 (Risks and capital) provided: “Develop rules to prevent BEPS by transferring risks among, or allocating excessive capital to, group members. This will involve adopting transfer pricing rules or special measures to ensure that inappropriate returns will not accrue to an entity solely because it has contractually assumed risks or has provided capital. The
financial transactions – either in the form of deductible interest payments or by other types of financial transactions – such as guarantee fees, intra-group insurance and reinsurance payments, cash pooling, hedging and other financial transactions. The BEPS Action 4 Final Report formulated specific recommendations regarding best practices to deal with some of these risks,\(^{320}\) namely interest payments for which a special measure (outside of the arm’s length principle) was designed. This measure provides an effective protection of the tax base against some common types of financial transactions, because its application extends not only to interest payments in the narrow sense, but also to other payments economically equivalent to interest, including financial guarantee fee payments.

635. As it is based on a fixed ratio, this measure does not rely on transfer pricing analysis. Since the development of this recommendation, a significant number of countries have adopted this type of measure,\(^{321}\) and it also became part of the EU Anti-Tax Avoidance Directive, which means that all EU Countries will implement it into their domestic law.\(^{322}\)

**Box 10.1. BEPS Action 4 Recommendations**

BEPS Action 4 called for recommendations regarding best practices in the design of rules to prevent base erosion through the use of interest expense. The BEPS Action 4 Final Report analyses several best practices and recommends an approach which directly addresses BEPS risks in this area, namely:

- Groups placing higher levels of third party debt in high tax countries.
- Groups using intragroup loans to generate interest deductions in excess of the group’s actual third party interest expense.
- Groups using third party or intragroup financing to fund the generation of tax exempt income.

**Fixed ratio rule**

The recommended approach is based on a fixed ratio rule which limits an entity’s net deductions for interest and payments economically equivalent to interest to a percentage of its earnings before interest, taxes, depreciation and amortisation (EBITDA). As a minimum this should apply to entities in multinational groups. To ensure that countries apply a fixed ratio that is low enough to tackle BEPS, while recognising that not all countries are in the same position, the recommended approach includes a corridor of possible ratios of between 10% and 30%. The report also includes factors which countries should take into account in setting their fixed ratio within this corridor. The approach can be supplemented by a worldwide group ratio rule which allows an entity to exceed this limit in certain circumstances.


\(^{321}\) In 2018, nearly 40 members of the Inclusive Framework on BEPS indicated to have adopted a fixed ratio rule based on the EBITDA.

**Group ratio rule**

Recognising that some groups are highly leveraged with third party debt for non-tax reasons, the recommended approach proposes a group ratio rule alongside the fixed ratio rule. This would allow an entity with net interest expense above a country’s fixed ratio to deduct interest up to the level of the net interest/EBITDA ratio of its worldwide group. Countries may also apply an uplift of up to 10% to the group’s net third party interest expense to prevent double taxation. The earnings-based worldwide group ratio rule can also be replaced by different group ratio rules, such as the “equity escape” rule (which compares an entity’s level of equity and assets to those held by its group) currently in place in some countries. A country may also choose not to introduce any group ratio rule. If a country does not introduce a group ratio rule, it should apply the fixed ratio rule to entities in multinational and domestic groups without improper discrimination.

**Other design features**

The recommended approach also allows countries to supplement the fixed ratio rule and group ratio rule with other provisions that reduce the impact of the rules on entities or situations which pose less BEPS risk, such as:

- A *de minimis* threshold which carves-out entities which have a low level of net interest expense. Where a group has more than one entity in a country, it is recommended that the threshold be applied to the total net interest expense of the local group.
- An exclusion for interest paid to third party lenders on loans used to fund public-benefit projects, subject to conditions. In these circumstances, an entity may be highly leveraged but, due to the nature of the projects and the close link to the public sector, the BEPS risk is reduced.
- The carry forward of disallowed interest expense and/or unused interest capacity (where an entity’s actual net interest deductions are below the maximum permitted) for use in future years. This will reduce the impact of earnings volatility on the ability of an entity to deduct interest expense. The carry forward of disallowed interest expense will also help entities which incur interest expenses on long-term investments that are expected to generate taxable income only in later years, and will allow entities with losses to claim interest deductions when they return to profit.

The BEPS Action 4 Final Report also recommends that the approach be supported by targeted rules to prevent its circumvention, for example by artificially reducing the level of net interest expense. It also recommends that countries consider introducing rules to tackle specific BEPS risks not addressed by the recommended approach, such as where an entity without net interest expense shelters interest income.


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636. Under that mandate, further work on transfer pricing guidance was developed starting in 2016 and the discussion draft was developed and published in July 2018.\(^{323}\) This draft did not represent a consensus position of the Inclusive Framework on BEPS or Committee on Fiscal Affairs (CFA) and its subsidiary bodies. It aimed to clarify the application of the principles included in the OECD Guidelines, notably the accurate delineation of the actual transaction analysis under Chapter I, to financial transactions as well as to provide specific guidance on how to approach the pricing of various types of financial transactions.

637. The purpose of this work on financial transactions, which is expected to be completed in early 2020, is to provide guidance for determining whether the conditions of certain financial transactions between associated enterprises are consistent with the arm's length principle. The draft guidance first describes the application of the principles of Section D.1 of Chapter I to financial transactions. Guidance is then provided on determining the arm’s-length conditions for intra-group financial and treasury activities, including intra-group loans, intra-group guarantees, cash pooling, hedging and captive insurance companies.

638. In addition, other special measures in line with the recommendations formulated under BEPS Action 2, which target mismatches resulting from differences in the tax treatment of financial instruments or entities in different jurisdictions, can be introduced to address some of the BEPS risks related to financial transactions.  

Box 10.2. BEPS Action 2 Recommendations concerning hybrid mismatch rules

The recommendations in the BEPS Action 2 Final Report set out rules targeting payments made under a financial instrument that give rise to one of three types of mismatches:

- a. deduction/no inclusion (D/NI) outcomes, where the payment is deductible under the rules of the payer jurisdiction but not included in the ordinary income of the payee.
- b. double deduction (DD) outcomes, where the payment triggers two deductions in respect of the same payment.
- c. indirect deduction/no inclusion (indirect D/NI) outcomes, where the income from a deductible payment is set off by the payee against a deduction under a hybrid mismatch arrangement.

The report includes specific recommendations for improvements to domestic law intended to reduce the frequency of such mismatches as well as targeted hybrid mismatch rules which adjust the tax consequences in either the payer or payee jurisdiction in order to neutralise the hybrid mismatch without disturbing any of the other tax, commercial or regulatory outcomes.

**Domestic rules**

Part I of the report sets out recommendations for rules to address mismatches in tax outcomes where they arise in respect of payments made under a hybrid financial instrument. It also recommends rules to address indirect mismatches that arise when the effects of a hybrid mismatch arrangement are imported into a third jurisdiction. The recommendations take the form of linking rules that align the tax treatment of an instrument with the tax treatment in the counterparty jurisdiction but otherwise do not disturb the commercial outcomes. The rules apply automatically and there is a rule order in the form of a primary rule and a secondary or defensive rule. This prevents more than one country applying the rule to the same arrangement and also avoids double taxation.

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325 Since the announcement of the BEPS Action 2 recommendations, a number of Inclusive Framework countries have rapidly adopted rules to address a comprehensive range of hybrid and branch mismatches. European Union Member States adopted Council Directive (EU) 2017/952, which requires hybrid and branch mismatch rules to be effective in Member States no later than beginning of 2020. The United Kingdom, Australia and New Zealand have enacted legislation consistent with the common approach in BEPS Action 2 and, in 2019 the US Treasury issued regulations clarifying the application of the hybrid mismatch rules introduced under the Tax Cuts and Jobs Act (TCJA).
The recommended primary rule is that countries deny the taxpayer’s deduction for a payment to the extent that it is not included in the taxable income of the recipient in the counterparty jurisdiction or it is also deductible in the counterparty jurisdiction. If the primary rule is not applied, then the counterparty jurisdiction can generally apply a defensive rule, requiring the deductible payment to be included in income or denying the duplicate deduction depending on the nature of the mismatch.

The report recognises the importance of co-ordination in the implementation and application of the hybrid mismatch rules to ensure that the rules are effective and to minimise compliance and administration costs for taxpayers and tax administrations. To this end, it sets out a common set of design principles and defined terms intended to ensure consistency in the application of the rules.

**Treaty law**

Part II of the report addresses the part of Action 2 aimed at ensuring that hybrid instruments are not used to obtain unduly the benefits of tax treaties and that tax treaties do not prevent the application of the changes to domestic law recommended in Part I.

The report proposes to include in the *OECD Model Tax Convention* (OECD, 2010) a new provision and detailed Commentary that will ensure that benefits of tax treaties are granted in appropriate cases.

Finally, Part II addresses potential treaty issues that could arise from the recommendations in Part I. It first examines treaty issues related to rules that would result in the denial of a deduction or would require the inclusion of a payment in ordinary income and concludes that tax treaties would generally not prevent the application of these rules. It then examines the impact of the recommendations of Part I with respect to tax treaty rules related to the elimination of double taxation and notes that problems could arise in the case of bilateral tax treaties that provide for the application of the exemption method with respect to dividends received from foreign companies. The report describes possible treaty changes that would address these problems.

The last issue dealt with in Part II is the possible impact of tax treaty rules concerning non-discrimination on the recommendations of Part I; the report concludes that, as long as the domestic rules that will be drafted to implement these recommendations are properly worded, there should be no conflict with these non-discrimination provisions.


639. Since the project on financial transactions is awaiting its final approval by Inclusive Framework and publication, only the key fundamental elements related to financial transactions are now covered in this section. Nevertheless, the following section considers and describes the existing approaches to deal with financial transactions in Brazil, as they may similarly give rise to transfer pricing issues.

### 10.2. Description of existing rules and practices in Brazil and gap analysis

640. As previously noted, the Brazilian transfer pricing rules do not incorporate the notion of accurate delineation of the transactions as set out in the OECD Guidelines. The absence of such a general principle thus implies potential limitations in the transfer pricing framework.

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[326] See the gap analysis in Chapter 1 of Part II of this report.
Next to the general deductibility rules, which are also applicable to interest, the existing system in Brazil also contains thin capitalisation rules based on the debt-to-equity ratio and specific prescriptive transfer pricing rules applicable to some financial transactions, namely to determine the arm’s length interest rate for loans.\(^{327}\)

In such cases, it is important to note that the prescriptive transfer pricing rules apply irrespective of the specific economically significant characteristics related to the transaction, such as the term or the size of the loan, or the creditworthiness of the debtor. Besides, these prescriptive rules do not provide for any exception that could allow taxpayers to apply a different interest rate. Unlike the mechanism available to taxpayers to challenge the profit margins available to taxpayers (provided in Article 18 and 19 of Law 9,430/1996), there is no mechanism established by the law to challenge the interest rate cap prescribed by the legal provision.\(^{328}\)

As mentioned above, for the interest to be deducted (even when the debt-to-equity ratio and interest cap rules are met – see explanation below), the taxpayer must be able to demonstrate the existing general deductibility requirement, under which expenses and costs are tax deductible only if they are necessary, usual and normal in the taxpayer’s activities. Therefore, one needs to demonstrate that the loan is necessary, usual and normal for the Brazilian company’s operations.\(^{329}\)

In addition to the interest rate cap approach and the obligation to demonstrate the necessity of the loan, intra-group loans are also subject to thin-capitalisation rules, which are not included in the scope of the Brazilian transfer pricing rules, but rather serve as additional special measures. This also has an implication on the calculation of the maximum amount of deductible interest.\(^{330}\) The debt-to-equity ratio contemplates two different scenarios depending on whether the interest is paid to any creditor (related or unrelated party) resident, domiciled or organised in a low-tax jurisdiction or subject to a privileged tax regime,\(^{330}\) or to a related party resident in jurisdictions that are not included on the relevant lists.

The general rule sets a debt-to-equity ratio applicable to related debt that may not exceed 2:1 (two times) the net equity value of the legal entity resident in Brazil. In a scenario where the interest is paid or credited to a related or unrelated party, physical person or legal person, resident, domiciled or incorporated in a low-tax jurisdiction or subject to a privileged tax regime, the debt-to-equity ratio cannot exceed 0.3:1 (30%) of the net equity value of the legal entity resident in Brazil.

The legislation is silent regarding the order of application of the three provisions – interest rate cap, thin-capitalisation rule and the obligation to establish the necessity of the loan. In absence of a specific norm establishing the order or hierarchy of these three rules all the three provisions apply, and in practice the following logical order is followed:

- Prove that the expense was necessary;
- Determine the acceptable amount for the principal amount of the loan in accordance with the thin-capitalisation rule; and finally

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\(^{327}\) Article 22 of Law 9,430/1996.

\(^{328}\) Article 47 of Law 4,506/64, which is reproduced in Article 311 of the new income tax regulation, Decree 9,580/2018. The provision states that the expenses paid or incurred are necessary when the transaction or operation is necessary for carrying out of the activity of the company. Additionally, it states that the expenses admitted are the expenses that qualify as usual or normal for the transactions, operations or activities of the entity.

\(^{329}\) Articles 24 and 25 of Law 12,249/2010. In addition, Normative Ruling 1,154/11 specified the formulas for computing the overall debt position of Brazilian companies, clarifying the applicability of the thin-capitalisation rules in back-to-back transactions and even domestic debt transactions with a certain level of involvement of a foreign party.

\(^{330}\) Low-tax jurisdiction and privileged tax regime as established under Articles 24 and 24-A of Law 9430/96.
Determine the maximum amount of the deductible interest based on the interest rate cap.

With regard to the determination of the interest rate for intra-group loans, until 2013, the rules provided an exception to the application of the transfer pricing rules, allowing that interests arising from a contract registered with the Central Bank of Brazil (BACEN) not be subject to the transfer pricing rules.\(^{331}\)

According to the current wording of the transfer pricing rules established in article 22 of Law 9,430/1996, which was introduced by Law 12,715/2012, interest paid or credited by source situated in Brazil to a related party resident or domiciled abroad, and entities incorporated in a low tax jurisdiction or under a privileged tax regimes, can be deducted for IRPJ (corporate income tax) and CSLL (social contributions) purposes only up to an amount not exceeding a given cap, increased by a spread based on the market average to be defined by the Minister of Finance.

This spread is currently regulated by Ordinance of the Ministry of Finance 427/13, which specifies a 3.5% spread for the purposes of determining the deductibility of interest paid to a foreign related party abroad. In the case of interest income, i.e. interest paid by a foreign related party abroad to a Brazilian company, the spread for determining the minimum income to be recognized is 2.5%.\(^{332}\)

Accordingly, regardless of the registration of the loan agreement with the Central Bank of Brazil, the interest deduction will be subject to the limitation of interest rates prescribed by the legislation. The interest rates referred to in this paragraph are:

- In the case of loan transactions in US dollars with a fixed interest rate, the interest rate cap will be the rate payable on the sovereign bonds of the Federative Republic of Brazil issued on the foreign market in US dollars;
- In the case of transactions in Brazilian Reais with a fixed interest rate, the interest rate cap will be determined as the interest rate payable on the sovereign bonds of the Federal Republic of Brazil issued on the foreign market in Brazilian reals; and
- For all other transactions, the six-month London Interbank Offered Rate (LIBOR).\(^{333}\)

The same principles apply for recognition of income in the form of interest for the purposes of determining the tax base of a lender entity resident in Brazil.\(^{334}\)

Despite the existence of the aforementioned rules, there is no other transfer pricing guidance, method or exception that would apply to loan transactions under the Brazilian framework. The imposition of the statutory interest rates cap to loans is the methodology applicable under the Brazilian transfer pricing rules, regardless of the payment term of the loan or the creditworthiness of the lender. It can be inferred that the only two relevant factors for transfer pricing purposes are whether the interest rate is fixed or not and the load currency.

With regard to cash pooling, hedging activities, financial guarantees and captive insurance companies, there are no specific transfer pricing rules nor case law. In principle, the general transfer pricing rules would apply to such transactions, which may raise difficulties for both tax authorities and taxpayers to comply with the current legislation, as they would require either identification of comparable uncontrolled transactions or use of the fixed margins in cases where such comparables are absent.

\(^{331}\) Previous wording modified by Provisional Measure 563/2012, converted into Law 12,715/2012.

\(^{332}\) Articles 1 and 2 of the Ordinance of the Ministry of Finance 427/13.

\(^{333}\) After 2021, the London Interbank Offered Rates (LIBORs) are not expected to be published. Ongoing discussions on the banking regulatory on the use of “nearly risk free” benchmark rates (RFRs) could have an impact on the conventional usage. The tax and transfer pricing implications of the transition are subject to imminent policy analysis.

\(^{334}\) Article 22, paragraph 1, of Law 9,430/1996.
654. In the case of financial guarantees, if a Brazilian party is the beneficiary of the guarantee, an arm’s-length price would likely be determined either by the PIC method (broadly equivalent to the OECD-recognised CUP method) from comparable transactions obtained in financial institutions, if available, or by the CPL method (broadly equivalent of the OECD-recognised cost plus method, plus a 20% fixed margin, whichever is preferred by the taxpayer. If the Brazilian party is the one granting the guarantee, again the equivalent of the CUP method or the method equivalent to the cost plus method 15% would be used.

655. In the case of cash pooling, in principle, each transaction carried out by a Brazilian company will be considered as a “separate loan” and will be subject to the same Brazilian transfer pricing rules for interests, as described in the paragraphs above. In other words, when the Brazilian entity receives cash or grants cash to the cash pool, the transaction may be subject to the transfer pricing rules on interest rate cap determination as if it were an individual loan.

656. On a separate note, Brazil has not implemented other special measures which could effectively and efficiently offer solutions against a number of the gaps identified above. Brazil has not implemented measures in line with the BEPS Action 4 Final Report on Limiting Base Erosion Involving Interest Deductions and Other Financial Payments,335 in order to address the use of third-party and related-party interest, in particular, the deductibility of interest expense that may give rise to double non-taxation in both inbound and outbound investment scenarios. This concerns interest payments which are deducted against the taxable profits of the operating companies while the interest income is taxed at comparatively low tax rates or not at all at the level of the recipient, despite the fact that in some situations the multinational group may have little or no external debt.

657. Brazil has also not implemented measures targeting mismatches resulting from differences in the tax treatment of financial instruments, in line with the BEPS Action 2 Final Report on Neutralising the Effects of Hybrid Mismatch Arrangements,336 which considers mismatches that are the result of differences in the tax treatment or characterisation of an instrument, and sets out recommendations for domestic rules designed to neutralise mismatches in tax outcomes that arise in respect of payments under a hybrid mismatch arrangement.

10.3. Assessment of effectiveness

Absence of special considerations for the transfer pricing aspects of financial transactions

658. The current methodology with respect to intra-group financing in the Brazilian transfer pricing legislation does not take into consideration all the relevant economically significant characteristics of transactions, e.g., the term of the loan, or the size and creditworthiness of the lender. It also does not consider the actual functional and risk profiles of the parties to the transaction. In this regard, the use of the aforementioned rates as prescribed by law may present a number of advantages in terms of simplicity and practicality, yet the outcomes may not be aligned to those that other countries may arrive at on the other side of such transactions. This creates potential risks and weaknesses, which raise some concerns as regards the dual objective of transfer pricing rules, i.e. securing the appropriate tax base and avoiding double taxation.


Findings of the assessment

Prevention of BEPS risks
In principle, the current legislation seems to protect Brazil from certain BEPS practices by ensuring a deductibility limitation on interest payments. There however remains BEPS risks for other types of financial transactions, for which no special rules apply and the general rules could allow the use of the generous mark-ups when applying the equivalent of the cost plus method. Taxpayers may be exploiting those opportunities even in cases where reliable comparables are available. In addition, since Brazil did not yet implement the recommendations of BEPS Actions 2 and 4, there is a lack of special measures based on international best practices that would provide protection against the BEPS risks involved in financial transactions.

Prevention of double taxation
The use of interest rates as prescribed in the law and the application of the general transfer pricing rules for other financial transactions may not always be aligned with industry standards, and may give rise to double taxation, especially because of the deductibility limitations and the fixed margins established by law, which may not correspond to the outcomes that would be reached in other jurisdictions.

Ease of tax administration
The use of objective rules with respect to loan transactions means that there is no need to systematically perform a complex analysis, resulting in administrative relief. In other words, it is easier to apply or verify their appropriate application for the tax administration. Nonetheless, because of the lack of guidance in regard to cash pooling, and hedging activities, financial guarantees and captive insurance, difficulties for tax authorities to comply with the current legislation may arise. In addition, the absence of measures based on BEPS Actions 2 and 4 recommendations could provide simplification for the tax administration on determining whether certain payments in financial transactions should be entitled to a deduction or not. This effectively means that the potential benefits of simplification of tax administration efforts are not fully exploited as foreseen in the international best practices.

Ease of tax compliance
Similarly, the current rules concerning loan transactions also simplifies tax compliance for taxpayers. It is less time-consuming and less resource-intensive than the comprehensive transfer pricing analysis set out in the OECD Guidelines. In the same context, the lack of guidance for some specific financial transactions may also lead to difficulties for taxpayers.

Tax certainty
From a domestic perspective, the use of objective rules for interest rates and the general transfer pricing rules for other financial transactions may provide certainty to taxpayers by generating objectively reliable expectations and guarantying that the margins will not be challenged by the tax administration.

From an international perspective, however, most countries currently follow the general arm’s length principle also to financial transactions. It is expected that they will achieve further consistency and certainty by following the up-coming guidance on financial transaction, which will provide further clarification on the application of arm’s length principle to various financial transactions. On the other hand, the rules in Brazil may not always necessarily lead to the same outcomes, which means that there is potential for uncertainty from an international perspective under the current system.
The eleventh chapter contains the analysis of Brazil’s relevant transfer pricing rules as compared with the OECD guidance on the attribution of profits to permanent establishments. The chapter provides an overview of the OECD guidance and key instruments and compares the principles enshrined therein with the existing legal framework present in Brazil, with the objective of identifying similarities but also potential gaps. Additionally, the nexus rules are analysed with a view to identifying whether and to what extent Brazil incorporated the recommendations contained in the BEPS Action 7 Final Report. The analysis is followed by the assessment of effectiveness of both the attribution of profits and nexus rules according to the policy objectives of transfer pricing rules.
Introduction

659. The concepts of transfer pricing are relevant not only to transactions between related parties that are separate legal entities, but also to transactions that involve parts of the same enterprise. The transactions involving different parts of the same enterprise – namely the transactions between the head office and permanent establishments as well as transactions between the permanent establishments (PEs) of the same enterprise – give rise to similar issues as transactions between related parties that are separate legal entities. The concerns of appropriate allocation of profit to the different parts of the enterprise, which may operate in different jurisdictions, as well as ensuring the prevention of double taxation, have led to the evolution of rules and concepts that are very similar or even the same as the principles that apply to the allocation of income among separate legal entities.

660. In this sense, the issues discussed in the OECD Guidelines also arise in the treatment of permanent establishments.337 The relevant OECD guidance, which is established through two main reports on attribution of profits to PEs, namely, the 2008 Report on the Attribution of Profits to Permanent Establishments (2008 Report)338 and the 2010 Report on the Attribution of Profits to Permanent Establishments (2010 Report).339 More recently, the topic of attribution of profits to permanent establishments was addressed in the context of changes introduced to the definition of permanent establishment resulting from the BEPS Action 7 recommendations,340 which is found in the Additional Guidance on the Attribution of Profits to a Permanent Establishment under BEPS Action 7.341

661. The OECD Council recommends OECD member countries to follow the 2008 Report when applying the provisions of their tax treaties that are drafted on the basis of the pre-2010 version of Article 7 of the OECD MTC, and to follow the 2010 Report in applying the provisions of their tax treaties that are drafted following the 2010 version of Article 7 of the OECD MTC. Such recommendation is further described in the relevant section below.

662. In this chapter, the above mentioned instruments and additional guidance produced by the OECD in respect of attribution of profits to PEs are compared with the existing concepts and rules currently present in Brazil with the objective of identifying similarities but also potential gaps that may be relevant for Brazil to consider in strengthening and potentially also aligning the existing approaches to the international standard.

663. While the main focus of this chapter is the attribution of profits to PEs, the issue of nexus and existence of a taxable presence is also briefly addressed with a view to identifying whether and to what extent Brazil has incorporated the recommendations contained in the BEPS Action 7 Final Report, which are especially relevant to prevent the use of certain common tax avoidance strategies that have been used to circumvent the traditional PE definition.

337 See paragraph 11 of the Preface to the OECD Guidelines.
For this purpose, the analysis in this chapter is organised in two sections.

- The first section (Analysis of the rules on attribution of profits to permanent establishments) is intended to discuss the existing OECD guidance on attribution of profits to PEs. The section provides a brief introduction to the relevant international principles, describes their evolution, and gives an overview on the OECD instruments and guidance on attribution of profits to PEs. Moreover, it describes the OECD approach, based on these instruments, to determine the profits attributable to the PE. Finally, this section provides for a comparative analysis of the OECD approach and the existing legal framework in Brazil to determine the profits attributable to PEs, and provides the assessment of effectiveness of the Brazilian rules regarding attribution of profits to PEs.

- The second section (Analysis of the status of the implementation of BEPS Action 7 Recommendations and nexus rules) provides an overview of the BEPS Action 7 recommendations, in order to highlight the issues of nexus and existence of a taxable presence that may arise in the context of PEs. Further, it provides an analysis of the nexus rules contained in the Brazilian domestic law and tax treaties to identify whether and to what extent Brazil has incorporated these recommendations. This analysis also includes an overview of case law in Brazil regarding the characterisation and tax treatment of PEs. Finally, this section provides the assessment of effectiveness of the Brazilian nexus rules regarding PEs in comparison to the BEPS Action 7 recommendations.

ANALYSIS OF THE RULES ON ATTRIBUTION OF PROFITS TO PERMANENT ESTABLISHMENTS

11.1. OECD instruments and approach on attribution of profits to permanent establishments

11.1.1. Introduction

Currently, the international tax principles for attributing profits to a PE are provided in Article 7 of the OECD MTC, which forms the basis of the extensive network of bilateral income tax treaties between OECD member countries and between many OECD member and non-member countries. These principles are, to a certain extent, also incorporated in the UN MTC. In both MTCs, the respective versions of Article 7 contain the separate entity principle, which is the key principle underlying the attribution of profits to PEs.

The latest version of Article 7, paragraph 2, of the OECD MTC contains the following wording since 2010:

For the purposes of this Article and Article [23 A] [23 B], the profits that are attributable in each Contracting State to the permanent establishment referred to in paragraph 1 are the profits it might be expected to make, in particular in its dealings with other parts of the enterprise, if it were a separate and independent enterprise engaged in the same or similar activities under the same or similar conditions, taking into account the functions performed, assets used and risks assumed by the enterprise through the permanent establishment and through the other parts of the enterprise.

The latest version of Article 7, paragraph 2, of the UN MTC contains the same wording as Article 7, paragraph 2, of the 2008 version of the OECD MTC:

Subject to the provisions of paragraph 3, where an enterprise of a Contracting State carries on business in the other Contracting State through a permanent establishment situated therein, there shall in each Contracting State be attributed to that permanent establishment the profits which it might be expected to make if it were a...
668. The principles in Article 7, paragraph 1, establish that it is the respective business profits attributable to the PE\textsuperscript{342} which may be taxed in the jurisdiction of the PE.\textsuperscript{343} This implies that these are net profits rather than gross income. As pointed out above, both of these provisions contain a principle providing that for the purposes of attribution of profits to the PE, the PE should be deemed to be a separate enterprise from the enterprise of which it is part. This implies that it is not all the profits of the enterprise which are taxed in the jurisdiction of the PE, but only the profits which would have been earned by a separate enterprise carrying on the same functions and activities under the same or similar conditions as those carried on by the PE.\textsuperscript{344}

669. The accurate determination of profits attributable to the PE will be relevant for the country where the PE is located to determine the tax liability in this jurisdiction, but also for the country of residence of the enterprise of which it is a PE. The country of residence will need to eliminate potential double taxation in accordance to Article 23 of the applicable tax treaty either by providing an exemption to the profits attributable to the PE or by providing a credit on the taxes paid on the profits attributable to the PE and paid in the country of the PE.

670. Where different or diverging rules and principles are applied by the two countries in attributing the profits to a PE, there is a potential risk of unrelieved double taxation and/or a risk of double non-taxation.

671. It should also be pointed out that, whether or not a tax liability on business profits arises in the respective jurisdictions is a question of domestic law. In some cases, such tax liability may be absent – either due to an intended policy choice or sometimes due to unintended legislative omissions. Where such tax liabilities are established and they are broader than the taxing rights foreseen in the tax treaties, such broader tax liabilities are constrained by the relevant provisions of applicable bilateral tax treaties – namely the provisions of Article 7, further referring to Article 5, which contains the relevant definition of the term “permanent establishment”.

672. The current tax treaty practices of different countries generally follow either the wording contained in the aforementioned Article 7 of the OECD or the UN MTC. There are also other approaches applied for the purposes of taxation of certain types of income – e.g., income from immovable property.\textsuperscript{345}

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\textsuperscript{342} It should be noted that the UN MTC includes a limited force of attraction rule, which is not included in the OECD MTC. This rule allows the country in which the PE is located to tax not only the profits attributable to that PE but other profits of the enterprise derived in that country to the extent allowed under the Article.

\textsuperscript{343} Article 7, paragraph 1, of the OECD MTC states: “Profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits that are attributable to the permanent establishment in accordance with the provisions of paragraph 2 may be taxed in that other State.”

Article 7, paragraph 1, of the UN MTC states: “The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to (a) that permanent establishment; (b) sales in that other State of goods or merchandise of the same or similar kind as those sold through that permanent establishment; or (c) other business activities carried on in that other State of the same or similar kind as those effected through that permanent establishment.”

\textsuperscript{344} See paragraphs 15-16 of the Commentaries on Article 7 of the OECD MTC.

\textsuperscript{345} Governed by Article 6 of OECD and UN MTCs.
from international transportation and shipping, passive income in the form of dividends, interest, royalties, or capital gains, which may however still rely to a certain extent on the concepts of Articles 5 and 7.

673. It is also worth noting that there is a particular divergence between the OECD and UN MTCs, which is also relevant to Brazil, and which relates to the tax treatment of income from technical services. Namely, the UN MTC contains a specific provision permitting taxation of payments for such services on a gross basis at the source of income. This divergence means that the general principles with respect to business profit taxation would not apply in cases where the special provision applies. In absence of a specific provision in the relevant tax treaty which would provide for taxation of technical services at source, the remuneration arising from the rendering of technical services will be subject to the provisions of Article 7 (business profits), Article 14 (independent personal services), or other specific articles in the relevant treaty.

674. The following subsection provides a brief description of the historical evolution of the guidance on attribution of profits to PEs. Such description is important for the purpose of determining whether a country has adopted the latest interpretation provided by the OECD with respect to attribution of profits to PEs. Moreover, a further subsection provides a description of the Authorised OECD Approach (AOA) and its two-step analysis for the attribution of profits to PEs.

11.1.2. Evolution and overview on the OECD guidance on attribution of profits to PEs

675. The OECD established guidance on the attribution of profits to PEs to ensure a common approach in order to avoid different interpretations of the general principles and provisions of earlier versions of Article 7, which could lead to undesired outcomes of double taxation or non-taxation.

676. Similarly to transfer pricing guidance incorporated in the OECD Guidelines, which evolve over time, the development of guidance on attribution of profits to PEs has also undergone gradual evolution.

677. The principles underlying Article 7, and in particular paragraph 2 of the Article, have a long history. The language has its origins in the draft convention adopted by the League of Nations in 1933 and is acknowledged as the statement of the arm’s length principle in the context of PEs. When the OECD first examined what criteria should be used in attributing profits to a PE, this question had previously been

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346 Governed by Article 8 of OECD and UN MTCs.
347 Governed by Article 10 of OECD and UN MTCs.
348 Governed by Article 11 of OECD and UN MTCs.
349 Governed by Article 12 of OECD and UN MTCs.
350 Governed by Article 13 of OECD and UN MTCs.
351 See Article 12A of the UN MTC.
352 In this context, most of the tax treaties that Brazil has in force include a particular provision in the protocols, which establishes that such services are to be taxed as royalties. The tax treaties with Austria, Finland, France, Japan and Sweden do not contain such protocol.
addressed in a large number of tax conventions and in various models developed by the League of Nations.\footnote{OECD (2010), \textit{Report on the Attribution of Profits to Permanent Establishments}, paragraph 52, accessible at www.oecd.org/ctp/transfer-pricing/45689524.pdf.}

678. While there was limited guidance on attribution of profits from the early days of the existence of the OECD MTC, in 1987, noting that the determination of profits attributable to a PE could give rise to some uncertainty, the Committee on Fiscal Affairs undertook a review of the topic which led to the adoption, in 1993, of the first guidance elaborated on this issue, entitled \textit{Attribution of Income to Permanent Establishments} (1993 Report).\footnote{Report of the Committee on Fiscal Affairs on the Attribution of Income to Permanent Establishments, which is reproduced in Volume II of the full version of the OECD MTC at page R(13)-1. Volume II of the OECD MTC can be accessed at: https://www.oecd-ilibrary.org/docserver/g2g972ee-en.pdf?expires=1560936063&id=id&accname=ocid84004878&checksum=58495DD72A8D151F548ECBD7D2D99E49.}

679. Nonetheless, the practices of OECD and non-OECD countries regarding the attribution of profits to PEs and these countries’ interpretation of Article 7 continued to vary considerably. In this context, in the 1995 edition of the Guidelines, the Committee indicated that further work would need to address the application of the arm’s length principle to PEs. The result of the work resulted in the 2008 \textit{Report on Attribution of Profits to a Permanent Establishment} (2008 Report).\footnote{OECD (2008), \textit{Report on the Attribution of Profits to Permanent Establishments}, accessible at: www.oecd.org/ctp/transfer-pricing/45689524.pdf.}

680. The approach adopted by the 2008 Report was not constrained by either the original intent or by the historical practice and interpretation of Article 7.\footnote{Paragraph 3 of the 2008 Report.} It introduced the “functionally separate entity approach” under the so-called Authorised OECD Approach (AOA). The AOA, which will be further explained in a separate section, was introduced by the OECD to align the rules for business profits in scenarios involving PEs with those of the arm’s length principle enshrined in Article 9 of the OECD MTC and the Guidelines.

681. As part of the implementation of the AOA, the OECD amended the Commentary on Article 7 in the 2008 OECD MTC to bring it in line, as far as possible, with the conclusions of the 2008 Report. Thus, it is understood that the 2008 Report reflects only partial implementation of the AOA, which also required for its full implementation a change in the wording of Article 7 of the OECD MTC.\footnote{OECD (2010), \textit{Report on the Attribution of Profits to Permanent Establishments}, paragraph 5, accessible at: www.oecd.org/ctp/transfer-pricing/45689524.pdf.}

682. The second phase of the implementation consisted in a new version of Article 7 of the OECD MTC that would fully implement the AOA with regard to future tax treaties. For this purpose, the OECD included the new Article 7 and relevant Commentary in the 2010 OECD MTC. Given that Article 7 was so modified in the 2010 OECD MTC, the Committee on Fiscal Affairs considered that it would be necessary to revise the 2008 Report in order to assist with the implementation of the new Article 7, to align its wording with the wording of the new Article 7 and to delete obsolete references to the pre-2010 version of Article 7. Therefore, the OECD revised the report in 2010 without changing the conclusions reached in the 2008 Report.\footnote{Paragraph 8 of the 2010 Report.}
683. In this regard, the 2010 Report as incorporated in the Commentary on the OECD MTC incorporates the full AOA and clearly acknowledges that the principles applied by the OECD Guidelines for transactions between associated enterprises should be applied by analogy in the context of dealings with parts of the enterprise, that is, between the PE and the head office.\(^{361}\)

684. The 2010 Report states that the Guidelines will apply by analogy because in applying the AOA for the purposes of Article 7, it is necessary to postulate the PE as a hypothetical enterprise that is separate from the enterprise of which it is a PE, whereas in an Article 9 case the enterprises being examined are actually legally separate. To reflect that issue, the AOA is to apply the guidance given in the Guidelines not directly but by analogy – to take into account factual differences between a PE and a legally separate enterprise.\(^{362}\)

685. Moreover, the AOA is reflected in the Recommendation of the OECD Council on attribution of profits to permanent establishments.\(^{363}\) The OECD Council recommends member countries:

(i) that their tax administrations follow, when applying the provisions of their bilateral tax conventions that are drafted on the basis of the pre-2010 Article 7 of the Model Tax Convention, the guidance in the 2008 Report to the extent that its conclusions do not conflict with the 2008 Commentary on Article 7;

(ii) that their tax administrations encourage taxpayers to follow the guidance in the 2008 Report when applying the provisions of bilateral tax conventions that are drafted on the basis of the pre-2010 Article 7 of the Model Tax Convention and, to that end, that they give the 2008 Report publicity in their country and have it translated, where necessary, into their national language(s);

(iii) that their tax administrations follow, when applying the provisions of their bilateral tax conventions that are drafted on the basis of the 2010 Article 7 of the Model Tax Convention, the guidance in the 2010 Report;

(iv) that their tax administrations encourage taxpayers to follow the guidance in the 2010 Report when applying the provisions of bilateral tax conventions that are drafted on the basis of the 2010 Article 7 of the Model Tax Convention and, to that end, that they give the 2010 Report publicity in their country and have it translated, where necessary, into their national language(s).

686. The OECD Council also invites in this Recommendation the non-member economies whose bilateral tax conventions contain provisions drafted on the basis of either the pre-2010 Article 7 or the 2010 Article 7 of the OECD MTC to take account of the terms of the Recommendation.

687. Further, BEPS Action 7 proposed amendments to the PE definition in Article 5 of the OECD MTC for the purposes of countering artificial avoidance of a PE status (which will be further discussed in the relevant section), and as a consequence mandated further guidance on attribution of profits to PEs (2018 Guidance on attribution of profits), which was published in 2018.\(^{364}\)

688. The new guidance contains a high-level explanation of how the existing principles would apply to the newly defined situations of PEs. It especially covers PEs arising from Article 5, paragraph 5, including

\(^{361}\) Paragraph 10 of the 2010 Report.

\(^{362}\) Paragraph 55 of the 2010 Report.


examples of a commissionnaire structure for the sale of goods, an online advertising sales structure, and a procurement structure.

689. It also includes additional guidance related to PEs created as a result of the changes to Article 5, paragraph 4, and provides an example on the attribution of profits to PEs arising from the anti-fragmentation rule included in Article 5, paragraph 4.1. The guidance also contains a recommendation to simplify possible tax compliance obligations, and cautions countries on preventing the allocation of the same profits twice – once under Article 9 and a second time under Article 7 analysis.

11.1.3. Existing OECD guidance on attribution of profits to permanent establishments

690. In this section, both of the existing OECD approaches contained in the Recommendation of the Council on the Attribution of Profits to Permanent Establishments are explained, namely, the approach following the 2008 Report and the approach based on the 2010 Report. The 2010 approach (AOA) will be discussed first, with a view to establishing an overview of the report and key principles of the latest attribution of profits to PEs approach. A separate section will then explain the major difference in applying the 2008 guidance on attributing profits to PEs as reflected in the Commentary on the 2008 version of Article 7.

691. The changes in the approach to the attribution of profits to PEs have been also reflected in the changes to the wording of Article 7 of the OECD MTC.

692. In the 2010 version of Article 7, paragraphs 1 and 2 have been amended and a new paragraph 3 has been included. Paragraphs 3 to 6 of the 2008 version of Article 7 were removed whilst paragraph 4 of the 2010 version of Article 7 (formerly paragraph 7 of the 2008 version of Article 7) remained the same.

AOA on attribution profits to permanent establishments

693. The introduction of the AOA was intended to further align the outcomes of profit allocation rules for business profits under tax treaties (Article 7) with those of the arm’s length principle enshrined in Article 9 of the OECD MTC and the Guidelines. To this end, the AOA adopts the “functionally separate entity” principle.

694. In this context, the 2010 version of Article 7 provides that the profits to be attributed to a PE are “the profits it might be expected to make, in particular in its dealings with other parts of the enterprise, if it were a separate and independent enterprise engaged in the same or similar activities under the same or similar conditions, taking into account the functions performed, assets used and risks assumed by the enterprise through the permanent establishment and through the other parts of the enterprise”.

695. Additionally, the Commentary on Article 7 confirms that the principle reflected in Article 7, paragraph 2, corresponds to the arm’s length principle, which is also applicable under the provisions of Article 9 for the purpose of adjusting the profits of associated enterprises. The arm’s length principle has thus always been at the heart of Article 7, and accordingly, the objective of the AOA is to apply the arm’s length principle of Article 9, as articulated in the Guidelines, to the attribution of profits to PEs using the arm’s length principle under Article 7, paragraph 2.

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365 Paragraphs 43-44 of the 2018 Guidance on attribution of profits.
366 Paragraphs 40-41 of the 2018 Guidance on attribution of profits.
367 See Article 7, paragraph 2, of the 2010, 2014 and 2017 OECD MTCs.
368 Paragraphs 52-53 of the 2010 Report.
696. The interpretation of Article 7, paragraph 2, under the AOA requires a two-step analysis.

697. The first step consists in performing a functional and factual analysis that is intended to hypothesise the PE as a separate and independent enterprise, which performs functions, owns assets, assumes risks and enters into “dealings” with the enterprise of which it is a part and with other related or unrelated enterprises.\textsuperscript{369}

698. Under this step, the functional and factual analysis must identify the economically significant activities and responsibilities undertaken by the PE. This analysis should, to the extent relevant, consider the PE’s activities and responsibilities in the context of the activities and responsibilities undertaken by the enterprise as a whole, particularly those parts of the enterprise that engage in dealings with the PE.

699. In step one, a functional and factual analysis should be performed, leading to:\textsuperscript{370}

- The attribution to the PE as appropriate of the rights and obligations arising out of transactions between the enterprise of which the PE is a part and separate enterprises;
- The identification of significant people functions relevant to the attribution of economic ownership of assets, and the attribution of economic ownership of assets to the PE;
- The identification of significant people functions relevant to the assumption of risks, and the attribution of risks to the PE;
- The identification of other functions of the PE;
- The recognition and determination of the nature of those dealings between the PE and other parts of the same enterprise that can appropriately be recognised, having passed the threshold test; and
- The attribution of capital based on the assets and risks attributed to the PE.

700. In the second step, the profits of the hypothesised separate and independent enterprise must be determined by applying, by analogy, the Article 9, as articulated in the Guidelines for separate enterprises.

\textsuperscript{369} Paragraph 10 of the 2010 Report.

\textsuperscript{370} Paragraph 44 of the 2010 Report.
Box 11.1. Hypothesising the PE as a separate and independent enterprise

The diagram above sets out a scenario where the PE is hypothesised as a separate entity which performs functions, owns assets, assumes risks and enters into “dealings” with the enterprise of which it is a part (Subsidiary A) and with other related (Subsidiary B) or unrelated enterprises (independent entity).

701. For example, in the diagram above, dealings undertaken between the PE and Subsidiary B are considered dealings between related parties and the consequence is the direct application of the OECD Guidelines. Dealings between the PE and an independent party are considered dealings between unrelated parties, and therefore, are out of the scope of the application of the Guidelines. Nevertheless, in both cases, it still remains to be determined, what amount of the profits derived from transactions with related and unrelated parties should be allocated to the PE and what amount of such profits should be allocated to the head office (Subsidiary A).

702. In the dealings between the PE and its head office (Subsidiary A), since they are part of the same enterprise, the calculation of profits will be performed under step 2 of the AOA, which requires the application of the Guidelines by analogy. Such dealings may include not only transactions limited to the interaction between the PE and the head office, but also dealings which are relevant for the transactions between the PE and the related and unrelated parties and where it needs to be determined what portion of those profits should be allocated to the PE and which portion should be allocated to the head office.

703. The analysis therefore involves the pricing of recognised dealings on an arm’s-length basis through:\footnote{Paragraph 44 of the 2010 Report.}

- The determination of comparability between the dealings and uncontrolled transactions, established by applying the Guidelines’ comparability factors directly (characteristics of property or services, economic circumstances and business strategies) or by analogy (functional analysis, contractual terms) in light of the particular factual circumstances of the PE; and
- Selecting and applying by analogy to the Guidelines the most appropriate method to the circumstances of the case to arrive at an arm’s-length compensation for the dealings between the
PE and the rest of the enterprise, taking into account the functions performed by and the assets and risks attributed to the PE.

704. The result of these two steps will allow the calculation of the profits (or losses) of the PE from all its activities, including transactions with other unrelated enterprises, transactions with related enterprises (with direct application of the Guidelines) and dealings with other parts of the enterprise (under step 2 of the AOA, i.e. application of the Guidelines by analogy). The hypothesis through which a PE is treated as a functionally separate and independent enterprise is a legal fiction necessary for purposes of determining the business profits in dealings with other parts of the enterprise under Article 7.373

705. It should be noted that a significant number of OECD member countries committed to follow the latest version of Article 7 in bilateral negotiations and to follow the Commentary on this version of Article 7, which incorporates the AOA.

706. There are OECD member countries that reserved the right not to use this latest version of Article 7 in bilateral negotiations, which means that they follow the previous version of Article 7, i.e. the 2008 version of the OECD MTC in their bilateral negotiations as well as the corresponding Commentary on this version of Article 7, unless indicated otherwise. In addition, a number of non-OECD member countries have also reserved the right to follow the previous version of Article 7.

11.1.4. 2008 approach on attribution of profits to permanent establishments

707. The 2008 approach reflects the evolution of the approach to allocation of profits to PEs and the attempt to provide more clarity and guidance to this complex topic. While the 2008 wording foresees the “separate entity” principle, i.e. treating the PE as if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment, some important limitations are foreseen to this principle in the 2008 version of the Commentary on paragraph 3 of Article 7. The limitations involve the following dealings between the PE and the enterprise of which it is part:

- Intangibles: limitation on recognising profit allocation due to exploitation of intangibles by a specific part of the enterprise (PE) and instead sharing the profits resulting from the use of intangibles as well as the costs of development of intangibles between the different parts of the enterprise. The “ownership” of intangibles and corresponding profit is therefore not allocated to only one part of the enterprise.376

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372 Paragraph 10 of the 2010 Report.
373 Paragraph 11 of the 2010 Report.
374 The following OECD member countries put forward a formal reservation on using the new version of Article 7 of the OECD MTC: Australia, Austria, Chile, Greece, Mexico, Latvia, Portugal, the Slovak Republic, Turkey and New Zealand. See paragraphs 95–100 of the Commentary on Article 7 of the MTC.
375 See position on Article 7 of the 2017 OECD MTC: Argentina, Azerbaijan, Brazil, Bulgaria, Costa Rica, Indonesia, Malaysia, Romania, Russia, Serbia, Singapore, South Africa and Thailand reserve the right to use the previous version of Article 7, i.e. the version that was included in the MTC immediately before the 2010 Update, subject to their positions on that previous version.
See position on the Commentary on Article 7 of the 2017 OECD MTC: Argentina, Brazil, Bulgaria, Indonesia, Malaysia, Romania, Russia, Serbia, Singapore, South Africa and Thailand will interpret Article 7 as it read before the 2010 Update in line with the relevant Commentary as it stood prior to that update.
376 See paragraph 34 of the Commentary on Article 7 of the 2008 version of the OECD MTC.
• Management services: limitation on recognising profit allocation due to management services performed by one part of the enterprise for the benefit of other parts of the enterprise and instead sharing the profits resulting from general management services among the different parts of the enterprise as well as the costs related to performing such activities.\textsuperscript{377} This means that despite the performance of management functions by one part of the enterprise, the profits generated from such “good management” (potentially equivalent of risk control functions) is not allocated to that part of the enterprise but is shared with other parts of the enterprise.

• Interest charges: limitation on deductibility of interest charges on capital owned by the enterprise with the exception of banking enterprises. This means that no profit may be allocated to a specific part of the enterprise and no interest charge may be deducted on capital owned by the enterprise and made available to other parts of the enterprise, but actual interest payments in respect of debt actually incurred by the enterprise in relation to third parties are to be taken account and allocated or apportioned to the relevant parts of the enterprise.\textsuperscript{378}

708. These limitations are significant and notable exceptions from the separate entity approach and will lead to outcomes which may not be fully in line with the arm’s length principle as foreseen in Article 9. As was highlighted above, the Council Recommendation foresees the application of such approach, which is also foreseen in the Commentary on the 2008 version of Article 7 of the OECD MTC. These limitations foreseen in the Commentary on Article 7 of the 2008 version of the OECD MTC also correspond to similar limitations explicitly foreseen in Article 7 paragraph 3 of the UN MTC.\textsuperscript{379} These limitations have been eliminated from the 2010 version of Article 7 and the AOA has brought the outcomes of profit allocation under Article 7 closer to the outcomes that would be determined in accordance to Article 9 if the activities carried out through a PE would have been in fact carried out by a separate legal entity.

709. Paragraph 4 of the 2008 version of Article 7 foresees the allocation of the profits according to an apportionment method (e.g., allocation of profits to the PE based on appropriate apportionment keys – such as volume of sales or proportion of expenses for personnel retained by the PE compared to such expenses borne by other parts of the enterprise) as long as the outcome is in line with the remaining principles foreseen in the 2008 version of Article 7.\textsuperscript{380} As noted earlier, this paragraph was also eliminated from the 2010 version of Article 7.

\textsuperscript{377} See paragraphs 35-40 of the Commentary on Article 7 of the 2008 version of the OECD MTC.

\textsuperscript{378} See paragraphs 41-49 of the Commentary on Article 7 of the 2008 version of the OECD MTC.

\textsuperscript{379} Article 7, paragraph 3, of the 2017 UN MTC establishes that: “In the determination of the profits of a permanent establishment, there shall be allowed as deductions expenses which are incurred for the purposes of the business of the permanent establishment including executive and general administrative expenses so incurred, whether in the State in which the permanent establishment is situated or elsewhere. However, no such deduction shall be allowed in respect of amounts, if any, paid (otherwise than towards reimbursement of actual expenses) by the permanent establishment to the head office of the enterprise or any of its other offices, by way of royalties, fees or other similar payments in return for the use of patents or other rights, or by way of commission, for specific services performed or for management, or, except in the case of a banking enterprise, by way of interest on moneys lent to the permanent establishment. Likewise, no account shall be taken, in the determination of the profits of a permanent establishment, for amounts charged (otherwise than towards reimbursement of actual expenses), by the permanent establishment to the head office of the enterprise or any of its other offices, by way of royalties, fees or other similar payments in return for the use of patents or other rights, or by way of commission for specific services performed or for management, or, except in the case of a banking enterprise, by way of interest on moneys lent to the head office of the enterprise or any of its other offices.”

\textsuperscript{380} Article 7, paragraph 4, of the 2008 OECD MTC establishes: “Insofar as it has been customary in a Contracting State to determine the profits to be attributed to a permanent establishment on the basis of an apportionment of the total profits of the enterprise to its various parts, nothing in paragraph 2 shall preclude that Contracting State from determining the profits to be taxed by such an apportionment as may be customary; the method of apportionment adopted shall, however, be such that the result shall be in accordance with the principles contained in this Article.”
710. The provision foreseen in Article 7, paragraph 5, of the 2008 version of the OECD MTC contains another limitation and departure from the arm’s length principle. This provision foresees that in the case where the PE purchases goods for its head office, no profit can be attributed to the PE for such activities. With the deletion of this provision in the 2010 OECD MTC and the full implementation of the AOA, such activities involving such purchasing activities will be taken into account and the profits will be allocated to the PE also for such activities.

711. The 2008 version of Article 7, paragraph 6, requires consistency of the methods used for the attribution of profits to PEs. It states that the same method shall be applied consistently every year unless there is sufficient reason to change the applicable method. The rationale underlying the paragraph is to avoid changes in the method used for the allocation of profits to ensure a consistent tax treatment. This paragraph was deleted in the 2010 version of the article, since the AOA no longer foresees various approaches to the allocation of profits to PEs.

712. Both the provisions found in the 2010 version of Article 7, paragraph 4, and the 2008 version of Article 7, paragraph 7, are identical and contain the same principle, which establishes the relationship of Article 7 to the other articles in the convention.

11.2. Description of existing rules and practices in Brazil and gap analysis

11.2.1. Tax treaty policy

713. Brazil reproduces Article 7, paragraphs 1, 2, and 3, of the 2008 OECD MTC in all of its 33 tax treaties currently in force and also in the tax treaties signed but not yet in force with the United Arab Emirates, Singapore, Switzerland and Uruguay.

714. With respect to Article 7, paragraph 4, of the 2008 OECD MTC, which reflects the practice, common in some jurisdictions, of allocating profits to a PE using an apportionment method based upon various formulae, Brazil has not reproduced this provision in its tax treaties, except for the tax treaties with China and Venezuela.

715. Article 7, paragraph 5, which states that no profits should be attributable to a PE by reason of the mere purchase of goods or merchandise for the enterprise, with a few exceptions, is reproduced in all tax treaties signed by Brazil.

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381 Article 7, paragraph 5, of the 2008 OECD MTC establishes: “No profits shall be attributed to a permanent establishment by reason of the mere purchase by that permanent establishment of goods or merchandise for the enterprise.”

382 See paragraph 57 of the Commentary on Article 7: “In such a case the paragraph provides that the profits of the permanent establishment shall not be increased by adding to them a notional figure for profits from purchasing. It follows, of course, that any expenses that arise from the purchasing activities will also be excluded in calculating the taxable profits of the permanent establishment.”

383 See paragraph 58 of the Commentary on Article 7: “This paragraph is intended to lay down clearly that a method of allocation once used should not be changed merely because in a particular year some other method produces more favourable results. One of the purposes of a double taxation convention is to give an enterprise of a Contracting State some degree of certainty about the tax treatment that will be accorded to its permanent establishment in the other Contracting State as well as to the part of it in its home State which is dealing with the permanent establishment; for this reason, paragraph 6 gives an assurance of continuous and consistent tax treatment.”

384 The newly signed tax treaties with Singapore, United Arab Emirates and Uruguay do not contain Article 7, paragraph 5 of the 2008 OECD MTC.
Moreover, Article 7, paragraph 6, which states that for the attribution of profits, the same method shall be applied every year unless there is sufficient reason to change it, is reproduced only in a few tax treaties, namely, the tax treaties with China, Japan, Portugal, Russia and Uruguay.

It is important to note that Brazil has reserved the right to use the previous version of Article 7, i.e. the version that was included in the pre-2010 version, and will interpret Article 7 as it read before the 2010 update in line with the relevant Commentary as it stood prior to that update.  

Although the relevant provisions of the OECD MTC with respect to profit attribution (Article 7) are commonly reproduced in the tax treaties signed by Brazil, there is only limited domestic guidance on how to implement these provisions in practice.

11.2.2. Domestic framework – introduction

Brazil has a set of specific rules to tax non-residents. Where there is no other special regime foreseen by the income tax law, the income derived by the non-resident from its activities in Brazil may be taxed by way of withholding income tax at rates that generally vary from 15% to 25% depending on the type of income.

The income tax regulation, however, provides for special regimes in certain cases. Where the non-residents are formally established in Brazil through a registered presence such as branches (filiais), main branches (sucursais), agencies (agências), or representative offices (representações), the law establishes that the taxable base of non-residents will be determined and taxed in the same way as that of a legal entity in Brazil, which entails taxation on net profit basis.

The tax base may be determined in accordance with two different regimes: (i) the actual profit regime (lucro real), based on taxable income (i.e. earnings before taxes) and adjusted according to certain exclusions established by the legislation, or, (ii) the prescriptive net profit regime, which includes two subsets, namely, the presumed profit regime (lucro presumido), and the arbitrary profit determination approach (lucro arbitrado). These two subsets of the prescriptive approach lead to the determination of the tax base by applying prescribed profit margins to the gross revenue of the company. The prescribed profit margins under these two approaches, which depends on the activity performed, are the same, but the arbitrary profit determination approach (lucro arbitrado) includes an additional increase of 20%. The presumed profit regime (lucro presumido) may be optionally available as a simplification measure to small taxpayers who do not exceed the gross revenue of BRL 78 million in the previous calendar year and they can choose whether to apply the actual profit or the presumed profit regime. If the total gross revenue exceeds this threshold, the actual profit regime is mandatory. Where the taxpayer, however, fails to properly keep the tax records, the arbitrary profit determination approach (lucro arbitrado) may be enforced by tax administration.

The taxation regimes discussed above are also applicable to arrangements which are equivalent to situations giving rise to an agency PE, i.e. in cases where the income is earned by the foreign principal domiciled abroad as a result of the operations performed by their commissionnaires (comissários) or representatives (mandatários) in Brazil. In such cases, the law also establishes some conditions, which

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385 See paragraph 1 on page 625 of the OECD MTC – Position on Article 7 and paragraphs 95-100 of the Commentary on Article 7 of the 2017 OECD MTC.

386 Article 257 of Decree 9,580/2018.

387 Article 257 of Decree 9,580/2018.

388 Article 587 of Decree 9,580/2018.
will also be discussed further below, for the calculation of the profits of the intermediary in Brazil and the profits of the principal abroad.\textsuperscript{389}

723. While there are specific rules to determine tax base for the situations involving registered branches, agencies and representative offices (PEs) it is observed that there is no special provision that deals with the attribution of profits to a PE in Brazil that is not formally registered or established through one of the structures mentioned above, i.e. branches, agencies or representative offices. In absence of such registration or specific rules, general rules apply, requiring that the income derived by non-residents from Brazil be subject to a withholding tax, which is also evidenced by the existing case law summarised below.

724. It should be however noted that the provision of Article 159 of Decree 9,580/2018 states that branches, agencies, and representative offices of a foreign company are considered independent legal persons, and taxed accordingly, regardless of whether the company is registered or not. In such a case, the PE can be registered \textit{ex officio}, and by doing so, the tax official should attribute a tax identification number to the PE and notify the company (\textit{inscrição de ofício no CNPJ}). If the taxpayers do not collaborate in providing the relevant documentation to determine the tax base, the tax liability could be established by way of arbitrary profit determination approach (\textit{lucro arbitrado}). Such an approach may be especially relevant where the tax liability may not be efficiently collected through the withholding tax mechanism (e.g. the payment of income takes place abroad while the activities take place in Brazil).

\textit{Withholding income tax from income derived from sources located in the country}

725. The income tax law provides that income from sources located in Brazil are subject to a withholding tax at source when earned/derived by individuals or legal entities resident or domiciled abroad.\textsuperscript{390} The income tax regulation establishes a withholding tax at the rate of 15% where income, capital gains, and other incomes are paid, credited, delivered, employed or remitted from a source located in Brazil to individual or legal entity residing abroad.\textsuperscript{391}

726. An increased withholding tax rate of 25% applies in cases where the income is paid to beneficiaries located in low-tax jurisdictions.\textsuperscript{392}

727. The same rate of 25% applies to income from the provision of services that are paid, credited, delivered, employed or remitted to individuals or legal entities which are resident or domiciled abroad.\textsuperscript{393}

728. On the other hand, the income tax law establishes a reduced rate of withholding tax at 15% applies on income from the provision of technical services, administrative, and similar assistance fees derived from the country and received by individuals or entities abroad.\textsuperscript{394} This reduced rate of withholding tax is however compensated by a 10% additional levy of Contribution of Intervention in the Economic Domain (CIDE), which is a special contribution for the financing of science and technology programmes, research

\textsuperscript{389} Article 468 of Decree 9,580/2018.
\textsuperscript{390} Article 743 of Decree 9, 580/2018.
\textsuperscript{391} Article 744 of Decree 9,580/2018 states that: “\textit{Income, capital gains and other income paid, credited, delivered, employed or remitted, by source located in the Country, to individual or legal entity residing abroad, shall be subject to source taxation, at the rate of 15%, when they have no specific taxation provided for in this Chapter.” It should be noted that the gains perceived by physical persons are subject to withholding tax rates that varies from 15% to 22,5% depending on the amount of gain perceived.
\textsuperscript{392} Article 748 of Decree 9,580/2018.
\textsuperscript{393} Article 746 of Decree 9,580/2018.
\textsuperscript{394} Article 765 of Decree 9,580/2018.
incentives and technological innovation, and the respective taxable event is any payment made abroad of royalties, technical services, copyrights, and other compensation derived from contractual obligations involving technology transference.

729. It is worth noting that Brazilian domestic law contains provisions that establish exemptions and reductions of withholding income tax for certain activities.395

730. From the analysis of the withholding tax provision, it can be established that this broad source taxation rule will apply, and tax will be levied on the non-resident in the situations where there is no specific regime provided in the income tax regulation and/or where the PE is not formally registered in Brazil.

731. The taxation of income on a gross basis is not foreseen in Article 7 of the OECD MTC, which refers to taxation of business profits (the term “profits” implies net income, not gross income). As pointed out above, this gross taxation of income derived from sources in Brazil may apply where the PE does arise in accordance to Article 5 but is not duly formalised/registered. In the situation where Article 7 applies and such tax burden is higher than that which would be levied on a net basis, such approach may not fully correspond to principles established in that Article. It is very likely that in most cases tax levied on gross income at the rates of 15% or 25% may exceed the amount of tax that would be due if net profits were subject to tax. This may give a rise to a risk of double taxation or over-taxation in situations where the actual profit is very small or where there is a loss situation. This approach may on the other hand fail to capture situations where economic activities are carried out in Brazil, which lead to high profits being booked outside of Brazil but no income is physically paid out of Brazil, and thus the withholding tax mechanism may not fully prevent potential BEPS risks.

Net profit taxation (actual profit regime)

732. Next to the general rules providing for withholding taxation on income derived by non-residents, the Brazilian tax legislation also contains specific provisions applicable in cases where the PE is duly formalised and registered and also to situations which give rise to an agency PE. The law establishes that where foreign entities establish (and accordingly register) in Brazil (i) branches (filiais), main branches (sucursais), agencies (agências) or representative offices (representações); or in case the (ii) foreign principal domiciled abroad, as regards the results of the operations performed by their commissionaires (comissários) or representatives (mandatários), will be subject to the Brazilian income tax regulation, according to the same rules applicable to Brazilian taxpayers.396

733. Based on these rules, a Brazilian taxpayer being subject to IRPJ and CSLL using the “actual profits” method, which is based on taxable income (i.e. earnings before taxes) and adjusted according to certain exclusions established by the legislation,397 is subject to IRPJ, on the taxable profits of an entity at a rate of 15% on the quarterly taxable income.398 A 10% rate surtax is imposed on taxable income exceeding BRL 240 000 on an annual basis.399 Additional CSLL is levied on entities subject to the IRPJ in order to finance the Brazilian federal social security system at the rate of 9% and at the rate of 15% for financial institutions.400

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395 Article 750 to 755 of Decree 9,580/2018.
396 Articles 158 and 159 of Decree 9,580/2018.
397 Article 257 of Decree 9,580/2018.
398 Articles 217 and 623 of Decree 9,580/2018
399 Article 624 of Decree 9,580/2018
400 Article 3 of Law 7,689/1988.
734. It is also relevant to point out that the existing transfer pricing legislation applies in determining the taxable income of the PE in dealings involving transactions with other related parties as well as the head office and other PEs of the same enterprise located abroad.\(^{401}\) Therefore, the issues highlighted in previous chapters also arise in the context of a transaction between the PE and the head office or other parts of the enterprise. In addition, specific provisions provide limitations to the deductibility of certain expenses (described in more detail below).

735. With respect to agency PEs,\(^{402}\) the law specifies that commissionnaires (comissários) and representatives (mandatários) that sell consigned goods on their own behalf but on the instruction and for the account of the non-resident principal are required to keep separate accounts for the activities relating to the foreign entity and their own activities.\(^{403}\) It is within this context that the provision sets out the rules for calculating the earnings of the principal and the intermediary, namely, that the intermediary in Brazil who is the importer or consignee of the goods shall record and calculate the profit from his activity separately from the profit of the principal resident or domiciled abroad and the tax base of the agent (intermediary) and the principal will be determined as follows: (a) “the operating profit of the intermediary shall be the difference between the remuneration received for its services and the costs and expenses of the operation for which they are liable”; (b) “the operating profit of the principal shall be the difference between the sale price in Brazil and the price at which the good has been imported, together with the expenses of the operation for which they are liable, including the remuneration for the services referred to in the preceding item”.\(^{404}\)

736. Where a PE of a non-resident taxpayer is subject to tax on a net basis, according to the same rules applicable to Brazilian taxpayers, there may be results that could lead to an outcome that is broadly in line with the principles prescribed by Article 7, subject to the gaps and limitations arising from the existing transfer pricing rules discussed in the previous section, which would in many cases lead to either over- or under-allocation of income to the PE, which would in turn lead to double taxation or double non-taxation.

737. It should be highlighted that, according to the domestic law, no deduction of royalties for licensing and trademarks is allowed in the case of payments from a Brazilian branch to its head office abroad.\(^{405}\)

\(^{401}\) Article 23 of Law 9,430/1996 states that for the purpose of the application of transfer pricing rules, will be considered related party to the legal entity domiciled in Brazil:

“I. its non-resident head office; II. a non-resident affiliate or branch; III. a non-resident individual or legal entity the holding of which in its capital characterizes it as a parent or associated company as defined in paragraphs 1 and 2 of article 243 of Law 6,404/1976; IV. a non-resident legal entity characterized as its subsidiary or associated company, as defined in paragraphs 1 and 2 of article 243 of Law 6,404/1976; V. a non-resident legal entity which, together with the company domiciled in Brazil, is under common corporate or administrative control, or when at least 10% of the capital of each of them is owned by the same individual or legal entity; VI. a non-resident individual or legal entity which, together with a legal entity domiciled in Brazil, has a holding in the capital of a third legal entity, the sum of which characterizes them as parent or associated companies as defined in paragraphs 1 and 2 of article 243 of Law 6,404/1976; VII. a non-resident individual or legal entity which is its associate in a joint venture or co-ownership in any venture, when so defined under Brazilian law; VIII. a non-resident individual who is a relative or kin down to the third degree, spouse or cohabitant of any of its directors or officers or of its direct or indirect controlling partner or shareholder; IX. a non-resident individual or legal entity that is its exclusive agent, distributor or dealer for the purchase and sale of goods, services or rights; and X. a non-resident individual or legal entity the exclusive agent, distributor or dealer of which for the purchase and sale of goods, services or rights is the legal entity domiciled in Brazil.”

\(^{402}\) Foreign principal domiciled abroad, as regards the results of the operations performed by their commissionnaires (comissários) or representatives (mandatários).

\(^{403}\) Article 468 of Decree 9,580/2018.

\(^{404}\) Article 468, sole paragraph, items I to III of Decree 9,580/2018.

\(^{405}\) Article 71, item ‘e’, (i), of Law 4.506/1974.
As regards the possibility to deduct costs and expenses which were incurred abroad for the purpose and benefit of the PE in Brazil, the Brazilian legislation establishes that legal entities domiciled abroad and authorised to operate in Brazil may only deduct as costs or expenses those incurred by their dependencies in the national territory, and is limited to the following: (a) costs and expenses incurred as a consequence of the activities in Brazil; (b) depreciation and amortisation of their assets in Brazil.

While limitation on the deductibility of expenses does not make it entirely clear whether item a) above would only include costs and expenses incurred in the national territory, or if it could also include these expenses, regardless of where they actually are incurred, provided they are attributable to the PE in Brazil, it is understood that Brazil would accept such expenses if incurred for the purposes of the PE. Otherwise, if this provision were to be interpreted restrictively, it would not be fully in line with Article 7, paragraph 3, of the 2008 version OECD and UN MTCs, which is also included in Brazilian tax treaties, and also provides that expenses incurred abroad may be deductible for the purposes of the determination of profits of the PE. It should be noted that certain limitations of expenses incurred by the other parts of the enterprise may be foreseen by the relevant tax treaties, namely that only actual expenses related to intangible assets, management services and interest can be deducted. Such limitations, with the exception of the deductibility limitation of royalty paid by the PE to the head office, are however not foreseen in the domestic law.

**Net profit taxation based on presumptive profit approaches**

As noted above, there are two presumptive profit approaches which are relevant also for the purposes of determination of tax base of the PE – namely the presumed profit approach (*lucro presumido*) and arbitrary profit determination approach (*lucro arbitrado*). Both of these approaches use the same prescribed net profit margin, which depends on the type of activities (see the profit margins listed in the table below). While these two approaches share the same starting point – gross revenue being the basis to which the same prescribed profit margins apply – the key difference is that the tax base determined based on the arbitrary profit determination approach (*lucro arbitrado*) includes an additional increase of the tax base by 20%.

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406 Article 467 of Decree 9,580/2018,

407 Article 7, paragraph 3, states that: “In determining the profits of a permanent establishment, there shall be allowed as deductions expenses which are incurred for the purposes of the permanent establishment, including executive and general administrative expenses so incurred, whether in the State in which the permanent establishment is situated or elsewhere.”

408 Notwithstanding the reservation made by Brazil in the 2008 OECD MTC on the words “whether in the State in which the permanent establishment is situated or elsewhere” found in paragraph 3 of Article 7, Brazil has six tax treaties which contain this wording, namely the treaties concluded with Mexico, Venezuela, Trinidad and Tobacco, Ukraine, Hungary and Uruguay (this last one is not yet in force).

409 It should be noted that the tax treaties with Mexico, Venezuela and Ukraine provide for a specific wording in Article 7, paragraph 3 (following the UN MTC), which generally indicates that these countries will not allow deductions in respect of amounts, if any, paid (otherwise than by way of reimbursement of actual expenses) by the PE to the enterprise or any of its other offices, by way of royalties, fees or other similar payments in return for the use of patents or other rights, or by way of commission, for specific services performed or for management (not included in the tax treaty with Ukraine), or, except, in the case of a banking enterprise, by way of interest on moneys lent to the permanent establishment (not included in the tax treaty with Ukraine).

410 Taxpayers have the option, where the total gross revenue in the previous calendar year has been equal to or less than BRL 78 million, to calculate the IRPJ and CSLL using the presumed profits method (*lucro presumido*), under which the income is calculated on a quarterly basis on an amount equal to different percentages of gross revenues based on the entities activities.
741. The arbitrary profit determination approach (lucro arbitrado) is applicable in cases of agency PEs where the taxpayer does not follow the prescribed rules for calculating their profits and the profits of the principal abroad. In such cases where the rules for determination of the tax base of an agency PE are not followed, tax authorities may impute income to the non-resident principal on sales made in Brazil according to the provisions of the income tax law, and tax this arbitrarily determined tax base accordingly.\(^{411}\) The taxable income will be determined on the basis of prescribed percentages, i.e. 1.6%, 8%, 16% or 32% depending on the activities performed, but with an additional increase of the tax base by 20%.\(^{412}\) It is also prescribed that the intermediary in Brazil will be responsible for the tax due upon the profits accrued by the foreign principal.\(^{413}\)

### Table 11.1. Presumed profit rate\(^{414}\)

<table>
<thead>
<tr>
<th>Activities</th>
<th>Profit rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retail sale of fuel and natural gas</td>
<td>1.6%</td>
</tr>
<tr>
<td>Sale of goods or products</td>
<td>8%</td>
</tr>
<tr>
<td>Cargo transportation</td>
<td></td>
</tr>
<tr>
<td>Real estate activities (purchase, sale, subdivision, development and construction of real estate)</td>
<td></td>
</tr>
<tr>
<td>Hospital services</td>
<td></td>
</tr>
<tr>
<td>Rural activity</td>
<td></td>
</tr>
<tr>
<td>Industrialisation with materials supplied by the client</td>
<td></td>
</tr>
<tr>
<td>Other unspecified activities (except services)</td>
<td></td>
</tr>
<tr>
<td>Transportation services (except freight)</td>
<td>16%</td>
</tr>
<tr>
<td>General services with gross revenues up to R$ 120,000 / year (*)</td>
<td></td>
</tr>
<tr>
<td>Professional services (Simple Societies - ‘SS’, doctors, dentists, lawyers, accountants, auditors, engineers, consultants, economists, etc.)</td>
<td>32%</td>
</tr>
<tr>
<td>Business intermediation</td>
<td></td>
</tr>
<tr>
<td>Administration, lease or assignment of movable / immovable property or rights</td>
<td></td>
</tr>
<tr>
<td>Construction services, when the provider does not use materials owned by it or be responsible for the execution of the work</td>
<td></td>
</tr>
<tr>
<td>Services in general, for which no specific percentage is established</td>
<td></td>
</tr>
<tr>
<td>In the case of exploration of diversified activities, the respective percentage will be applied to the gross revenue of each activity</td>
<td>1.6% to 32%</td>
</tr>
</tbody>
</table>

Source: Article 592 of Decree 9,580/2018.

742. This arbitrary profit determination approach (lucro arbitrado) also applies to agents and representatives where the taxable income is derived by a non-resident principal from sales concluded by agents or representatives and invoiced directly from the non-resident seller to the domestic customer.\(^{415}\) This approach will be applicable in the cases where the agent or representative has the power to enter into

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\(^{411}\) This deemed profit will be determined in different ways depending on whether the gross revenue can be found. Article 605 of the Decree 9,580/2018, establishes that if the gross revenue is found the deemed profit will be calculated by way of the application of specific rates depending on the activity.

\(^{412}\) Article 605 of Decree 9,580/2018, following the percentages prescribed in Articles 591 and 592.

\(^{413}\) Article 468, sole paragraph, items IV and V of Decree 9,580/2018.

\(^{414}\) Article 592 of Decree 9,580/2018.

\(^{415}\) Article 605 of Decree 9,580/2018, following the percentages prescribed in Article 591 and Article 592.
a binding agreement with domestic customers in Brazil on behalf of the principal, or through a branch or agency of the principal in Brazil but the actual invoicing and delivery is carried out by the principal.\footnote{Article 612 of Decree 9,580/2018.}

743. Additionally, the provision states that deemed profit basis taxation would not apply in the case of sales where the intervention of the agent or representative has been limited to acting as a business intermediary, obtaining or forwarding orders or proposals, or other acts necessary for the commercial agency, even when these services are compensated by commission payments or other forms of remuneration, provided that the agent or representative does not have power to bind the principal to a contract. This exception seems to contain a principle of negative definition of agency PE, which is further discussed in the relevant section dealing with nexus.\footnote{Furthermore, Article 612 of Decree 9,580/2018 also establishes that (i) the sole fact that the principal holds an equity interest in the agent or representative in Brazil does not attribute to the latter power to enter into a binding contract on the principal’s behalf, and that (ii) the fact that the legal representative or attorney of the principal may occasionally sign a contract in Brazil on behalf of the principal is not sufficient to determine the application of the deemed profit standard.}

744. In conclusion, foreign entities acting as principals that carry out activities in Brazil through commissionnaires (comissários) and representatives (mandatários) that sell the consigned goods on their own behalf but on the instructions and for the account of the non-resident principal will held liable to tax in Brazil and the tax base will be determined either on a net profit basis considering their earnings and expenses in Brazil or, if the conditions are not observed, the tax base will be determined through the arbitrary determination approach (lucro arbitrado).

745. In the case of the presumed profit regime (lucro presumido) and the deemed profit approach (lucro arbitrado), the application of these rules may in some cases lead to an outcome, which is broadly in line with Article 7, but key divergences will arise due to the fact that the fixed profit rates (margins) may in most cases diverge from the actual outcomes and economic profitability of such transactions. This approach, which is only applicable in limited circumstances, may however provide a degree of simplicity, and therefore, may reduce compliance burden and increase efficiency of tax administration.

\begin{quote}
Examples on application of the current attribution of profits to permanent establishments rules in Brazil
\end{quote}

746. In this section, some practical examples are considered with a view to highlighting the strengths and weaknesses of the existing rules in Brazil.
Box 11.2. Example – income of the foreign head office which is effectively connected to the Brazilian PE and not formally registered in Brazil

Non-resident Company A is an oil and gas drilling entity and undertakes activities in Brazil, which constitute a PE based on the bilateral tax treaty. However, such PE was not formally registered or formalised as a branch in Brazil.

Company B with a PE duly formalised (registered) in Brazil is a non-resident company which participates in an oil and gas project in Brazil that requires the provision of services from Company A. While the drilling services are provided by Company A through its activities in Brazil, the payments for the provision of drilling services are made abroad, between Company A and B.

Based on the OECD guidance on attribution of profits, the PE should be deemed to be a separate enterprise dealing independently with its head office abroad and being remunerated as if it were a separate and independent enterprise engaged in the same or similar activities under the same or similar conditions, taking into account the functions performed, assets used and risks assumed by the enterprise through the PE and through the other parts of the enterprise. If the head office of Company A and its PE were separate enterprises and the PE was carrying out the drilling services for which Company A would receive a payment, the head office of Company A would have to pay for the service provided by the PE. Thus, there would have been an allocation of profits between the head office of Company A and the PE in Brazil as if the PE was an independent service provider.

For instance, if BRL 120 of total profits were derived by Company A from this transaction, and if we hypothesise the PE as an independent service provider that would have made a profit of BRL 100 for the drilling services, the portion of profits representing BRL 100 should be allocated to the PE and BRL 20 of profits should be allocated to the head office of Company A for its limited functions carried out in this transaction.

In this situation which involves a PE of Company A not being formally registered in Brazil, one can assume that the special rules allowing for the net profit taxation will not apply, because no taxable presence was formalised to allow the application of such an approach. Instead, the application of general rules providing for the application of a withholding tax may apply. If this is the case, it is not clear from the legislation how withholding taxation should apply, because the actual payment was not executed between the PE of Company B and Company A, but between the two head offices. There is thus a risk that in the absence of special guidance, the profits which would otherwise be allocated to the Brazilian PE of
Company A under OECD guidance, may not be necessarily allocated to the PE of Company A, which was not duly formalised.

**Box 11.3. Example – income of the foreign head office which should be allocated to its branch in Brazil**

Non-resident Company A is a software developer with an office in Brazil (branch PE), in which it has a centre of excellence and all the DEMPE functions as well as the risk control functions are performed by this PE.

Company A sells the software and invoices the customers all over the world and the payments for the software are made directly to Company A abroad.

Assuming that actual costs of all the people’s functions in Brazil as well as other costs in Brazil are BRL 100. Assuming that the total profit for the software sold by Company A is BRL 1 000. Assume also that based on the analysis following the OECD Guidelines, it would have concluded that most of the profit (BRL 950) should be attributable to the PE and BRL 50 should be attributed to the head office of Company A.

748. In this scenario, considering that the non-resident is formally established in Brazil through a branch, the law establishes that the branch will be subject to tax in the same manner as a Brazilian taxpayer, by way of net taxation. Accordingly, the existing transfer pricing rules will be applicable.

749. The taxpayer will thus have the freedom to choose any applicable method. In this given scenario, the specific DEMPE functions and risk control functions are unlikely to be comparable to other easily benchmarkable activities as the development of unique and valuable intangibles is involved. This may rule out the applicability of the equivalent of the CUP method. In addition, due to the fact that the PE is not engaged in resale activities, but rather in software development activities, this also rules out the application of the equivalents of the resale price method. The taxpayer may thus only consider the application of the equivalent of the cost plus method for exports (CAP method), which foresees the application of a fixed margin at the rate of 15% gross profit mark up.

750. Under the current rules, it is not possible for the tax administration to allocate more profits to the branch in Brazil to align the outcome to the OECD analysis.

751. This is a consequence of the aspects of the existing transfer pricing system, which arise in relation to the issues discussed in this report concerning Chapters I - III of the OECD Guidelines, which create further difficulties and challenges in addressing attribution of profits to permanent establishments. Among others, the absence of comparability (including functional and risk) analysis, absence of accurate
delineation of the actual transactions, freedom of choice of methods and unavailability of some methods – especially the profit split method and other (valuation) methods – make it extremely challenging to reach a reasonable outcome from a transfer pricing perspective.

11.3. Assessment of effectiveness

Absence of guidance on attribution of profits to a permanent establishment

752. The above analysis as well as practical examples point out some of the same or similar weaknesses and issues in the existing rules as is the case with the existing transfer pricing rules, which can give rise to double taxation and double non-taxation and losses of revenues of Brazil but on the other hand may provide a degree of simplicity.

Findings of the assessment

Prevention of BEPS risks

The existing approach of applying a withholding tax mechanism in the case where no PE is registered and formalised may be an effective approach to dealing with BEPS risks arising from practices of avoiding the PE registration. This approach may however prove limited in cases where the payments are not made from Brazil, making the administration of the withholding tax potentially difficult or even impossible. This approach will thus not provide sufficient protection from related BEPS risks, but may cause potential over-taxation and double taxation as outlined in the next criterion of the assessment.

The special rules providing for net profit taxation imply the application of the existing transfer pricing rules, but this also means that all the existing issues in the transfer pricing rules as discussed in the previous chapters play out in the context of profit attribution to PEs. As was established earlier, these existing approaches do not provide sufficient protection against BEPS and some features may even further amplify such risks, leading to further revenue losses for Brazil.

Finally, the existing approaches to allocation of income to agency PEs provide a degree of guidance and also potentially protection from BEPS, but their reliance on importation values may lead to potential manipulation of importation prices, or problems where the transactions involve services or intangible assets, where such importation values may be irrelevant. The fall-back approach based on the deemed fixed profit margins may provide some degree of protection from BEPS risks but only to the extent that such deemed fixed profit margins reflect the actual commercial reality.

Prevention of double taxation

In both cases where the withholding tax on a gross basis is triggered and where the non-resident is subject to net taxation in Brazil (while using the existing transfer pricing rules, including the fixed margins), the tax base may not be in line with the principles established in Article 7 and the risk of overtaxation and double taxation is high. These divergences potentially lead to double taxation in different scenarios.
Ease of tax administration

The existing approaches, including the withholding tax mechanism, where the comparability analysis is limited or absent due to the use of fixed margins or presumptive profit approaches, may present potential simplification, which may have a positive effect on ease of tax administration.

Ease of tax compliance

The existing approaches also provide a degree of ease of tax compliance for taxpayers who may rely on the withholding tax mechanism, fixed margins and deemed profits. In other areas, the ease of tax compliance may be comparable to OECD guidance.

Tax certainty

The application of the withholding income tax or net taxation to non-residents established in Brazil or deriving income from source in Brazil has a positive impact on tax certainty from a domestic perspective. Nevertheless, the lack of a broader definition in the context of earnings from source in Brazil, may create uncertainty as to whether an income would be captured by the relevant provision. The fixed margins approach used under the transfer pricing rules represents an objective methodology based on mathematical formulae and promotes tax certainty in the domestic context to that extent.

From an international perspective, the application of the current transfer pricing rules in Brazil differs significantly from the international tax standards applied by the majority of jurisdictions, which may increase tax uncertainty in the cross-border context.

ANALYSIS OF THE STATUS OF THE IMPLEMENTATION OF BEPS ACTION 7 RECOMMENDATIONS AND NEXUS ISSUES

11.4. BEPS Action 7 Recommendations

753. As already noted above, whether or not a tax liability of the business profits of a non-resident arises in the respective jurisdictions is a question of domestic law. In some cases, such tax liability may be absent – either due to intended policy choice or sometimes due to unintended legislative omissions. Where such tax liabilities are established and are broader than the taxing rights foreseen in the tax treaties, such broader tax liabilities are constrained by the relevant provisions of applicable bilateral tax treaties – namely the provisions of Article 7, further referring to Article 5, which contains the relevant definition of the term “permanent establishment”.

754. The tax liability of a non-resident in the domestic law can be established in different ways. It can be established in a way that establishes the tax liability of the non-resident in respect to the income derived through his activities, which give rise or constitute a permanent establishment. In such a case, the domestic law needs to contain also the relevant definition of what is meant by a PE and such definition may be broader or narrower than what is foreseen in Article 5 of the bilateral tax treaties. In addition, the domestic law may also need to establish the approach to the tax base determination and tax compliance of such a PE. The approach of the tax base determination may lead to outcomes, which are in line or may be different from the outcomes foreseen in Article 7 – i.e. the tax base determination may lead to outcomes that more or less tax base is allocated to such PE based on the specific bilateral tax treaty. In situations, where the domestic law establishes broader definition of PE than the definition foreseen in Article 5 or where the
domestic law establishes that the tax base determination is broader than the one foreseen in Article 7, the actual provisions of the bilateral tax treaty will have the effect that they will narrow down the relevant definitions and tax base determination. Where on the other hand, the domestic law provides for more narrow definition of PE and/or more narrow determination of tax base, the provisions of the bilateral tax treaty do not expand the tax liability, which was so narrowly established in domestic law.

755. Alternatively, such tax liability of the non-resident may be established more broadly, for instance, in establishing that the non-resident is liable to tax on income derived from the sources in the jurisdiction, without defining the term PE. Such approach, however, requires a definition of income from sources and the mechanism for tax base determination and tax compliance. Such tax base may be determined either on gross or net income basis and it can lead to outcomes which may or may not be in line with outcomes foreseen in Articles 5 and 7 of the bilateral tax treaties. In the cases where such domestic law provisions establish tax liability, which is not due based on the provisions of bilateral tax treaty, the application of domestic law will be fully constrained. In cases, where such domestic law provisions establish tax liability, which is due, but the amount of tax due is less than the amount of tax established by the provisions of the specific bilateral tax treaty, the effect of domestic law provisions will be again constrained by application of the tax treaty provisions. Finally, where the approach used in domestic law leads to outcomes that some types of income are not defined as income from sources and therefore tax liability of non-resident in respect of such income was not established, the relevant provisions of the bilateral tax treaty do not give a rise to such a tax liability, which was not foreseen in the domestic law.

756. The objective of this section is to review the concept of PE in Brazil and to compare it to the approach foreseen in Article 5 of OECD MTC especially as recently amended as a consequence of Action 7 of BEPS Project and currently reflected in the 2017 version of OECD Model Tax Convention.

757. The concept of permanent establishment has a history as long as the history of double taxation conventions, and has played a significant role in influencing the design and implementation of both domestic and international tax systems. Despite the long history of this concept, its practical application may still raise issues, since countries adopt different criteria to determine a PE in their domestic laws.

758. Countries that follow the approach of introducing a definition of PE into their domestic law, generally follow the wording contained in Article 5 of the OECD and the UN MTC, which is primarily used for the purpose of determining whether the jurisdiction is entitled to tax the business profits of the non-resident enterprise derived from the activities at its territory. As noted above, the inclusion of such definition into the domestic law is not a necessary precondition to create the tax liability, which can be also established through other approach – e.g. defining the tax liability of the non-resident with the reference to income derived from the sources in the jurisdiction. There are countries that do not have neither the PE concept nor any guidance concerning PEs in their domestic framework, but they do have other rules that establish the tax liability of the non-resident concerning the income derived from the activities performed in the country.

759. The PE topic has been subject to recent discussions by the OECD and the international community, especially as part of the international measures to counter BEPS issues. The evidence showed that a large number of multinational companies has been avoiding the tax liability in the countries from where they derived income through various techniques – including those based on avoiding the status of permanent establishment by circumventing the domestic law or tax treaty based definition of permanent establishment.

760. Action 7 of the OECD/G20 BEPS initiative called for a review of the definition of PE contained in Article 5 of the OECD MTC, to prevent artificial avoidance of PE status in relation to BEPS, including
through the use of commissionaire arrangements and the specific preparatory and auxiliary activity exemptions. Work on these issues also addressed related profit attribution issues.\footnote{OECD (2013), \textit{Action Plan on Base Erosion and Profit Shifting}, OECD Publishing, Paris, \url{https://doi.org/10.1787/9789264202719-en}.}

761. These changes were incorporated into Article 5 as part of the 2017 Update of the OECD MTC. The changes were also integrated in Part IV of the MLI (Articles 12 to 15).

762. In particular, the BEPS Action 7 Final Report recommended changes to tackle arrangements through which a non-resident enterprise makes sales in a jurisdiction through a commissionaire or a dependent agent that does not formally conclude contracts in the jurisdiction. In this context, since the previous wording of Article 5, paragraph 5, relies on the formal conclusion of contracts in the name of the foreign enterprise, the use of a commissionaire arrangement, to the extent that the contracts concluded by the person acting as a commissionaire are not binding on the foreign enterprise, could avoid taxation in the jurisdiction despite having the type of economic nexus that justifies the recognition of a taxable presence.

763. Similarly, BEPS Action 7 also identified strategies to avoid the application of Article 5 paragraph 5, in scenarios where contracts would be substantially negotiated in a jurisdiction, but that would not be formally concluded in that jurisdiction because they are finalised or authorised abroad, or where the person that habitually exercises an authority to conclude contracts constitutes an "independent agent".

764. The Report also included changes to prevent the exploitation of the specific exceptions to the PE definition provided for by Article 5, paragraph 4, of the OECD MTC, an issue which is relevant in the case of all business models, including those of digitalised businesses.\footnote{OECD (2015), \textit{Preventing the Artificial Avoidance of Permanent Establishment Status, Action 7 - 2015 Final Report}, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris \url{http://dx.doi.org/10.1787/9789264241220-en}.} BEPS concerns related to Article 5, paragraph 4 also arise from what is typically referred to as the “fragmentation of activities”. Given the ease with which multinational enterprises (MNEs) may alter their structures to obtain tax advantages, it was considered important to clarify that it is not possible to avoid PE status by fragmenting a cohesive operating business into several small operations in order to argue that each part is merely engaged in preparatory or auxiliary activities that benefit from the exceptions of Article 5, paragraph 4.

765. Finally, BEPS Action 7 also addressed concerns related to the splitting-up of construction services and related activities contracts into several parts so that each part would not exceed the time threshold required to constitute a PE. This BEPS issue was addressed by the implementation of the Principal Purposes Test (PPT) – as a result of BEPS Action 6, but also included an example and further changes to the commentary on Article 5, paragraph 3 of the OECD MTC.
Box 11.4. BEPS Action 7: Preventing the Artificial Avoidance of Permanent Establishment Status

The BEPS Action 7 Final Report on *Preventing the Artificial Avoidance of Permanent Establishments Status* called for a review of the PE definition to prevent the use of certain common tax avoidance strategies that are currently used to circumvent the existing PE definition, such as arrangements through which taxpayers replace subsidiaries that traditionally acted as distributors by commissionnaire arrangements, with a resulting shift of profits out of the country where the sales took place without a substantive change in the functions performed in that country. Changes to the PE definition were also identified in order to prevent the exploitation of the specific exceptions to the PE definition currently provided for by Art. 5(4) of the OECD Model Tax Convention.

The recommendations set out in Action 7 Final Report are summarised below.

**Artificial avoidance of PE status through commissionnaire arrangements and similar strategies**

A commissionnaire arrangement may be loosely defined as an arrangement through which a person sells products in a State in its own name but on behalf of a foreign enterprise that is the owner of these products. Through such an arrangement, a foreign enterprise is able to sell its products in a State without technically having a permanent establishment to which such sales may be attributed for tax purposes and without, therefore, being taxable in that State on the profits derived from such sales. Since the person that concludes the sales does not own the products that it sells, that person cannot be taxed on the profits derived from such sales and may only be taxed on the remuneration that it receives for its services (usually a commission).

A foreign enterprise that uses a commissionnaire arrangement does not have a permanent establishment because it is able to avoid the application of Art. 5(5) of the OECD Model Tax Convention, to the extent that the contracts concluded by the person acting as a commissionnaire are not binding on the foreign enterprise. Since Art. 5(5) relies on the formal conclusion of contracts in the name of the foreign enterprise, it is possible to avoid the application of that rule by changing the terms of contracts without material changes in the functions performed in a State. Commissionnaire arrangements have been a major preoccupation of tax administrations in many countries, as shown by a number of cases dealing with such arrangements that were litigated in OECD countries. In most of the cases that went to court, the tax administration’s arguments were rejected.

Similar strategies that seek to avoid the application of Art. 5(5) involve situations where contracts which are substantially negotiated in a State are not formally concluded in that State because they are finalised or authorised abroad, or where the person that habitually exercises an authority to conclude contracts constitutes an “independent agent” to which the exception of Art. 5(6) applies even though it is closely related to the foreign enterprise on behalf of which it is acting.

As a matter of policy, where the activities that an intermediary exercises in a country are intended to result in the regular conclusion of contracts to be performed by a foreign enterprise, that enterprise should be considered to have a taxable presence in that country unless the intermediary is performing these activities in the course of an independent business.
Artificial avoidance of PE status through the specific exceptions in Art. 5(4)

When the exceptions to the definition of permanent establishment that are found in Art. 5(4) of the OECD Model Tax Convention were first introduced, the activities covered by these exceptions were generally considered to be of a preparatory or auxiliary nature.

Since the introduction of these exceptions, however, there have been dramatic changes in the way that business is conducted. This is outlined in detail in the Report on Action 1 (Addressing the Tax Challenges of the Digital Economy, OECD, 2015b). Depending on the circumstances, activities previously considered to be merely preparatory or auxiliary in nature may nowadays correspond to core business activities. In order to ensure that profits derived from core activities performed in a country can be taxed in that country, Article 5(4) was modified to ensure that each of the exceptions included therein is restricted to activities that are otherwise of a “preparatory or auxiliary” character.

BEPS concerns related to Art. 5(4) also arise from what is typically referred to as the “fragmentation of activities”. Given the ease with which multinational enterprises (MNEs) may alter their structures to obtain tax advantages, it is important to clarify that it is not possible to avoid PE status by fragmenting a cohesive operating business into several small operations in order to argue that each part is merely engaged in preparatory or auxiliary activities that benefit from the exceptions of Art. 5(4).

Other strategies for the artificial avoidance of PE status

The exception in Art. 5(3), which applies to construction sites, has given rise to abuses through the practice of splitting-up contracts between closely related enterprises. The Principal Purposes Test (PPT) rule that will be added to the OECD Model Tax Convention as a result of the adoption of the Report on Action 6 (Preventing the Granting of Treaty Benefits in Inappropriate Circumstances) will address the BEPS concerns related to such abuses. For States that are unable to address the issue through domestic anti-abuse rules, a more automatic rule will be included in the Commentary as a provision that should be used in treaties that do not include the PPT or as an alternative provision to be used by countries specifically concerned with the splitting-up of contracts issue.


766. It is worth mentioning that the UN MTC generally departs from the OECD MTC’s definition by broadening the definition of activities that would lead to the existence of a PE for the purposes of allocating taxing rights to the country where such activities take place. Such provisions are also reflected in some of the tax treaties signed by Brazil and are discussed in more detail in the relevant section.

767. Finally, the UN MTC also contains a provision deeming a PE of an insurance company when it collects premiums in the territory of a Contracting State other than the State of residence or insures risks situated therein through a person.420

11.5. Description of existing nexus rules contained in Brazil's legal framework

768. This section focusses on analysing the nexus rules contained the Brazilian tax treaties, especially with a view to identifying whether and to what extent Brazil has incorporated the recommendations contained in the BEPS Action 7 Final Report. Additionally, considerations concerning the interaction

420 See Article 5, paragraph 6, of the UN MTC.
between domestic rules and the provisions contained in tax treaties signed by Brazil are also highlighted in order to assess issues that may arise in this context.

769. Brazil has included the concept of PE as defined in Article 5 of the OECD MTC and the UN MTC in all 33 tax treaties currently in force.

770. Furthermore, as regards the outcomes of BEPS Action 7, it should be noted that in its recently signed tax treaties with Singapore\textsuperscript{421} and Switzerland,\textsuperscript{422} Brazil left aside all of the recommendations of BEPS Action 7, which may potentially be to the detriment of the fiscal interests of Brazil. On the other hand, the new tax treaties signed with Uruguay\textsuperscript{423} and the United Arab Emirates\textsuperscript{424} contain all the provisions associated with BEPS Action 7, such as the provisions designed to prevent PE-related BEPS opportunities derived from the splitting-up of contracts, to prevent BEPS opportunities associated with specific activity PE exemptions, and provisions designed to prevent the artificial avoidance of a PE status through the use of commissionaire arrangements. These two tax treaties also include a provision which defines the expression “a person closely related to an enterprise”, and the tax treaty with Uruguay includes an “insurance company” PE provision in its Article 5, paragraph 6, based on the UN MTC.

11.5.1. Definition of a PE and listed examples – Article 5, paragraphs 1 and 2, of the OECD MTC

771. In general, Brazil follows Article 5, paragraphs 1 and 2, of the OECD MTC and the UN MTC, which have the same wording.\textsuperscript{425}

772. The consistent use of the PE definition in the bilateral tax treaties by Brazil, is not reflected in the domestic legislation, as the legal framework does not contain a general rule to define a PE. In this context, even though a PE may exist where a tax treaty has been concluded between Brazil and another jurisdiction, the concept of PE has not been extensively applied in practice and was not interpreted by tax authorities or administrative and judicial courts in a consistent way. Therefore, there is a potential lack of clarity regarding how Brazil would interpret the conditions for the characterisation of PEs with jurisdictions covered by its tax treaties.

773. Apart from a few rare cases that discuss issues related to PEs in the context of tax treaties, the administrative and judicial courts in Brazil also did not provide a comprehensive ruling on the concept of PE. A summary of the relevant case law is provided in the Section 11.5.8.

\textsuperscript{421} Tax treaty concluded on 7 May 2018.

\textsuperscript{422} Tax treaty concluded on 3 May 2018.

\textsuperscript{423} Tax treaty concluded on 7 June 2019.

\textsuperscript{424} Tax treaty concluded on 12 November 2018.

\textsuperscript{425} Nonetheless, it is worth noting that an analysis of Brazil’s tax treaties revealed that most of the tax treaties have a difference with respect to the provisions on construction sites. Such provision is usually included in Article 5, paragraph 2, as item g of the Brazilian treaties, instead of having it indicated in paragraph 3 of the same article. The tax treaties with Chile, China, Finland, Israel, Korea, Mexico, Netherlands, Peru, Portugal, South Africa, Turkey and Ukraine have the construction site provision reproduced in paragraph 3 of Article 5. Additionally, the new tax treaties signed but not yet ratified with Uruguay, Singapore and Switzerland also include the construction site provision in paragraph 3.
774. References to PE in the domestic legislation can be found in the provisions introduced on the occasion of the World Cup\textsuperscript{426} and the Olympic Games\textsuperscript{427} which introduced the term “permanent establishment” for the first time in the Brazilian legislation. The provision was used in the negative, mainly for the purpose of clarifying that entities carrying on business activities in Brazil to support the organisation of the events would not qualify as PEs. The relevance of such negative definition is however questionable, taken the absence of a positive definition, which would lead to a tax liability due to such activities.

775. In 2016, with the implementation of Country-by-Country Reporting, Brazil provided for the first time a definition of the concept of a PE in its secondary domestic law, which generally follows the definition provided by the OECD MTC in Article 5, paragraphs 1, 2, 3.\textsuperscript{428}

776. The recent inclusion of the PE provision in Normative Instruction 1,681/2016 did not bring any further clarification or guidance to taxpayers and tax authorities on the matter, since the purpose of this provision was limited to the purposes of preparation and filing of CbC reports only.

777. Nevertheless, even before the introduction of these specific provisions, Brazil already had other provisions in its legislation which are relevant in the context of the traditional concept of PE. Articles 158 and 159 of the income tax decree establish that a local branch, office, agency or representative of a foreign legal entity have the same treatment as legal entities incorporated and domiciled in Brazil.

778. According to these provisions, where foreign entities establish in Brazil branches (filiais), main branches (sucursais), agencies (agências) or representative offices (representações), the law will treat the foreign entities as corporate taxpayers and they will be subject to the Brazilian income tax regulation, following the same rules applicable to Brazilian taxpayers.\textsuperscript{429} This means that such activities will be subject to taxation on the net profit basis as determined based on the specific provisions of income tax legislation.

779. It should be noted that Article 1.134 of the Civil Code prescribes that a foreign entity needs the permission of the Executive Branch of the Government (Casa Civil) to operate in the country. Due to this requirement for prior approval from the Federal Government by presidential decree, such procedure was considered too burdensome and time-consuming for foreign enterprises to follow. Therefore, for practical reasons, most MNEs in Brazil tended not to adopt this type of business model and instead opted to incorporate an entity in the country (e.g., a subsidiary).

780. However, recent Decree 9 787/2019 delegated this competence to the Minister of Economy to decide and deliver the acts of authorisation for a foreign enterprise to operate in the country, which seems to provide a much less burdensome framework for foreign enterprises to formally establish their business presence in Brazil. The decree, through the sub-delegation of competency, also authorises the National Department of Business Registration, which is part of the structure of the Ministry of Economy, to be the body responsible for analysing the documentation and issuing the authorisation to open branches in Brazil before registration with the commercial board. The announcement made by the official Ministry of Economy indicates that the timeframe for foreign companies to obtain the authorisation to open a branch in Brazil will be reduced significantly.

\textsuperscript{426} Law 12,350 of 20 December 2010.

\textsuperscript{427} Law 12,780 of 9 January 2013.

\textsuperscript{428} Normative Instruction 1,681/2016, Article 2, item IV, states: “Permanent establishment means a fixed place of business by which an entity engages in all or part of its business in another jurisdiction and includes in particular: a) a place of management; (b) a branch; c) an office; d) a factory; e) a workshop; (f) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources; or g) A building site or construction or installation project constitutes a permanent establishment only if it lasts more than twelve months.”

\textsuperscript{429} Decree 9,580/2018, Articles 158 and 159.
Additionally, the income tax law contains other situations which are included in the concept of agency PE. The provision states that (i) foreign principal domiciled abroad, as regards the results of the operations performed by their commissionnaires (comissários) or representatives (mandatários), which similarly to the above, will be subject to the Brazilian income tax law, according to the same rules applicable to Brazilian taxpayer, and (ii) the income earned by non-residents from sales performed in Brazil through representatives, when invoiced directly to the purchaser. These two provisions will be further assessed in the relevant section below.

It is also important to highlight that regardless of whether a business is duly incorporated under Brazilian corporate law (without being formally registered with the competent authorities), it can be considered a taxpayer by the tax authorities, as stated in Article 126, Item III, of the Brazilian tax code. In the absence of such registration, the business activities of the non-incorporated Brazilian entity itself may result in the deemed taxable presence of the non-resident enterprise, which is ultimately subject to tax in Brazil.

Even though the current rules do not provide for a comprehensive provision or guidance on how to interpret the definition of PE in the tax treaty context through Article 5, paragraphs 1 and 2, it seems that the current rules foresee the application of the concept of PE by the tax authorities in the context of Article 5, paragraph 1 and 2, of the OECD MTC, especially where the business presence of non-residents is duly formalised and registered in one of the forms mentioned in the relevant provisions. In cases, where no such registration takes place, the general rules on tax liability of non-residents in respect of income from sources may apply. Therefore, the lack of registration does not prevent the application of the domestic law and tax liability will not be avoided. Rather, the tax burden will increase due to the fact that withholding taxation determined with reference to gross income may apply instead of taxation of net income.

11.5.2. Construction site – Article 5, paragraph 3, of the OECD MTC

As regards a PE arising as a consequence of construction and related activities as established in paragraph 3 of Article 5, the OECD and UN MTCs have some differences in the wording, scope of activities covered and time thresholds. Article 5 of the UN MTC provides for a six-month test for a building or construction site to constitute a PE, rather than the 12 months provided under the OECD MTC, and it extends the test to assembly projects, as well as supervisory activities in connection with building sites and construction or installation projects.

Brazil, with few exceptions, has adopted the OECD MTC wording and the UN MTC six-month threshold in its tax treaties. The tax treaties with Israel, Portugal, Russia and Switzerland (signed but not in force) provide for a threshold of nine months, while the tax treaties with Ecuador, Turkey and Ukraine provide for the twelve-month threshold. All the other tax treaties provide for a six-month period.

In practice, there seems to be no evidence of experience with construction PEs in the context of tax treaties in Brazil. Enterprises would either establish themselves in Brazil through a subsidiary or through

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430 Decree 9,580/2018, Article 159, item III.
431 Decree 9,580/2018, Articles 469 and 612.
432 Art. 126. The tax liability does not depend upon:
"(...) III – the legal entity being duly incorporated, in which case it is only necessary that an economic or professional unit is characterised."
433 See Article 5, paragraph 3, item a, of the UN MTC.
434 Tax treaties with Chile, China, Mexico, Peru, Singapore, United Emirates Arab and Uruguay (these last three tax treaties were signed but are not yet in force) have the wording of the UN MTC.
a branch in order to fulfill the tax obligations derived from the construction activity carried out in Brazil, which is treated for income tax purposes as a corporate entity domiciled in the country.\textsuperscript{435}

787. Concerns that may arise in the context of the inclusion of a time threshold in tax treaties are related to abuses through the practice of splitting up contracts between closely related enterprises, as highlighted in the BEPS Action 7 Final Report. Evidence collected by tax administrations in different countries shows that MNEs sometimes divide their contracts into several parts, each covering a period less than the time threshold established in the tax treaty provision, and attribute the different parts of the contract to different companies which are part of the same MNE group.

788. As discussed in previous chapters, Brazil could, to some extent, rely on the concepts of simulation, fraud and the substance-over-form approach developed in the current legal framework to tackle this practice. However, these concepts require a high degree of proof threshold in order to be triggered and may not be entirely effective in addressing the practice of splitting up contracts between closely related enterprises. In this sense, one possible approach that could be envisaged is the implementation of a specific anti-avoidance provision regarding the splitting-up of contracts under the domestic legislation which would be in line with the outcomes of BEPS Action 7 and preferably also including such a provision in the bilateral tax treaties as foreseen by recommendations of BEPS Action 7, such as the provisions integrated in Part IV of the MLI (Articles 12 to 15).

789. Brazil already seems to demonstrate willingness to adopt these outcomes, since it included them in the recent tax treaties signed with Uruguay and the United Arab Emirates.

11.5.3. List of exceptions – Article 5, paragraph 4 of the OECD MTC

790. Paragraph 4 of Article 5 contains a list of exclusions to show activities that will not constitute a PE, even though the activity is carried on through a fixed place of business. The main characteristic of these activities is that they are all of preparatory or auxiliary nature. The UN MTC has a narrower scope of exemptions from the PE definition in the case of preparatory and auxiliary activities, which does not include the activities involving “delivery of goods”. This wording has been omitted from the UN MTC. In other words, delivery alone is an activity that may constitute a PE in the UN MTC, but not under the OECD MTC.\textsuperscript{436}

791. With few exceptions, Brazil follows the OECD MTC when negotiating tax treaties with other jurisdictions as to what preparatory and auxiliary activities would not constitute a PE.\textsuperscript{437} In this sense, Brazil reproduces the provision of the OECD which includes the activities involving “delivery of goods”. This means that in Brazil, delivery alone is an activity that would not constitute a PE.

792. Despite this tax treaty scenario, no further guidance is found in the domestic legal framework and there is no case law to help determining which activities should be and which should not be included in the negative list of such activities.

793. As noted above, in the context of Article 5, paragraph 4, of tax treaties, the BEPS risks arise either from presenting main activities of the enterprise as constituting only preparatory and auxiliary activities or because of practices which are typically referred to as “fragmentation of activities”.

794. Given the ease with which MNEs can structure their operations to obtain tax advantages, it is important to address the practices leading to avoidance of a PE status through the fragmentation of a

\textsuperscript{435} Articles 158 and 159 of Decree 9,580/2018.
\textsuperscript{436} See paragraph 4 of the Commentary on Article 5.
\textsuperscript{437} The wording “delivery of goods” is not found in the tax treaties with Russia, Philippines and Uruguay.
cohesive operating business into several separate operations in order to argue that each part is merely engaged in preparatory or auxiliary activities that benefit from the exceptions of Article 5, paragraph 4.

795. Brazil currently does not have any domestic law rules or guidance which would establish an exception for preparatory or auxiliary activities rules, and thus, the issue does not arise in the domestic context. Nevertheless, issues may arise from the application of the tax treaty provisions.

796. In a tax treaty scenario, Brazil does not have any specific rules which incorporate the elements contained in BEPS Action 7, and it is uncertain under the current rules to what extent taxpayers are or could be able to abuse the exceptions prescribed in tax treaties. Again, tax authorities may be able to rely on the concepts of simulation, fraud and the substance-over-form approach, in order to address such situations, but likely with only limited effectiveness of such attempts.

797. To tackle the avoidance practices based on fragmentation of activities, Brazil should implement the BEPS Action 7 outcomes in all of its tax treaties and introduce practical guidance in the domestic legal framework, which would clarify this practical aspect of tax treaty interpretation to achieve the objectives foreseen by BEPS Action 7.

11.5.4. Agency PEs – Article 5, paragraph 5, of the OECD MTC

798. Brazil has concluded tax treaties which generally follow the approach of the OECD MTC to agency PEs. Article 5, paragraph 5, of the UN MTC has the same wording of the same article of the OECD MTC, with one exception. Under Article 5, paragraph 5 (b), of the UN MTC, a PE is deemed to exist where a person (other than an agent of independent status acting in the ordinary course of business within the meaning of Article 5, paragraph 7, of the UN MTC) who does not have the authority to conclude contracts in the name of the enterprise, habitually maintains a stock of goods or merchandise in a state from which it regularly delivers goods or merchandise on behalf of the enterprise.

799. Only two of the tax treaties concluded by Brazil include the provision contained in the UN MTC that extends the rule regarding agency PEs to situations in which an agent has no power to sign contracts. This is the case for the tax treaties with Trinidad and Tobago, and Ukraine. The provision deems a PE any person that has no authority to conclude contracts on behalf of the enterprise, but habitually maintains in that jurisdiction a stock of goods or merchandise from which it regularly delivers goods or merchandise on behalf of the enterprise. It should be noted that Brazil does not have any specific rules which incorporate the elements contained in BEPS Action 7 with regard to agency PEs, nor are such provisions reproduced in the Brazilian tax treaties which are currently in force.

800. The Brazilian domestic income tax law legislation seems to capture the concept of agency PE in two different scenarios.

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438 Paragraph 4 of these tax treaties reads as follow: Notwithstanding the provisions of paragraphs 1 and 2, where a person, other than an agent of an independent status to whom paragraph 5 applies, is acting in a Contracting State on behalf of an enterprise of the other Contracting State, that enterprise shall be deemed to have a permanent establishment in the first-mentioned Contracting State in respect of any activities which that person undertakes for the enterprise, if such person: a) has and habitually exercises in that State an authority to conclude contracts in the name of the enterprise, unless the activities of such person are limited to those mentioned in paragraph 3 which, if exercised through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph; or b) has no such authority, but habitually maintains in the first-mentioned State a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the enterprise.
First scenario

801. The first scenario refers to the provision which states that a foreign principal domiciled abroad, as regards the results of the operations performed by their commissionnaires (comissários) or representatives (mandatários), are subject to income tax according to the same rules applicable to Brazilian taxpayers. In such cases, the intermediary is responsible for the importation of the goods and will further sell the goods in Brazil. As a consequence, the accounting records are segregated, as described in the previous section.

802. In the context of the concept of agency PE, a question may arise as to whether the specific types of representation established in the Brazilian legislation (commissionnaires, official representatives, and agents) could narrow the nexus as stated in the OECD MTC, which refers to the broader term “person acting on behalf of an enterprise” in a jurisdiction.

803. The Brazilian tax laws do not provide for a specific definition of commissionnaire, representative, or agent. Nevertheless, this definition is found under the private law in Brazil.

804. The Brazilian Civil Code establishes that a commission agreement has for object the acquisition or sale of goods by the commissionnaire (comissário), in his own name, for the account of the principal (indirect representation). The Civil Code also provides that the commissionnaire is personally liable to the persons with whom he contracts. However, the commissionnaire is obliged to act in accordance with the orders and instructions of the principal.

805. As regards the definition of representatives (mandatários), the Civil Code establishes that the representation operates when someone receives powers from someone else to perform acts or administer interests in their name and on their behalf, and that the power of attorney is the instrument of the representation (direct representation).

806. Furthermore, the Civil Code establishes that under an agency contract, a person assumes, on a non-occasional basis and without ties of dependence, the obligation to promote, on behalf of another, through remuneration, the carrying out of certain businesses in a specific area. Additionally, the agent may be empowered to represent the principal in the conclusion of contracts.

807. Another type of contract found in the Civil Code is the brokerage contract. According to the provision, through brokerage contract, “a person, not linked to another by virtue of mandate, provision of services or any relationship of dependence, is obliged to carry out or arrange for the second, one or more affairs, according to the instructions received.” The law establishes that the broker is required to perform the mediation with diligence and prudence, and to provide the client with all information about the business progress.

808. It is thus established that under such contract the broker acts as the intermediary of the business to be carried out between the interested parties, and through the granting of powers by the interested parties, the broker is authorized to perform transactions on their behalf.

439 Article 159, item III, of Decree 9,580/2018.
809. The current notion of taxable presence of a non-resident due to the activities carried out by commissionnaires (comissários) or representatives (mandatários) seems to have a narrow scope, limited to the two types of direct and indirect representation, rather than being based on the substantive activities actually performed by the person carrying out the activities for the benefit and on behalf of the non-resident. By limiting the tax obligation of the non-resident to these two types of representations, the risk could be that the non-resident enterprise will formalise the representation through other legal arrangements to escape the potential tax liability. In other words, if there are more types of representation possible in the civil law, one could use a type of representation that is not mentioned by the law as a trigger of tax liability for non-residents, in order to avoid the constitution of taxable presence in the country, which may create potential BEPS risks for Brazil.

810. This could be the case, for instance, concerning the brokerage contract mentioned above, or any other atypical contract, that may not be clearly defined by private law, and which would contain similar elements of an actual representation agreement or actual conduct of the intermediary who would carry out the actions on behalf of the non-resident enterprise.

811. In the context of this rule, it is also important to refer to Article 468 and its sole paragraph of the income tax decree, which describes the method for assessing the taxable income of the principal. This sole paragraph provides that income earned by the non-resident principal is connected to the “remittance of goods to Brazil which are consigned to commissionnaires, agents or representatives, for them to sell in Brazil on the instructions and for the account of the principal”. The abovementioned provision makes reference to “goods”, which led some authors to discuss whether such provision should be interpreted in a restrictive way, in the sense that this rule would only be applicable in the context of tangible goods, without covering for instance transactions involving the provision of services or intangible goods.

812. While discussions about the interpretation of this provision have been observed by some authors in Brazil it should be noted that the actual legal basis for Article 468 and its sole paragraph of the income tax decree is Article 76, paragraphs 1 and 2, of the Law 3,470/1958. The law refers to a broader term, rather than making reference only to goods, namely, “operations effected by their agents or commissionaires in Brazil”. Nonetheless, the Ordinance issued by the Ministry of Finance which provides guidance for the application of Article 76, paragraphs 1 and 2, mentioned above, refers to the income accrued by the foreign principal from the consigned goods remitted to commissionnaires, agents or representatives, which does create potential uncertainty and legal interpretation issues.

813. With respect to the element of habitualness, while all of the tax treaties signed by Brazil generally reproduce Article 5 of the OECD MTC and therefore contain the rule that it is the habitual performance of actions on behalf of the non-resident enterprise, which is a condition for a PE to exist, the domestic provision does not include such element. In this sense, it seems that the domestic law, by not providing for this element, has a broader scope and would capture a scenario even in cases where there is no “habituality” element present. In those cases, the tax treaties containing such a condition would prevail and the corresponding domestic rule would be applicable only if the “habituality” element is present or where no bilateral tax treaty is applicable.

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446 Article 468, sole paragraph, of Decree 9,580/2018,

447 Ordinance 228/1974.

448 Article 158, and 159, item III, establish that a foreign principal domiciled abroad, as regards the results of the operations performed by their commissionnaires (comissários) or representatives (mandatários), are subject to the income tax regulation in Brazil.
Second scenario

814. The second scenario relates to the rule that applies to representatives, where the taxable income is derived by the non-resident principal from sales concluded by agents or representatives but where the purchase price is invoiced directly from the non-resident seller to the domestic purchaser. In such a scenario, the functions of the representatives are limited to the conclusion of contracts and the foreign principal invoices directly to the domestic purchaser in Brazil. It also seems to explain why the law foresees a special alternative approach to profit determination in this case, which is the deemed profit standard.

815. Further, in this rule, the law establishes that the fact that the representative of the principal may occasionally sign a contract in Brazil on behalf of the principal is not sufficient to determine the application of the deemed profit standard. Therefore, this provision does contain the element of “habituality” which seems to also reflect the condition provided in Article 5, paragraph 5, of the OECD MTC.

816. This same provision also states that the deemed profit would not be applicable in the case of sales where the intervention of the agent or representative has been limited to acting as a business intermediary, obtaining or forwarding orders or proposals, or other acts necessary for the commercial agency, even when these services are compensated by commission payments or other forms of remuneration, provided that the agent or representative does not have power to bind the principal to a contract.

817. In the context of BEPS Action 7, strategies that seek to avoid the application of Article 5, paragraph 5, involve situations “where contracts which are substantially negotiated in a State are not formally concluded in that State because they are finalised or authorised abroad, or where the person that habitually exercises an authority to conclude contracts constitutes an “independent agent” to which the exception of Article 5, paragraph 6, applies even though it is closely related to the foreign enterprise on behalf of which it is acting.”

818. If activities mentioned above in the Brazilian rules, namely, obtaining or forwarding orders or proposals, or other acts necessary for the commercial agency and conclusion of contracts, do not trigger application of the rule i.e. the deemed profit taxation this exemption from the application of the rule may raise concerns related to abuses as highlighted in BEPS Action 7, unless other rules could be triggered such as the general withholding tax or net taxation. Since the domestic provision and the current Article 5, paragraph 5 of the Brazilian tax treaties would rely on the formal conclusion of contracts in the name of the foreign enterprise, it is possible to avoid the application of that rule where contracts which are substantially negotiated in a State are not concluded in that State because they are finalised or authorised abroad, or where the person that habitually exercises an authority to conclude contracts constitutes an “independent agent” to which the exception of Article 5, paragraph 6 applies even though it is closely related to the foreign enterprise on behalf of which it is acting. The functions of acting as an intermediary, the obtaining or forwarding orders or proposals, and other acts can effectively lead to the conclusion of the contract even though the local agent does not necessarily formally conclude them. Therefore, this exemption from the application of the rule may amplify BEPS risk concerns in Brazil.

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449 Article 612, item IV, of Decree 9,580/2018.


11.5.5. Agency PEs – Article 5, paragraph 6, of the OECD MTC

819. Article 5, paragraph 6 of the OECD MTC excludes independent agents that acts for the enterprise in the ordinary course of their business.

820. In the context of BEPS Action 7, it was found practices where entities could use strategies to avoid the application of Article 5, paragraph 5 in situations where the person that habitually exercise an authority to conclude contracts constitutes an “independent agent” to which the exception of Article 5, paragraph 6 applies, even though it is closely related to the foreign enterprise on behalf of which it is acting.

821. As a result, such provision was revised with a view to narrowing the definition of independent agent. It especially included that where a person acts exclusively or almost exclusively on behalf of one or more enterprises to which it is closely related, that person shall not be considered to be an independent agent with respect to any such enterprise. Additionally, Article 5, paragraph 8, brought considerations on the definition of “closely related” referred to in Article 5 paragraph 6.

822. The equivalent of the provision contained in Article 5, paragraph 6, of the OECD MTC is incorporated in all Brazilian tax treaties. Nevertheless, it should be noted that the updates introduced by BEPS Action 7 (to both, paragraphs 6 and 8 of Article 5) are not included in the current tax treaties that Brazil has in force.

823. It should be noted that the domestic rules in Brazil, especially the ones which deal with agency PEs discussed above, do not include such concept of independent agent that acts for the enterprise in the ordinary course of its business, nor does it address the concerns raised by BEPS Action 7. Therefore, if under the relevant tax treaty Article 5, paragraph 6, of the OECD MTC would apply, the international rule would prevail over the domestic rules established in Articles 468, 469 and 612 of the income tax law discussed above and which describe the treatment of agency PEs.

824. Nevertheless, to fully be able to tackle the avoidance practices based on strategies adopted by MNEs to avoid the application of Article 5, paragraph 6, Brazil should implement the BEPS Action 7 outcomes in all of its tax treaties and introduce practical guidance in the domestic legal framework, which would allow to clarify this practical aspect of tax treaty interpretation to achieve the objectives foreseen to interpret the treaties on the basis of the element prescribed by BEPS Action 7. Brazil seems to indicate through its new tax treaties that they intend to include the outcomes of BEPS Action 7 in its future tax treaties.

11.5.6. Service PEs

825. The UN MTC in its Article 5, paragraph 3(b) contains a specific provision in the sense that the PE would also encompass “the furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose, but only if activities of that nature continue within a Contracting State for a period or periods aggregating more than 183 days in any 12-month period”.

826. The 2017 OECD MTC also provides for an alternative provision in the Commentary of Article 5 which deals with the service PE.452

827. Since Brazil has concluded tax treaties which follow to a certain extent the UN MTC in respect of construction sites, it is interesting to note that only very few of Brazil’s tax treaties incorporate the provisions regarding the service PE of the UN MTC. However, the tax treaty with China and the newly signed tax

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452 See commentary 144 on Article 5 of the 2017 OECD MTC.
treaties with Singapore and Uruguay are the only tax treaties that incorporate a service PE clause, which is based on Article 5, paragraph 3, b, of the pre-2017 version of the UN MTC.

828. A possible reason for such a limited presence of the service PE concept in the Brazilian tax treaties is the fact that Brazil aims at taxing the income derived from the provision of services not only in respect of services performed in Brazil, but also in respect of services which have been performed abroad and for which payment is made out of Brazil. In general, income earned by a non-resident derived from the provision of services in Brazil is subject to a withholding tax at the rate of 25% on the gross amount and a reduced 15% rate applies to fees for technical services and technical assistance, which are also subject to CIDE technology as explained before.

829. This approach involving the application of a withholding tax is also reflected in most of the Brazilian tax treaties, which contain a specific provision (mostly in the protocols to the relevant treaties) enabling them to exercise this taxing right also in the presence of a tax treaty. Brazil thus follows the UN MTC, through which such services are to be taxed as royalties on a gross basis at the source of the income.

830. In addition, as was pointed out in the previous chapters, next to the withholding tax obligations, special measures also limit the deductibility of outbound payments for certain types of services. Currently, there is no co-ordinating rule, so it may be possible that both provisions – denial of deduction and withholding taxation – will apply simultaneously.

831. It can also be interesting to consider what will be the consequences in case the foreign service provider registers a branch in Brazil through the activities of which the services are provided to the clients in Brazil. In such a case, the withholding tax would not be triggered, and the PE would be treated as a Brazilian taxpayer and taxed on a net profit basis. In addition, the payments for such services made to such a branch, while made legally to non-resident entity, but with a branch in Brazil, would not be considered as outbound payments and the deductibility limitations would not apply.

832. As a conclusion, it can be established that the provision of services from abroad to Brazil will not constitute a PE, but such income may be still subject to tax at source due to the withholding tax on technical services as well as additional CIDE levied in some instances (e.g. technical services). Where the services are provided through the activities of a non-resident in Brazil, the withholding tax may also apply, unless the resident registers a branch, in which case the income derived by the non-resident will be subject to taxation on the net basis with the potential limitations and divergences as pointed out in Part I of this chapter.

453 The tax treaties with China and Singapore contain the following provision: “The term “permanent establishment” likewise encompasses: The furnishing of services, including consultancy services, by an enterprise of a Contracting State through employees or other engaged personnel in the other Contracting State, provided that such activities continue for the same project or a connected project for a period or periods aggregating more than six months within any 12-month period.”

454 The pre-2017 version of the UN MTC states: “The term “permanent establishment” also encompasses: (b) The furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose, but only if activities of that nature continue (for the same or a connected project) within a Contracting State for a period or periods aggregating more than 183 days in any 12-month period commencing or ending in the fiscal year concerned.”

455 Article 746 of Decree 9,580/2018.

456 Article 765 of Decree 9,580/2018.

457 In this context, most of the tax treaties that Brazil has in force include a particular provision in the so-called protocols, which establishes that such services are to be taxed as royalties. The tax treaties with Austria, Finland, France, Japan and Sweden do not contain such protocol.
11.5.7. Insurance PEs

833. The insurance provision in Article 5, paragraph 6, is only seen in the UN MTC and deals with some special characteristics of insurance. This provision deems a PE to exist where an insurance enterprise “collects premium in the territory of that other State or insures risks situated therein through a person other than an agent of an independent status to whom paragraph 7 applies.” There is no reference to reinsurance, where the risk has been transferred from one insurance company to another.

834. Fifteen out of Brazil’s 33 tax treaties currently in force include the insurance PE provision. Only four of these 15 tax treaties explicitly refer to reinsurance and include the reinsurance activities into the scope of the insurance PE provision, i.e. the tax treaties with Mexico, the Netherlands, Peru and the Philippines.

835. In the context of insurance, since the sector is regulated in Brazil, it is understood that the foreign entity has to formalise a branch to operate its activities in the country, and therefore, net taxation would be triggered under the same rules applicable to enterprises domiciled in Brazil.

836. In the absence of any registration of the branch, to the extent that the payments are made from Brazil to the foreign entity from the insurance activity provided, the income paid, credited, delivered, employed or remitted abroad are subject to a withholding tax.

837. With respect to reinsurance, the tax administration issued Private Ruling 91/2018. The taxpayer had submitted a query questioning the tax treatment of a reinsurance activity in Brazil. The ruling provided that a “local reinsurer” and an “admitted reinsurer” with a representative office that actually acts with full power in reinsurance operations must be taxed on a net basis according to the income tax rules applied for such activity.

838. Moreover, the abovementioned ruling also established that for the “eventual reinsurer” and the “admitted reinsurer” with a representative office in the country that operates only through ancillary activities, the income paid, credited, delivered, employed or remitted abroad, is subject to a withholding income tax at the rate of 25%, since the reinsurer is engaged in providing services.

839. The private ruling indicated that it did not analyse the tax treatment under a tax treaty scenario, where the “local reinsurer” and the “admitted reinsurer” perform activities with a representative office that actually acts with full power in reinsurance operations, since the taxpayer did not indicate the relevant tax treaty and the respective provision in the query, nor the relevant facts for the analysis.

840. No further guidance on the characterisation of an insurance or reinsurance PE, or on the attribution of profits to insurance or reinsurance PEs, is provided under the domestic legislation.

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458 Tax treaties with Argentina, Austria, Belgium, Canada, Denmark, Ecuador, France, Italy, Luxembourg, Mexico, the Netherlands, Peru, the Philippines, Spain, and Sweden.

459 The insurance activity is regulated by Law 4,594/1964, Decree 73/1966, and Decree 56.903/1965 which regulates the life insurance activity.

460 Article 746 of Decree 9,580.

461 Complementary law 126/2007 regulates the reinsurance activity.

462 Private Ruling (Solução de Consulta) nº 91/2018.
11.5.8. Brief overview of Brazilian case law regarding PEs

841. In this section, a brief overview of the relevant case law involving PEs is presented. Brazilian courts addressed questions related to the existence of a PE, which consecutively raise issues regarding allocation of taxing rights and also attribution of profits, i.e. net taxation on profits versus gross taxation at source.

Judicial case law

842. The first case is a decision rendered by a federal court.\textsuperscript{463}

843. Brazilian entity A, the subsidiary of a French entity, was engaged by another Brazilian company to provide services in the automotive industry. Entity A hired its French shareholder to provide administrative and commercial support regarding the provision of the services. Entity A filed a request in order to avoid withholding income tax on the remittances paid abroad related to service payments under the application of Article 7 of the Brazil-France tax treaty (business profits), with the argument that only France had taxing rights because of the absence of a PE in Brazil. It should be noted that the Brazil-France tax treaty does not contain the technical services provision which would establish that such services should to be taxed as royalties and not as business profits.

844. However, the Federal Court concluded that entity A was a “type of permanent establishment of the French entity”, and that the formation of the Brazilian company was part of a tax planning scheme with the objective to avoid the characterisation of a PE. Therefore, the entity was subject to a withholding income tax on the remittances paid abroad to the French entity.

845. In another case, however, a second level decision was given by a federal court in the sense that a withholding income tax on the remittances made from Brazil to the foreign company could not be charged due to the application of Article 7 of the applicable tax treaty. In this case, the Brazilian entity paid amounts related to the contract signed with its Dutch shareholder for the reimbursement of costs in respect of the deployment of a software to be used by the whole group. The court held that the mere fact that the parent company is a controller of the legal entity domiciled in Brazil was not sufficient to characterise a PE, provided that the events generating the income in Brazil are under the authority and decision of that controlling company and not the other, which occasionally acts as its agent, without autonomy to conclude contracts.\textsuperscript{464} In this sense, it was concluded that the entity in Brazil was not a PE of the Dutch parent company, and as such the withholding income tax on the remittance could not be levied in Brazil as a consequence of the application of Article 7 of the applicable tax treaty.\textsuperscript{465}


\textsuperscript{464} Regional Federal Court for the third region (TRF3), Case nº 0025200-76.2007.4.03.6100. Accessed at http://web.trf3.jus.br/consultas/Internet/ConsultaProcessual. The government’s appeal against the decision was dismissed by the Superior Court of Justice (STJ), and the decision became final and unappealable in August 2018.

\textsuperscript{465} Other three judicial cases, in a similar context, generally concluded that a shareholding per se could not automatically give rise to a permanent establishment in Brazil: Regional Federal Court for the first region (TRF1), Case nº 0044229-29.2000.4.01.3800, decision appealed by the government and the admissibility of the appeal to the Superior Court of Justice is still pending; Regional Federal Court for the second region (TRF2), Case nº 0025802-26.2003.4.02.5101, decision is still pending at the Superior Court of Justice (REsp nº 1713496); Regional Federal Court for the third region (TRF3), Case nº 0002035-92.2010.4.03.6100, final decision.
Administrative case law

846. The CARF in Brazil has recently issued two relevant decisions. These decisions do not seem to represent the position of the administrative court on the issue, since they were not analysed by the Superior Chamber (last instance within the administrative court), and the issue under discussion relates to a specific scenario under the Brazil-France tax treaty, which, as indicated before, does not contain the specific provision that tax the income from technical service as royalties.

847. The first case is related to a Brazilian entity which engaged in the manufacturing, trade, import, export and distribution of auto parts and the provision of services relating to R&D and technical analysis of the automotive industry. The Brazilian entity remitted management fee payments abroad to two other French group companies that provided administrative services, such as marketing, programme administration, accounting, treasury, legal issues, insurance, human resources, etc.

848. In analysing whether Article 7 of the Brazil-France would be applicable, the administrative court concluded that the Brazilian company was a PE of the French company, because it understood that the scope of the contracted services (e.g. general management and treasury) demonstrated that the French companies performing their activities in Brazil through the Brazilian company satisfied the conditions established in Article 5 of the Brazil-France tax treaty. In this context, the court ruled that the profits of the PE should be taxed at source by way of the withholding income tax.

849. In another case, the tax authorities also characterized a PE in Brazil (not formally registered as a branch or representative office) in a service agreement which involved a French company. The decision stated that the exception in article 7 of the Brazil-France tax treaty applied to permit the taxation of the PE in Brazil and, therefore, the application of the withholding income tax on the remittance of the payments made from the PE in Brazil to the French company, i.e. a gross basis of taxation.

850. In both decisions, a PE was recognised and the court concluded that PEs should not have the same tax treatment as Brazilian legal entities, but rather, that in the recognition of a PE without formal registration as a branch or representative office, profits should be taxed at source, on a gross basis, by way of a withholding tax.

851. These two administrative decisions are not yet final, since they were subject to an appeal to the Superior Chamber of CARF (the final decision is pending since 2016). The outcomes of the conclusions established in the two decisions received criticism from some authors in Brazil, especially from the fact that the decision maintained the withholding income tax. Some authors hold the opinion that when the PE is recognised (even when not formally registered in Brazil as a branch or representative office) in accordance with Article 7, the profits of the non-resident should be subject to tax on its net income. The reason for levying the withholding tax is, nevertheless, possibly the fact that the PE was not registered and there may be cases where no additional information is available to the tax administration to assess the tax on the net basis. It may thus need to be considered whether a special mechanism should be foreseen in such cases, where the PE is constituted in accordance with Article 5, to permit the taxpayer to present all the relevant information and allow him to assess its taxes on a net basis.

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466 CARF, Second Chamber, judgment 2202-003.063 and 2202-003.114. It is important to highlight that the decisions were issued by the same chamber of CARF. In addition, the decisions were not unanimous and one of them was decided on a casting vote of the president of the panel.

467 CARF, Second Chamber, judgement 2202-003.063 (09.11.2015).
11.6. Assessment of effectiveness

Issues pertaining to the nexus rules

852. The analysis above indicates that most of the concepts foreseen in Article 5 of the OECD MTC are in some form present in Brazil, but there is a distinction made concerning whether the PE is formally registered or not. In cases where there is no formal registration of the PE, the tax is levied on a gross basis – the approach of levying tax on the non-resident’s income at source is used, while where the PE is registered, the tax is due on a net basis. The domestic law thus establishes a tax liability, which is in some cases broader than what the provisions of Article 5 would foresee and in other cases potentially narrower, which could also give rise to BEPS risks and avoidance practices.

Findings of the assessment

Prevention of BEPS risks

There are several instances where the status of PE may be potentially avoided due to the fact that Brazil did not take a comprehensive approach to the adoption of the recommendations of BEPS Action 7 in the domestic law, and only a sporadic and inconsistent approach was identified in the renegotiation of the tax treaties of Brazil. In addition, the domestic source taxation rules may not effectively capture the different scenarios which arise when income is derived and earned in Brazil but not necessarily paid out from Brazil.

Prevention of double taxation

The broad approach foreseen in the tax liability established with reference to taxation of income of sources and the lack of guidance and also lack of consistent jurisprudence on the interpretation of the tax treaty provisions, which legally may constrain the application of domestic laws, may potentially give rise to tax liabilities even where such tax liabilities are not specifically foreseen in the bilateral tax treaties. This may give a rise to unrelieved double taxation.

Ease of tax administration

The source taxation approach may reduce the tax administration burden in many instances, because the tax is levied at source and minimum tax administration efforts are needed, given that the tax is withheld by the paying agent.

Ease of tax compliance

The lack of clarity on the registration process involving registration of establishment PE can make it burdensome for taxpayers to register the PE, which may on one side be a motivation for non-compliance and on the other hand may also lead to over-usage of the withholding mechanism, which may simplify the tax administration for taxpayers at the cost of potential over-taxation.
Tax certainty

The lack of clear guidance on the application of the current nexus rules in tax treaty scenarios may create uncertainty as to whether income is liable to tax or not. The administrative practices as presented through the cases initiated in the courts indicate inconsistency and the use of potentially contradictory approaches.

The source taxation approach may also create uncertainty as to how it should be applied when the income was not effectively paid out of Brazil, but was earned in Brazil.

The approach used in Brazil of applying gross taxation even in cases where net taxation is foreseen in the tax treaty with the absence of a mechanism to permit the taxpayer to file the tax return and present the necessary information to allow a net taxation assessment creates significant uncertainty and potentially also constitutes a violation of the relevant tax treaty provisions.
Part III Options for alignment of the Brazilian transfer pricing rules with the OECD Transfer Pricing Guidelines
Way forward to achieve full alignment

This chapter summarises the findings of the assessment of the strengths and weaknesses of the Brazilian transfer pricing framework and groups the issues identified in ten key areas. It then provides the rationale for changing the current situation in Brazil and makes recommendations to resolve these issues.
Introduction

853. As part of future accession discussions, terms, conditions and process for the accession to the OECD based on the commitments to align policies with OECD standards must be set with the objective of enabling the decision whether to invite Brazil to accede and thereby become a member of the OECD.

854. Accordingly, Brazil will undergo in-depth reviews by different OECD technical committees, including the Committee on Fiscal Affairs. This review by the technical committees entails an evaluation of the willingness and ability of Brazil to implement any substantive OECD legal instruments within the Committee’s competence and an evaluation of Brazil’s policies and practices as compared to OECD best policies and practices in this area.

855. The basis for the review is a confidential questionnaire that identifies ten key areas in the chapter dedicated to transfer pricing. The issues raised as part of the assessment of the strengths and weaknesses of the Brazilian transfer pricing rules and administrative practices can be categorised in accordance with these ten areas.

856. While the following paragraphs are not intended to describe the questionnaire designed to collect the information necessary for the relevant subsidiary body of the Committee on Fiscal Affairs (i.e. Working Party No. 6) to determine whether the Brazilian transfer pricing system is sufficiently aligned with the OECD standard, the same structure is used. In each area or grouping, the issues are summarised with reference to the relevant OECD guidance, followed by the rationale for changing the existing rules.

857. The “Taxation of Multinational Enterprises” – i.e. the determination of transfer pricing between associated enterprises – will be the subject of a review by the Working Party No. 6 (WP6). As noted above, the questionnaire is organised in ten sections, which contain questions on the various aspects of transfer pricing legislation. The assessment of the strengths and weaknesses of the Brazilian transfer pricing framework gave rise to a number of issues. These issues and other considerations are discussed under the relevant sections.

858. The importance of these issues should be viewed according to whether the rules in question achieve the dual policy objective of transfer pricing rules, namely to secure the appropriate tax base and to avoid double taxation. The achievement of other tax policy objectives (ease of tax compliance, ease of tax administration, and tax certainty), while important from a tax policy and tax administration point of view, are not specifically addressed in the review process by WP6. The elements contributing towards the achievement of these objectives are nevertheless also noted, as achieving these objectives would contribute to keeping the system simple and practical, and this is a desirable outcome in the pursuit of a modern and efficient system, as long as these elements are in line with the OECD transfer pricing standard.

859. Achieving full alignment implies resolving the issues highlighted in this part of the report. Therefore, both immediate alignment and gradual alignment entail the resolution of these issues.

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468 See Part II of this report. The issues identified stem from the absence of concepts covered in the OECD Guidelines, insufficient guidance or absence of guidance for certain types of transactions, specificities and peculiarities of the Brazilian system, issues due to the design of the existing rules, issues related to specific policy decisions and issues arising from other rules that interact with the transfer pricing rules.
1.1. OECD Council Recommendation on the Determination of Transfer Pricing between Associated Enterprises and future BEPS Recommendations

860. The first area under review concerns the 1995 OECD Council Recommendation\(^ {469}\) and the Council Recommendation related to the BEPS transfer pricing outcomes,\(^ {470}\) as well as their implementation. Whether the jurisdiction is a member of the Inclusive Framework on BEPS to support and monitor the implementation of the BEPS package is also evaluated.

1.1.1. Adherence to the OECD Council Recommendations on transfer pricing

861. The 1995 Council Recommendation recommends to (i) follow, when reviewing, and if necessary, adjusting transfer pricing between associated enterprises for the purposes of determining taxable income, the OECD Guidelines – considering the whole of the Guidelines and the interaction of the different chapters – for arriving at arm’s length pricing for transactions between associated enterprises; (ii) encourage taxpayers to follow the Guidelines; and to that effect give the Guidelines publicity and have them translated, where necessary, into their national language(s); and (iii) develop further co-operation, on a bilateral or multilateral basis, in matters pertaining to transfer pricing.

862. The 2016 BEPS Recommendation recommends to follow the guidance set out in the Actions 8-10 Report and the Action 13 Report of the BEPS Project. These reports have produced a number of recommendations in the area of transfer pricing. They were designed to tackle transfer pricing issues relating to:\(^ {471}\)

- Transactions involving intangibles (BEPS Action 8);
- Contractual allocation of risks, and the resulting allocation of profits to those risks (BEPS Action 9); and
- Other high-risk areas (BEPS Action 10), including: the scope for addressing profit allocations resulting from transactions which are not commercially rational for the individual enterprises concerned (re-characterisation); the scope for targeting the use of transfer pricing methods in a way which results in diverting profits from the most economically important activities of the MNE group; and neutralising the use of certain types of payments between members of the MNE group (such as management fees and head office expenses) to erode the tax base in the absence of alignment with value creation.

863. As a result, new or revised guidance was issued in Chapter I, Section D (accurate delineation of transactions, framework for analysis of risk, non-recognition of transactions and guidance on location savings and other local market features, assembled workforce, and MNE group synergies), in Chapter II (commodity transactions), in Chapter VI (intangibles, including hard-to-value intangibles), in Chapter VII (low value-adding intra-group services), and in Chapter VIII (cost contribution arrangements). Conforming changes were also made to Chapter IX (business restructurings). These key concepts and elements of the guidance are discussed in more detail in other parts of this report.\(^ {472}\)

\(^ {469}\) OECD/LEGAL/0279.

\(^ {470}\) OECD/LEGAL/0424.


\(^ {472}\) See Section 1.2 (Statement and application of the arm’s length principle) and Section 1.5 (Special considerations).
864. The BEPS Project also led to the development of “rules regarding transfer pricing documentation to enhance transparency for tax administration” (BEPS Action 13), consisting of a three-tiered approach to transfer pricing documentation, namely: (i) a master file containing standardised information relevant for all MNE group members; (ii) a local file referring specifically to material transactions of the local taxpayer; and (iii) a Country-by-Country report containing certain information relating to the global allocation of the MNE’s income and taxes paid together with certain indicators of the location of economic activity within the MNE group. This resulted in new guidance in Chapter V (Documentation).

865. Additional work on transfer pricing was also undertaken to develop transfer pricing guidance on financial transactions, which was mandated by BEPS Action 4. Further, additional guidance on the attribution of profits to a permanent establishment was mandated under BEPS Action 7. Questions related to attribution of profits to a PE are discussed below in the context of the OECD legal instrument on this matter.

866. Being a member of the Inclusive Framework on BEPS is crucial to support and monitor the implementation of the BEPS package. To join the framework countries and jurisdictions are required to commit to the comprehensive BEPS package and its consistent implementation and to pay an annual BEPS Member fee. The programme of work of the Inclusive Framework is categorised in five strands of work: (i) standard setting in respect of remaining BEPS issues; (ii) reviewing the implementation of the four minimum standards; (iii) implementing decisions in terms of monitoring on the digital economy (BEPS Action 1) and the economic impact of BEPS (BEPS Action 11), (iv) gathering data on other aspects of implementation; and (v) implementation support, guidance and toolkits.

1.1.2. Current situation in Brazil

868. Brazil’s current position with respect to the recommendations of the 1995 OECD Council Recommendation is the following. Due to the specificities of the current transfer pricing system, in respect of recommendation (i), Brazil does not follow the OECD Guidelines, as revised over time, for arriving at arm’s length pricing for transactions between associated enterprises. In respect of recommendation (ii), the OECD Guidelines are not given publicity in Brazil and have not been translated to Brazilian Portuguese; taxpayers are also not actively encouraged to follow the Guidelines. Finally, in respect of recommendation (iii), it can be argued that Brazil does develop further co-operation, on a bilateral or multilateral basis, in matters pertaining to transfer pricing.

869. In relation to the recommendations formulated by the 2016 BEPS Transfer Pricing Recommendation, Brazil has not implemented the key concepts and guidance resulting from the work

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474 See Section 5.1 (Special considerations).


477 See Section 1.10 (Determination of a permanent establishment’s profits).
mandated by BEPS Actions 8-10 due to the specificities of the current system. As regards BEPS Action 13, Brazil implemented Country-by-Country Reporting.478

Table 1.1. Current situation in Brazil regarding the implementation of BEPS transfer pricing outcomes

<table>
<thead>
<tr>
<th>BEPS Actions related to transfer pricing</th>
<th>Status of implementation in Brazil</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aligning transfer pricing outcomes with value creation (BEPS Action 8-10)</td>
<td>No guidance was implemented.</td>
</tr>
</tbody>
</table>

870. Brazil is a member of the Inclusive Framework on BEPS.

1.1.3. Rationale for the change

871. With its perceived emphasis on contractual allocations of functions, assets and risks, the guidance on the application of the arm’s length principle proved vulnerable to manipulation. This manipulation could lead to outcomes which do not correspond to the value created through the underlying economic activity carried out by the members of an MNE group. It is within this context that the recommendations under Actions 8-10 of the BEPS Action Plan were developed to ensure that transfer pricing outcomes are better aligned with value creation. As will be discussed in further details in the relevant parts of this section, new guidance provides the tools to tax administrations to effectively address situations of base erosion and profit shifting. The absence of the key concepts resulting from the BEPS Project in the domestic law prevents the Brazilian tax authorities from effectively tackling profit shifting practices and the absence of specific rules creates misalignment. Therefore, the existing framework creates opportunities for base erosion and profit shifting and risks of double taxation.

1.1.4. Way forward

872. To achieve full alignment, it is required that Brazil adhere to the 1995 Council Recommendation and the 2016 BEPS Transfer Pricing Recommendation. Accordingly, Brazil is required to follow the OECD Guidelines and to implement the transfer pricing outcomes of the BEPS Project.

Table 1.2. Implementation of the BEPS transfer pricing outcomes

<table>
<thead>
<tr>
<th>BEPS Actions related to transfer pricing</th>
<th>Way forward</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aligning transfer pricing outcomes with value creation (BEPS Actions 8-10)</td>
<td>Implement BEPS Actions 8-10 recommendations, including guidance on accurate delineation of transactions, framework for analysis of risk, non-recognition of transactions and guidance on location savings and other local market features, assembled workforce, and MNE group synergies, intangibles, including hard-to-value intangibles, low value-adding intra-group services and cost contribution arrangements.</td>
</tr>
<tr>
<td>Guidance on transfer pricing documentation and Country-by-Country Reporting (BEPS Action 13)</td>
<td>Implement the remaining of the BEPS Action 13 recommendations, namely the master file and the local file.</td>
</tr>
</tbody>
</table>

1.2. Statement and application of the arm’s length principle

873. The second area concerns the statement and application of the arm’s length principle.

1.2.1. The arm’s length principle

874. The arm’s length principle is the cornerstone of transfer pricing rules. It is embedded in treaties and appears as Article 9, paragraph 1, of the OECD and UN Model Tax Conventions. A shared interpretation of the principle by many of those countries is set out in the OECD Guidelines, first published as the Report on Transfer Pricing and Multinational Enterprises in 1979, revised and published as Guidelines in 1995, followed by regular updates, with a significant further update in 2017.\(^{479}\) The principle requires that transactions between associated enterprises be priced as if the enterprises were independent, operating at arm’s length and engaging in comparable transactions under similar conditions and economic circumstances. Where the conditions of the transaction are different to those between third parties in comparable circumstances, adjustments to the profits may be needed for tax purposes.

875. This section explores the elements of Brazil’s transfer pricing framework which demonstrate the implementation of the arm’s length principle. Elements that deviate from the OECD Guidelines should are also discussed in this section. Second, it addresses the definition of “related parties (associated enterprises)” and the scope of “transactions covered”.

1.2.2. Current situation in Brazil

Restatement of the arm’s length principle

876. Brazil’s domestic legislation does not restate the arm’s length principle and arguably does not embody the arm’s length principle. The arm’s length principle is only stated in the bilateral tax treaties concluded by Brazil.

877. In terms of rules that deviate from the OECD Guidelines, the most apparent example is the use of predetermined, fixed margins for the application of the Brazilian methods that are broadly equivalent to the OECD-recognised resale price and cost plus methods. Such methods are however not fully equivalent to the OECD-recognised resale price and cost plus methods because they do not always produce arm’s-length outcomes. The existence of fixed margins has broad implications when considering the application of the arm’s length principle as foreseen in the OECD Guidelines. Notably, a complete comparability analysis relying on available comparables to calculate these margins is no longer necessary.\(^{480}\)

878. The definition of related parties and the scope of transactions covered present a number of differences as well.

Broader personal scope

879. The scope of application of the transfer pricing rules is different from the scope foreseen in the OECD Guidelines. The personal scope is notably broader.\(^{481}\) This broader scope resembles features in

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\(^{480}\) See Section 1.4 (Comparability issues).

\(^{481}\) It targets the transactions with entities established in low-tax jurisdictions or benefiting from preferential tax regimes, in addition to other situations that qualify parties as being related, including relations involving a legal entity domiciled
other OECD countries’ frameworks and is clearly motivated by an anti-abuse objective, which aims to address situations of information asymmetry and situations of high likelihood of BEPS risks.

*Narrower material scope*

880. Also differently from the OECD Guidelines, the material scope is narrower in that the transfer pricing rules expressly exclude outbound royalties and outbound payments in regard to technical, scientific, administrative or similar assistance. These exclusions are explained by the existence of special measures which limit the deduction of the relevant expenses. The interaction between the transfer pricing rules and these special deductibility limitations is clear in that the aforementioned types of transactions are excluded from the material scope.

*Territorial scope*

881. The territorial scope of the Brazilian transfer pricing rules is limited to cross-border transactions, and they do not apply to transactions between associated enterprises conducting domestic transactions within Brazil. This aspect of the scope is not evaluated in the review by WP6, but it remains relevant for the prevention of BEPS risks because Brazil operates various special regimes domestically and also does not allow for group consolidation of losses.

1.2.3. *Rationale for the change*

882. The restatement of the arm’s length principle in the domestic law would guarantee that the Brazilian transfer pricing rules are based on this key principle, which is to be applied in accordance with the OECD Guidelines, or at least that this principle will be the leading principle used to eliminate double taxation that could result from a transfer pricing adjustment.

883. Assuming that the alignment of key policies and practices is achieved, the broader personal scope does not represent a critical issue. It is also noted that a number of other OECD member countries have a similarly broad scope. The consequence of this broader scope is an increase of the compliance burden for taxpayers concerned who will have to demonstrate compliance with the arm’s length principle, which is justified by the need to assess the arm’s-length nature of more risky types of transactions, as it allows to overcome the issue of information asymmetry.

884. The narrow material scope issue, however, is more critical. It is necessary that transfer pricing rules appropriately cover all types of controlled transactions, notably transactions involving intra-group services and intangibles. The application of special measures to specific types of transactions which create BEPS risks could be contemplated, as was done for example in BEPS Actions 2 and 4. Such measures, if appropriately designed, could address the BEPS risks while care should be taken to prevent double taxation and ensure compliance with other international obligations, such as non-discrimination clauses in bilateral tax treaties. This would mean that the transfer pricing rules will co-exist with the special measures

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in Brazil and a non-resident individual who is a relative or kin down to the third degree, spouse or cohabitant of its directors or officers, or of its direct or indirect controlling partner or shareholder; a non-resident individual or legal entity for which the Brazilian entity is the exclusive agent, distributor or dealer of the Brazilian entity for the purchase and sale of goods, services and rights; or a non-resident individual or legal entity for which the Brazilian entity is the exclusive agent, distributor or dealer for the purchase and sale of goods, services and rights.

482 It should be noted that the OECD Guidelines do not address domestic issues and only focus on the international aspects of transfer pricing.

483 It is worth noting, however, that there are specific anti-abuse provisions in the Brazilian income tax rules, which are known under the term “disguised distribution of profits” (DDL), governed by Article 60-62 of Decree 1,598/1977. However, the scope of this rule is limited and it may not provide full protection against BEPS risks.
where the transfer pricing rules will help to appropriately allocate the tax base (items of income as well as expenses) among the members of the MNE group, and the special measures may in some instances reasonably limit the amount of deductions in respect of some types of payments (e.g., interest payments or other).

1.2.4. Way forward

885. The arm’s length principle should be clearly restated in the domestic law, and more specifically the primary law, to ensure that the rules and administrative practices are consistent with the arm’s length principle and their application is in line with the guidance for applying the arm’s length principle contained in the OECD Guidelines. It is especially necessary to prevent the risk of divergent outcomes of transfer pricing adjustments in cross-border situations leading to double taxation and creating risks that double taxation cases will not be effectively resolved.

886. A number of elements in the current system constitute deviations from the arm’s length principle and will need to be addressed as a consequence; notably, the absence of complete comparability analysis, the fixed margins approach, and the freedom of selection of the transfer pricing method. These elements, among others, are discussed and elaborated upon in further subsections.

887. The broader personal scope of the existing transfer pricing rules clearly addresses situations of low or no taxation and information asymmetry. The current proposal for a global minimum tax discussed under Pillar 2, as part of the discussions on the tax challenges arising from the digitalisation of the economy, is also relevant in this context. Its implications in addressing these challenges should therefore be monitored and considered in the implementation phase. One possible way to refine the personal scope would be to allow for the parties to the transaction to provide the necessary information to demonstrate that it has been carried out at arm’s-length, and thus to overcome the challenge of information asymmetry that usually motivates these types of measures.

888. The material scope would have to be modified to ensure that double taxation cases resulting from inconsistencies across jurisdictions would be effectively resolved. This could be addressed by broadening the material scope to include outbound royalty payments and outbound payments in regard to technical, scientific and administrative assistance. Special measures could be retained if they comply with international obligations, but refining the existing rules applicable to these out-of-scope transactions could also be considered.

889. Finally, the current transfer pricing rules do not address the BEPS risks in the domestic context. Therefore, broadening the territorial scope of transfer pricing rules can also be considered to also cover the domestic intra-group transactions involving BEPS risks or to address these risks by other equally effective special measures or anti-avoidance rules.

Table 1.3. Statement and application of the arm’s length principle

<table>
<thead>
<tr>
<th>Issues/divergences</th>
<th>Way forward</th>
</tr>
</thead>
<tbody>
<tr>
<td>Restatement of the arm’s length principle</td>
<td>Restate the arm’s length principle in the primary law.</td>
</tr>
<tr>
<td>Deviations from the arm’s length principle</td>
<td>Change or refine elements in the system that deviate from the arm’s length principle (e.g., fixed margins, comparability issues, etc.) – see relevant sections.</td>
</tr>
<tr>
<td>Scope of application of transfer pricing rules</td>
<td>Refine the scope as necessary by addressing issues related to the personal, material, and territorial scopes.</td>
</tr>
</tbody>
</table>

1.3. Transfer pricing methods

The third area concerns the transfer pricing methods available, the hierarchy among the transfer pricing methods and the criteria to determine the selection of a transfer pricing method.

1.3.1. Availability of methods and selection of a transfer pricing method

The approach for the application of transfer pricing methods has been clarified over time in the OECD Guidelines to respond to a number of transfer pricing challenges, which arise in the context of increasingly global value chains of MNE groups. The OECD Guidelines provide for five OECD-recognised methods that can be used to establish whether the conditions imposed in the commercial or financial relations between associated enterprises are consistent with the arm’s length principle. In addition, “other methods” can also be applied provided they are the most appropriate method.

Five OECD-recognised methods

The OECD-recognised methods include three “traditional transaction methods”, namely the comparable uncontrolled price (CUP) method, the resale price method, and the cost plus method and two “transactional profit methods”, namely the transactional net margin method (TNMM) and the transactional profit split method.

As noted above, the OECD Guidelines give the possibility to apply “other methods” that are not described in Chapter II of the Guidelines, provided the prices established through the other method satisfy the arm’s length principle and the taxpayer can justify that it is the most appropriate method. Their selection should be supported by an explanation of why OECD-recognised methods were regarded as less appropriate or nonworkable in the circumstances of the case and of the reason why the selected other method was regarded as providing a better solution.

Selection of the method

The 2010 update of the Guidelines introduced the most appropriate method criterion, according to which the transfer pricing method must be selected where it is found to be the most appropriate method to the case at hand. Previously, the hierarchy for the selection of a transfer pricing method as established in 1995 imposed an order for the application of the methods. It was replaced by the most appropriate method criterion in 2010, although it is still recognised that “[where] a traditional transaction method and a transactional profit method can be applied in an equally reliable manner, the traditional transaction method is preferable to the transactional profit method” and that “[where] the CUP and another transfer pricing method can be applied in an equally reliable manner, the CUP method is to be preferred”. The determination of the most appropriate method relies on a number of factors. They include the respective strengths and weaknesses of the OECD-recognised methods; the appropriateness of the method considered in view of the nature of the controlled transaction, determined in particular through a functional analysis; the availability of reliable information (in particular on uncontrolled comparables) needed to apply the selected method and/or other methods; and the degree of comparability between controlled and uncontrolled transactions, including the reliability of comparability adjustments that may be needed to eliminate material differences between them.

1.3.2. Current situation in Brazil

Brazil adopted methods inspired by the three traditional transaction methods used for the determination of an arm’s length consideration:

See paragraph 2.3 of the OECD Guidelines.
Four methods are conceptually broadly similar to the OECD-recognised comparable uncontrolled price (CUP) method. The first two are the “comparable independent price” method (Preços Independentes Comparados, PIC) for imports and the “export sales price” method (Preço de Venda nas Exportações, PVEx) for exports. Two special methods also apply to transactions involving specific commodities: the “price under quotation on import” (Preço sob Cotação da Importação, PCI) and the “price under quotation on export” (Preço sob Cotação da Importação, PECEX) methods.

Three methods are conceptually broadly similar to the OECD-recognised resale price method: the “resale price less profit” method (Preço de Revenda Menos Lucro, PRL) for imports, the “wholesale price in the country of destination less profit” method (Preço de Venda por Atacado no País de Destino, Diminuído do Lucro, PVA) for exports and the “retail price in the country of destination less profit” method (Preço de Venda a Varejo no País de Destino, Diminuído do Lucro, PVV) for exports.

Two methods are conceptually broadly similar to the OECD-recognised cost plus method: the “production cost plus profit” method (Custo de Produção Mais Lucro, CPL) for imports and the “acquisition or production cost plus taxes and profit” (Custo de Aquisição ou de Produção Mais Tributos e Lucro, CAP) for exports.

The transfer pricing methods are classified between those that apply to import transactions and those that apply to export transactions. The main consequence of this distinction is the application of different fixed margin percentages from one method to the other.

The absence of transactional profit methods among the available transfer pricing methods in the Brazilian transfer pricing rules, which are commonly accepted and used around the world, represents another significant divergence.

In Brazil, the taxpayer is free to select any of the transfer pricing method provided in the legislation, regardless of whether is the most appropriate method in a particular case as would be determined based on OECD guidance. The use of “other methods” is not allowed, meaning that any other methods than those provided in the legislation cannot be considered, which represents another limitation or gap compared to the OECD guidance.

1.3.3. Rationale for the change

The five OECD-recognised methods represent the international consensus on the manner of applying the arm’s length principle. It is therefore necessary that all five methods be made available and applied in accordance with the OECD Guidelines.

The use of “other methods” would be useful in the circumstances where the use of the five OECD-recognised methods would be less appropriate. However, the application of “other methods” should be carefully foreseen in the legislation because they should be applied only if they are the most appropriate methods or in very specific situations (e.g., where no comparables are available for transfers of hard-to-value intangibles).

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486 Special considerations for commodities are addressed under Section 1.5.

487 As an exception to the rule, the application of the methods designed for commodity transactions is mandatory. Interest payments derived from financial transactions are also subject to a specific methodology.

488 “In cases where other methods are used, their selection should be supported by an explanation of why OECD-recognised methods were regarded as less appropriate or nonworkable in the circumstances of the case and of the reason why the selected other method was regarded as providing a better solution.” Paragraph 2.9 of the OECD Guidelines. In the context of Brazil,
901. More specifically, introducing the two transactional profit methods in Brazil would provide several advantages, in line with the common international approach for the application of transfer pricing methods as prescribed in the OECD Guidelines. First, the transactional net margin method (TNMM) could provide a useful tool to fight tax planning strategies because it allows to assess comparability at the net profit level, and this could lead to further protection against BEPS risks. When appropriately applied, it also simplifies the transfer pricing analysis while providing reasonable outcomes. Second, the profit split method can effectively address situations where the application of other methods may not determine a reasonable return for the activities or contributions made by the parties to the transaction. This is especially the case with respect to situations in which income is not appropriately allocated where the profit split method is found to be the most appropriate method, especially for highly integrated transactions (e.g., global trading of financial instruments), transactions where each party makes unique and valuable contributions (e.g., use or transfer of intangibles), and transactions in which the parties share economically significant risks, or separately assume closely related risks.

902. The existing rule for the selection of the method in Brazil – i.e. the freedom of selection of the transfer pricing method – can lead to inappropriate results, and especially to significant BEPS risks, and therefore it would be advisable that the OECD principle for the selection of the most appropriate method be adopted instead. This principle ensures that the selected method is the most appropriate based on the specific facts and circumstances of the case at hand. Otherwise, free choice will provide tax planning opportunities and taxpayers will continue to be able to engage in method shopping by selecting the method that allocates the lesser amount of taxable income to Brazil.

1.3.4. Way forward

903. Full alignment requires the adoption of the five OECD-recognised methods. First, the existing transfer pricing methods, which are only broadly based on the three OECD-recognised traditional transaction methods, should be modified to become fully in line with the methods set out in the OECD Guidelines.

904. Second, the two OECD-recognised transactional profit methods should be introduced in the Brazilian transfer pricing system, namely:

- The transactional net margin method (TNMM), which constitutes an effective tool to fight tax planning strategies, and which also simplifies the transfer pricing analysis while providing reasonable outcomes (when appropriately applied); and
- The profit split method to address situations where income is not appropriately allocated, and in which it is the most appropriate method, especially for highly integrated transactions, transactions where each party makes unique and valuable contributions, and transactions in which the parties share economically significant risks, or separately assume closely related risks.

905. With this, the adoption of the most appropriate method criterion (in substitution of the freedom of selection of the method current in effect) is also necessary for the different available transfer pricing methods to be applied where they are found to be the most appropriate to the facts and circumstances of the case at hand, in line with the OECD Guidelines.

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the use of “other methods” would only be advisable if the selection of the most appropriate method is required; otherwise, including “other methods” in the options available to the taxpayers could have negative consequences.

489 The method also presents weaknesses, notably concerning the shifting of risk and intangibles.

490 The use of “other methods” is also an accepted approach under the OECD Guidelines that is part of the guidance on transfer pricing methods contained in Chapter II of the OECD Guidelines.
In this regard, the specific factors that are taken into account to make that determination should be made clear. In accordance with the OECD Guidelines, they would include their respective strengths and weaknesses; their appropriateness in view of the nature of the controlled transaction, determined in particular through a functional analysis; the availability of reliable information (in particular on uncontrolled comparables) needed to apply them; and the degree of comparability between controlled and uncontrolled transactions, including the reliability of comparability adjustments.

Retaining the existing criterion for the selection of the method, which is the freedom of selection, would not only represent a major divergence with the OECD standard, but it would also lead to significant revenue losses as taxpayers would always choose to apply the method that leads to the lowest tax liability possible. The application of any OECD-recognised method, without having regard to whether the method is appropriate given the facts and circumstances, does not necessarily lead to arm’s-length outcomes.

“Other methods”, such as valuation models, should only be made available when they are found to be the most appropriate method or in certain situations specified in the legislation (e.g., for transactions involving the use or transfer of intangibles, including hard-to-value intangibles, for transfers of shares, etc.).

### Table 1.4. Transfer pricing methods

<table>
<thead>
<tr>
<th>Issues/divergences</th>
<th>Way forward</th>
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</thead>
<tbody>
<tr>
<td>Freedom of selection of the transfer</td>
<td>Adopt the most appropriate method criterion.</td>
</tr>
<tr>
<td>pricing method</td>
<td></td>
</tr>
<tr>
<td>Traditional transaction methods with fixed</td>
<td>Align the existing methods to the OECD-recognised traditional transaction</td>
</tr>
<tr>
<td>margins</td>
<td>methods.</td>
</tr>
<tr>
<td>Absence of transactional net margin method</td>
<td>Introduce the OECD-recognised TNMM.</td>
</tr>
<tr>
<td>(TNMM)</td>
<td></td>
</tr>
<tr>
<td>Absence of profit split method</td>
<td>Introduce the OECD-recognised profit split method.</td>
</tr>
<tr>
<td>“Other methods” not permitted</td>
<td>Permit the use of “other methods”, including valuation techniques, if</td>
</tr>
<tr>
<td></td>
<td>demonstrated to be the most appropriate method and the five OECD-recognised</td>
</tr>
<tr>
<td></td>
<td>methods are shown to be less appropriate or nonworkable in the circumstances</td>
</tr>
<tr>
<td></td>
<td>of the case.</td>
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</tbody>
</table>

### 1.4. Comparability issues

The fourth area deals with comparability issues, namely with the definition of comparables, the distinction between internal and external comparables, guidance on the determination of whether comparables are actually comparable, etc.

#### 1.4.1. Comparability

The OECD Guidelines contain the definition of a “comparable uncontrolled transaction”, which can be either a comparable transaction between one party to the controlled transaction and an independent party (“internal comparable”) or between two independent parties, neither of which is a party to the controlled transaction (“external comparable”), as well as guidance on the use of internal and external comparables, non-domestic comparables and secret comparables.

The OECD Guidelines also set out how to establish whether there is comparability between the controlled and uncontrolled transactions being compared or for accepting the (potential) comparable by performing a comparability analysis. There are two key aspects in such an analysis: the first aspect is to
identify the commercial or financial relations between the associated enterprises and the conditions and economically relevant circumstances attaching to those relations in order that the controlled transaction is accurately delineated; the second aspect is to compare the conditions and the economically relevant circumstances of the controlled transaction as accurately delineated with the conditions and the economically relevant circumstances of comparable transactions between independent enterprises.

912. Further, the OECD Guidelines contain detailed guidance on the application of the arm’s length principle, including on the aggregation of transactions, the use of multiple year data, the determination of the arm’s length range, the effect of government interventions such as price controls in certain industry sectors, the use of statistical tools and databases, etc.

913. Finally, guidance is provided on when and how comparability adjustments can be made.

1.4.2. Current situation in Brazil

914. The Brazilian transfer pricing system does not rely on a complete comparability analysis similar to the one described in the OECD Guidelines.

Comparability issues

915. The methods broadly corresponding to the OECD-recognised CUP method (PIC and PVEx methods and PCI and PECEX methods) are very similar in terms of the extent to which they rely on a comparability analysis based on an identification of comparable uncontrolled transactions, but a higher degree of comparability is required, i.e. goods, rights or services must be identical or similar, and permitted comparability adjustments are strictly limited and focus mostly on differences pertaining to their physical nature or content.

916. Apart from the equivalents of the CUP method (PVEx and PIC methods, and PCI and PECEX methods), the concept of comparability is either completely absent, or is very limited and applies only in respect of the calculation of the average costs or sales prices of “similar” and “identical” goods, rights, or services in the case of methods which are equivalents of the cost plus method for imports and resale price method for exports.

917. This absence or limited need for comparables with some of the methods is due to the concept of fixed margins, which reduces the relevance of comparables in the case of all the methods which are equivalents of the cost plus and resale price methods. The acceptance of internal/external and local/foreign comparables depends on the method to be applied.

918. The use of information undisclosed to taxpayers (or so-called “secret comparables”) is typically not foreseen, unless the independent parties whose data is used agree to disclose this data to the assessed taxpayer.

919. Because of the significant differences between the transfer pricing analysis in the Brazilian system and the OECD system, legislative or administrative guidance on the application of the arm’s length principle is limited or simply does not exist. An important aspect of the comparability analysis is not foreseen, namely the identification of the commercial or financial relations between the associated enterprises and the conditions and economically relevant circumstances attaching to those relations in order that the controlled transaction is accurately delineated. Further, the determination of the arm’s length range, the effect of government interventions such as price controls in certain industry sectors, the use of statistical tools and databases, etc.

491 Except for the Brazilian versions of the resale price method for imports (PRL method) and the cost plus method for exports (CAP method), which do not rely on these concepts as they directly use the items involved in the transactions.
databases are not addressed by further legislative or administrative guidance because these considerations are irrelevant in the current configuration of the system.

920. The aggregation of transactions is not permitted because of the strict application of the item-per-item approach. The use of intentional set-offs is not addressed by the legislation and no guidance is provided on this matter.

921. Finally, comparability adjustments are limited both in terms of how and when they can be performed. Comparability adjustments are limited not only in terms of the types of comparability adjustments that can be performed, but also in terms of the transfer pricing methods that allow them, namely the Brazilian versions of the CUP method for imports, including the methods for commodity transactions (PIC/PVEx and PCI/PECEx methods) and the resale price related method for exports (PVA/PVV methods). Possible comparability adjustments are explicitly listed in the respective provisions.

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Fixed margins

922. The principal aspect of the Brazilian system that offers simplification is the use of fixed margins for the application of the Brazilian methods that are broadly equivalent to the OECD-recognised resale price and cost plus methods. In some cases, the fixed margins currently produce outcomes that are not in line with the arm’s length principle. They are also not designed according to a transparent methodology allowing for scrutiny. In addition, the existing mechanism that was supposed to provide for some degree of flexibility of the fixed margins is dysfunctional.

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1.4.3. Rationale for the change

Comparability issues

923. A complete comparability analysis, which should include a functional analysis and a risk analysis, as well as other comparability factors prescribed by the OECD Guidelines, is necessary for a number of reasons. Currently, many situations arise where the comparability factors which influence the arm’s-length pricing are disregarded, thereby leading to failures in terms of preventing BEPS risks and preventing double taxation. For instance, such situations may include those where fixed margins ignore the functional profile of the tested party and deviate from the arm’s-length margin that would be determined under a complete comparability analysis in line with the OECD Guidelines.

924. This change will require addressing several peculiarities (absence of complete comparability analysis, fixed margins approach, freedom of selection of the method, item-per-item approach, etc.) of the existing transfer pricing analysis in Brazil. If the complete comparability analysis is implemented based on the typical 9-step process of the OECD Guidelines, other comparability issues discussed above will need to be resolved. As part of the implementation of the complete comparability analysis, the role of

492 For the exhaustive list of the adjustments permitted for import transactions, see the items under Article 9, paragraph 1, of Normative Instruction 1,312/12; for export transactions see Article 22, paragraph 1. For the importation of commodities, see Article 16, paragraph 9; for the exportation of commodities, see Article 34, paragraph 10.

493 The mechanism to challenge the fixed margins, which appears to be designed in a way that does not facilitate its use by taxpayers, has not been successfully applied to date.

494 This includes the contractual terms of the transaction, the functions performed by each of the parties to the transaction, the characteristics of property transferred or services provided, the economic circumstances of the parties and of the market in which the parties operate, and the business strategies pursued by the parties.

495 See paragraph 3.4 of the OECD Guidelines.
comparables will become more prominent than under the current system and this concept will need to be introduced in the legislation.\textsuperscript{496} Relatedly, the existing provisions that limit allowable comparability adjustments and only concern a limited number of methods will have to be modified accordingly. Finally, the implementation of package deal or basket approaches (or other similar approaches) that would allow to combine or aggregate transactions – doing away with the strict item-per-item approach – in line with the evolution of the OECD Guidelines towards simplification (combined with the most appropriate method criterion), would be more workable that the item-per-item approach, which creates a number of practical challenges.\textsuperscript{497} Similarly, other legislative or administrative guidance on the application of the arm’s length principle (aggregation of transactions, arm’s length range, effect of government interventions, statistical tools and databases, etc.) will contribute to more accurate and reliable outcomes.

Fixed margins

925. For the existing fixed margins approach to remain part of the system, the various fixed margins should be transformed into safe harbours and refined to ensure conformity with the arm’s length principle. Importantly, such safe harbours must be based on sound economic and commercial analysis and accurately reflect industry practices and economic reality, which is not the case of the fixed margins currently.

926. Safe harbour provisions, if properly designed (in line with the arm’s length principle) and applied in appropriate circumstances (under specified entry criteria), can help to achieve some of the objectives currently addressed by the fixed margins and they may thus prove to be a more effective tool than the existing fixed margins, which are not carefully designed and lead to double taxation as well as significant revenue losses for Brazil, especially when combined with the freedom of choice of the transfer pricing method.

1.4.4. Way forward

927. All peculiarities related to the existing process of performing a transfer pricing analysis in Brazil need to be addressed through the implementation of the concept of complete comparability analysis, whereby the fixed margins are not applicable or in parallel thereof in the form of carefully tailored safe harbour regimes. This means that, as made possible by the introduction of concepts such as the functional analysis and the risk analysis, as well as the recognition of other comparability factors detailed in the OECD Guidelines, the current process needs to be replaced by the typical 9-step process (or a similar process) of the OECD Guidelines, starting with a preliminary analysis of the conditions of the controlled transaction, including the selection of the transfer pricing method and the identification of comparables, and ultimately a conclusion about whether the controlled transactions under review are consistent with the arm’s length principle.

928. Other issues identified with regard to the existing limited comparability analysis in Brazil need to be resolved. This also includes the role of comparables in the analysis, and relatedly, the comparability adjustments allowed, which are determined by following a principle-based approach (rather than definition-based). As the OECD Guidelines point out, there is a high risk in using various transfer pricing adjustments and therefore appropriate scrutiny would need to be exercised in practice, or alternatively, only some limited adjustments could be considered in the justified cases, especially in situations where experience shows that the various adjustments have led to abuse and BEPS issues. This could be considered as

\textsuperscript{496} Although it should not be understood as excluding the possibility of adopting more prescriptive approaches for restricting allowed comparables. For example, this could be the case if abuse is identified for specific types of transactions.

\textsuperscript{497} The possibility of grouping or combining transactions should still be carefully considered to achieve the objectives of simplicity while also preventing possible BEPS risks.
specific anti-avoidance measures to provide some protection against BEPS. Such approach may still need to be subject to mutual agreement procedure to prevent undesired outcomes of potential double taxation. Finally, the implementation of package deal or basket approaches (or other similar approaches) that allow combining or aggregating transactions is required to achieve full alignment with the OECD Guidelines.

929. Transforming the fixed margins into the safe harbours designed in line with the arm’s length principle, including carefully considered entry criteria, is essential to ensure that transfer pricing outcomes will be broadly consistent with the outcomes produced by complete comparability analysis according to the OECD Guidelines. The use of rebuttable presumptions could also be contemplated for selected groups of taxpayers or types of transactions, especially in cases where BEPS risks have been identified. However, the use of rebuttable presumptions should be carefully considered and it may also need to be made available to address potential double taxation through MAP.

Table 1.5. Comparability issues

<table>
<thead>
<tr>
<th>Issues/divergences/considerations</th>
<th>Way forward</th>
</tr>
</thead>
<tbody>
<tr>
<td>Limited comparability analysis</td>
<td>Introduce the complete comparability analysis in line with the adoption of the OECD-recognised transfer pricing methods.</td>
</tr>
<tr>
<td>Fixed margins</td>
<td>Transform the fixed margins into carefully designed safe harbours or rebuttable presumptions in line with the arm’s length principle and based on sound economic analysis.</td>
</tr>
<tr>
<td>Process of performing a comparability analysis</td>
<td>Introduce the 9-step process (or a similar process) of performing a comparability analysis in line with the OECD Guidelines.</td>
</tr>
<tr>
<td>Item-per-item approach</td>
<td>Eliminate the strict item-per-item approach, allow basket or package deal approaches, and address intentional set-offs.</td>
</tr>
<tr>
<td>Comparability adjustments</td>
<td>Consider allowing comparability adjustments on a principle basis in line with the OECD Guidelines.</td>
</tr>
<tr>
<td>Other</td>
<td>Provide for other necessary elements as part of the complete comparability analysis, including arm’s length range, effect of government interventions, statistical tools and databases, etc.</td>
</tr>
</tbody>
</table>

1.5. Special considerations

930. The fifth area focuses on special considerations that may apply to specific transactions. For some types of transactions, the application of the arm’s length principle requires special considerations in the form of tailored guidance, usually because of their complexity. However, it should be understood that these special considerations are based on the key principles found in Chapters I - III of the OECD Guidelines and follow the general guidance for applying the arm’s length principle.

1.5.1. Specific types of transactions

931. The section concerns special considerations which were developed to address specific transactions, including transactions relating to the following areas:

- Intangible property;
- Intra-group services;
- Cost contribution arrangements;
• Financial transactions between associated enterprises, including interest rates, guarantee fees, or other (e.g. insurance arrangements, captive insurance arrangements);
• Thin capitalisation rules and/or other rules on expenses relating to debt instruments (whether from associated or independent enterprises); how the thin capitalisation and/or other rules interact with domestic transfer pricing rules and with Article 9-type clause in bilateral tax treaties; and
• Commodities.

932. It also considers safe harbour rules and other simplification measures.

General observations

933. The principles of Chapters I - III of the OECD Guidelines apply equally to the transactions listed above. Under those principles, the analysis of cases involving these transactions should begin with a thorough identification of the commercial or financial relations between the associated enterprises and the conditions and economically relevant circumstances attaching to those relations in order that the actual transaction is accurately delineated. The functional analysis should identify the functions performed, assets used, and risks assumed by each relevant member of the MNE group.

934. The development of bespoke guidance has contributed to an internationally accepted common approach to the application of the arm's length principle to transactions involving the use or transfer of intangibles (including hard-to-value intangibles) in Chapter VI of the OECD Guidelines, intra-group services in Chapter VII, cost contribution arrangements in Chapter VIII, business restructurings in Chapter IX, and financial transactions (the draft guidance should be finalised soon and, once approved and published, will be included in the next edition of the OECD Guidelines).498

935. Further, special considerations for establishing the arm's-length price for the transfer of commodities between associated enterprises have been issued in the guidance framework of the CUP method in Chapter II. Safe harbour regimes are also the object of useful guidance in Chapter IV and offer potential benefits for both tax administrations and taxpayers (assuming they are carefully designed in line with the arm's length principle and based on sound economic analysis).

1.5.2. Current situation in Brazil

936. In Brazil, key principles, concepts and notions, such as the accurate delineation of the actual transaction and the comparability (including functional) analysis, have not been adopted or are not appropriately reflected in the transfer pricing analysis, which already proves challenging to grapple with issues related to high-risk areas. These differences are particularly apparent when dealing with specific transactions for which specially tailored guidance contained in the OECD Guidelines, if applied at the domestic level, is desirable.

Intangible property

937. Intangibles represent a particularly sensitive area from a transfer pricing perspective insofar as intangibles are by definition mobile and often hard to value. Misallocation of the profits generated by valuable intangibles has heavily contributed to base erosion and profit shifting. In Brazil, there are no special considerations for intangibles to ensure appropriate allocation of income as far as controlled transactions involving intangibles are concerned.

938. In the absence of such special considerations, the general transfer pricing rules apply to most types of transactions involving the transfer or use of intangibles, with the exclusion of outbound royalty

498 The guidance on transfer pricing aspects of financial transactions has not been published yet but it is underway.
payments and outbound payments for technical, scientific, administrative or similar assistance, which are addressed by a special measure limiting their deductibility by a fixed percentage.

939. The definition of intangibles contained in the private law, which is used in the absence of a special definition for transfer pricing purposes, may not be as broad as in the OECD Guidelines because the strict legal interpretation and potential accounting recognition rules may not reflect all intangible assets for the purposes of transfer pricing. Further, the concepts of development, enhancement, maintenance, protection, and exploitation (DEMPE) functions and risk control are not reflected in the Brazilian transfer pricing framework. In addition, the available transfer pricing methods may in most cases prove inappropriate to apply to transactions involving the use or transfer of intangibles.

940. For transactions involving the use or transfer of intangibles, guidance has evolved under the OECD framework principally to clarify that legal ownership alone does not necessarily generate a right to all (or any) of the return that is generated by the exploitation of the intangible. Newly revised OECD guidance is also intended to ensure that the transfer pricing analysis is not weakened by information asymmetries between the tax administration and the taxpayer in relation to hard-to-value intangibles (as explained above). According to the OECD Guidelines, contractual allocations of intangibles and risk should be respected only when they are supported by actual decision-making and thus exercising actual control over these assets and risks. All of these concepts are currently absent in Brazil.

941. Transfer pricing issues relating to controlled transactions involving intangibles is a key area where the Brazilian system is not adequate, as other aspects of the existing transfer pricing system create further difficulties and challenges in addressing these transactions. As noted, the absence of a complete comparability (including functional and risk) analysis, absence of accurate delineation of the actual transactions, inappropriateness of available methods (including the application of fixed margins and freedom of choice of the method), and unavailability of transactional profit methods – especially the profit split method and other (valuation) methods –, among other issues, contribute to this inadequacy.

942. Intra-group services

No specific guidance for the treatment of intra-group services is provided in Brazil, so the relevant general transfer pricing rules apply to most types of transactions with the exception of outbound payments for technical, scientific, administrative or similar assistance, which are addressed by a special measure limiting their deductibility by a fixed percentage.

943. A related concept missing from Brazilian transfer pricing rules is the benefits test, which allows to test whether the party making a payment for a controlled service transaction has actually derived any benefit from entering into such transactions for which an independent party would be willing to pay. The absence of the benefits test potentially gives rise to BEPS risks considering the differences between this test and the general deductibility limitation rules, including the fact that it does not distinguish between different types of intra-group activities (e.g., shareholder activities, incidental benefits, etc.). The lack of alignment with the OECD Guidelines can also give rise to situations where activities which would not normally pass the benefits test and would not be considered as services (e.g., incidental benefits or shareholder services) may be treated as a provision of services and charged in one jurisdiction while the

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499 Under this guidance, the MNE performing important functions, controlling economically significant risks and contributing assets, as determined through the accurate delineation of the actual transaction, should be entitled to an appropriate return reflecting the value of their contributions.

500 In that sense, risks contractually assumed by a party that cannot in fact exercise meaningful and specifically defined control over the risks, or does not have the financial capacity to assume the risks, will be allocated to the party that does exercise such control and does have the financial capacity to assume the risks.
other jurisdiction may not allow its deduction. Therefore, while they also scrutinise service transactions, the existing general deductibility rules may not always lead to the same outcomes as the OECD guidance.

Cost contribution arrangements

944. Only limited guidance has been issued in Brazil with regard to cost contribution arrangements (CCA) in respect of services. The issue was only discussed through administrative guidance and there is no clear direction on how Brazil would treat transactions under a CCA. There is also no clear distinction between service CCAs and development CCAs, and there is also no specific guidance on development CCAs.

945. Limited guidance on CCAs creates confusion and significant uncertainty regarding the treatment of transactions in connection to a CCA for transfer pricing purposes, or if they would even be subject to transfer pricing control. The weaknesses of the existing system compared to concepts established in Chapters I - III, VI and VII of the OECD Guidelines also undermine the effectiveness of the transfer pricing rules in Brazil with respect to CCAs.

946. The adoption of comprehensive guidance to ensure the appropriate characterisation and treatment of CCAs for transfer pricing purposes is essential. The lack of clear guidance combined with the absence of a complete comparability analysis may give rise to double taxation, since the outcomes potentially differ from the outcomes following the OECD Guidelines.

947. Additionally, the fact that the transfer pricing legislation may not be applicable in some cases involving CCAs may raise significant BEPS risks, especially in cases involving high-value transactions, or where valuable services are being provided for a mere cost contribution. In addition to that, the CCA concept could be potentially used by enterprises to avoid other types of taxes, which may create BEPS risks also in areas such as withholding taxes and other duties and levies.

Financial transactions

948. Brazil’s domestic transfer pricing legislation contains only limited guidance on financial transactions. The limited guidance in place addresses the determination of the interest rate, both in outbound and inbound situations. The legislation establishes the methodology for determining the maximum interest rate that can be deducted or minimum interest rate that is to be recognised as taxable income based on the fixed mark-up on top of the reference interest rate.\(^\text{501}\)

949. This approach does not take into consideration all the relevant economically significant characteristics of transactions, e.g., the term of the loan, or the size and creditworthiness of the lender. It also does not consider the actual functional and risk profiles of the parties to the transaction. The use of rates prescribed by law may present a number of advantages in terms of simplicity and practicality, yet the outcomes may not be aligned to those that other countries arrive at on the other side of such transactions.

950. For the interest to be deducted, taxpayers must also be able to demonstrate that expenses and costs were necessary, usual and normal in their activities. In addition, thin capitalisation rules apply, as explained in the following subsection.

\(^{501}\) The interest deduction will be subject to the following interest rates cap, which are increased by a spread based on the market average to be defined by the Minister of Finance: (i) in the case of transactions performed in the United States in US dollars with a prefixed rate, the rate will be the one payable on the sovereign bonds of the Federative Republic of Brazil issued on the foreign market in US dollars; (ii) in the case of transactions performed abroad in Brazilian reals with a prefixed rate, the rate will be the one payable on the sovereign bonds of the Federal Republic of Brazil issued on the foreign market in Brazilian reals; and (iii) for all other transactions, the London Interbank Offered Rate (LIBOR) for the relevant 6-month period.
No further transfer pricing guidance for the treatment of other financial transactions, such as cash pooling, hedging activities, financial guarantees and captive insurance arrangements, is provided in Brazil, so the relevant general transfer pricing rules apply to these types of transactions, which may not always lead to reasonable outcomes.

**Thin capitalisation rules**

In addition to the interest rate cap approach and the obligation to demonstrate the necessity of the loan, intra-group loans are also subject to thin-capitalisation rules.

The general rule sets a debt-to-equity ratio applicable to related debt that may not exceed 2:1 (two times) the total net equity value of the legal entity resident in Brazil. In cases where the loan is provided by a direct shareholder, this debt-to-equity ratio is also calculated on the basis of a 2:1 ratio, but on the basis of net share of this shareholder in the total net equity of the company. The debt-to-equity ratio is different depending on whether the interest is paid to a party (related or not) residing, domiciled or organised in a low-tax jurisdiction or subject to a privileged tax regime. In a scenario where the interest is paid, or credited to any creditor located in a low-tax jurisdiction or benefitting from a privileged tax regime, the debt-to-equity ratio cannot exceed 0.3:1 (30%) of the total net equity value of the legal entity resident in Brazil.

**Commodities**

The application of methods for commodity transactions, on the basis of a benchmark determined through the averaging of published commodity prices from public exchanges on the transaction date, is mandatory in Brazil. Similar guidance has been included in the OECD Guidelines as a part of the BEPS Project, where reference prices are considered as a possible approach to applying the CUP method while allowing reasonable adjustments. Although existing comparability adjustments in Brazil take into account various relevant aspects, and include adjustments, such as the quantities negotiated, premium or discounts, packing, freight and insurance, the permitted adjustments are limited.

**Business restructurings**

The Brazilian transfer pricing rules do not provide any guidance on the treatment of business restructurings for transfer pricing purposes. Therefore, Brazil’s transfer pricing rules also lack the ability to monitor and control the reallocation of profit potential among the members of the MNE group, either immediately after a business restructuring or over a few years. The existing transfer pricing rules may thus not capture the profit potential being transferred due to a reorganisation, i.e. transfer of functions, assets and risks.

**Safe harbour rules**

While the Brazilian transfer pricing rules do not contain the simplified approach for low value-adding services foreseen in the OECD guidance, the current rules provide three safe harbour regimes. These safe harbours raise the following concerns as to their appropriateness:

- The 5% de minimis rule applies to any taxpayer and since the 5% threshold is determined with reference to the transactional value of the turnover of the company, this means that mispriced

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502 These methods are the “price under quotation on import” (PCI) and the "price under quotation on export" (PECEX) methods. They provide for the possibility to make adjustments, considering potential premium/discounts and others, limited and specified by the legislation related to the differences between the net amount received by the seller and the variables that are considered in the specific commodities and futures exchange market.
revenues could be used as the basis for assessment, which is a significant concern in relation to this safe harbour.

- The 90% test safe harbour, applies in cases where the export price represents 90% or more of the domestic market price. In such a case, the export price adopted is deemed acceptable. This may also raise BEPS risks for the following reasons: the safe harbour test is based on a comparison of prices applied in the domestic market in Brazil and prices of the same goods or products in transactions seen in foreign markets, even though profit potential may be significantly different in foreign markets; differences in purchasing power or premium pricing due to scarcity or uniqueness of the particular products, and the specificity of the market may create inappropriate outcomes. In addition, in cases involving exporting of a product, with only a 10% or smaller profit margin on the domestic market (e.g., costs of production are 90 and the sales price on the domestic market is 100) allows to export these products for a value at cost or even below the cost.

- The profitability test safe harbour allows a Brazilian exporter to demonstrate that, on an overall basis, exports to related parties generated a minimum 10% net profit margin, for the transactional conditions to be deemed acceptable. The provision also states that 80% of export volume should be in relation to unrelated parties. Thus, there should be sufficient information available to apply the Brazilian equivalent of the CUP method for exports (PEVEx method) in the cases where there are comparable transactions with unrelated parties, and the safe harbour could lead to under-taxation, given that all the taxpayer is required to do is justify the minimum 10% net profit margin.

957. These specific safe harbours in place give rise to BEPS concerns because even if they may be perceived as incentives for exportation, these safe harbours are effectively incentives for BEPS practices, as the profitability will not be recognised in the Brazilian foreign entities, but rather in the foreign trading hubs.

958. There is another simplification and safe harbour measure in the form of a tolerated deviation. For the application of all the methods, a small deviation of the transaction price from the parameter price is tolerated on each side, which means that no transfer pricing adjustment will be required if the transaction price is within this tolerated deviation. The rules provide for a general tolerated deviation of 5% and a special deviation of 3% for commodity transactions.

959. In addition to the simplification measures described above in this subsection and other subsections, the other features of the existing system are also intended to provide additional certainty and simplicity – namely the absence of comprehensive comparability (including functional and risk) analysis, the freedom of selection of the method, the use of the fixed margins approach, among others. These other features however raise a number of concerns because they give rise to potential double taxation and significant BEPS issues.

1.5.3. Rationale for the change

960. In instances where limited or no guidance exists for specific types of transactions, the general transfer pricing rules apply. The application of more prescriptive rules and especially the fixed margins approach may not be suitable and sufficient for specific types of transactions which require special considerations. In consequence, the dual objective of transfer pricing rules may be undermined.

961. These gaps or areas left unaddressed by the existing rules generally increase the risk of double taxation as they represent significant divergences from internationally accepted transfer pricing practice based on the OECD Guidelines. They also deprive Brazil of significant tax revenues in some cases.

1.5.4. Way forward

962. To effectively align with the OECD standard, Brazil should introduce special considerations based on the OECD guidance related to intangibles (along with adopting a definition of intangibles, allocation of
income to entities which carry out DEMPE functions and control the related risk rather than to mere legal owners of intangibles, and the hard-to-value intangibles approach, intra-group services (including the benefits test), cost contribution arrangements, financial transactions and transfer pricing aspects of business restructurings.

963. This special guidance is also linked to key transfer pricing concepts as established in Chapter I - III of the OECD Guidelines, including more recent developments which are outcomes of the BEPS Project, and are currently not reflected in the Brazilian transfer pricing rules. These fundamental concepts should form the basis for the special considerations discussed above.

964. The type of special measure imposing fixed deductibility limitations on outbound royalty payments and outbound payments related to technical, scientific, administrative or similar assistance (which are out of the scope of transfer pricing rules in Brazil) is not discussed in the OECD Guidelines. Outbound royalty and technical services payments should however be scrutinised by relying on principles that are not currently present in Brazil, that is, through the perspective of the appropriate delineation of the actual transaction and the benefits test, as well as the arm’s-length pricing test. While these outbound payments should be brought into the scope of transfer pricing rules, any change should be explored in consideration of the broader policy objectives that underlie the deductibility limitations, and, once they are carefully reviewed and potentially redesigned, they could continue to apply on top of the general transfer pricing rules as special anti-BEPS measures.

965. Finally, the existing safe harbour rules need to be reviewed and either refined or abolished. If they are refined, they should be brought in line with the arm’s length principle and be based on sound economic analysis. The introduction of other simplification measures, such as the simplified approach for low value-adding services, could also be considered.

966. Some of the features of the existing system which provide for simplicity and certainty, such as the fixed margins, will have to be redesigned into carefully tailored safe harbour regimes to ensure the achievement important policy objectives of transfer pricing rules.

1.6. Transfer pricing compliance and examination practice

967. An important aspect of tax administration relates to transfer pricing compliance and examination practices; in particular, any general or specific provisions for transfer pricing examinations in the domestic legislation, regulations and internal guidance, and exceptions from the general examination practice.

968. This also includes procedural aspects of transfer pricing examinations, such as the administration of the burden of proof, examination process (including risk assessment and selection of cases), confidentiality of information, penalties, appeals and litigation, exchange of information, simultaneous examinations, liaison with customs authorities, as well as any other relevant issue.
Table 1.6. Special considerations

<table>
<thead>
<tr>
<th>Issues/divergences</th>
<th>Way forward</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intangible property</td>
<td>Adopt concepts related to intangibles, including a broad definition for transfer pricing purposes, DEMPE functions and income allocation based on their performance and control of related risk, and the concept of hard-to-value intangibles, and provide special considerations for intangibles.</td>
</tr>
<tr>
<td>Intra-group services</td>
<td>Adopt concepts related to intra-group services, notably the benefits test, and provide special considerations for intra-group services.</td>
</tr>
<tr>
<td>Cost contribution arrangements (CCA)</td>
<td>Provide guidance for determining whether the conditions established by associated enterprises for transactions covered by a CCA, including a development CCA, are consistent with the arm's length principle.</td>
</tr>
<tr>
<td>Financial transactions</td>
<td>Provide guidance for the application of the arm's length principle to all types of financial transactions.</td>
</tr>
<tr>
<td>Thin capitalisation rules</td>
<td>Refine the existing thin-capitalisation rules and consider adopting BEPS Action 2 and BEPS Action 4 recommendations to address the BEPS challenges related to financial transactions and hybrid mismatches.</td>
</tr>
<tr>
<td>Business restructurings</td>
<td>Provide guidance on transactions comprising business restructurings.</td>
</tr>
<tr>
<td>Safe harbours</td>
<td>Revise, refine or abolish safe harbours.</td>
</tr>
<tr>
<td>Special measures</td>
<td>Carefully review the existing deductibility limitation rules and ensure they do not violate international commitments in tax treaties. If negative side-effects are identified, consider relevant modifications and refinement.</td>
</tr>
<tr>
<td>Other simplification measures</td>
<td>Consider adopting further simplification measures, such as the simplified approach for low value-adding services, and the development of new safe harbour regimes.</td>
</tr>
</tbody>
</table>

1.6.1. Compliance and examination practice

969. Transfer pricing compliance practices (and tax compliance practices in general) are a matter of domestic legislation and administrative practices. That said, the OECD Guidelines identify three main policy objectives shared by many domestic tax compliance practices: (i) to reduce opportunities for non-compliance; (ii) to provide positive assistance for compliance; and (iii) to provide disincentives for non-compliance. Appropriate and consistent application of the arm’s length principle requires that countries develop and implement procedural rules both to ensure adequate protection of the tax base so that tax revenue is not shifted to low or no tax jurisdictions and to ensure protection of taxpayer so that tax revenue is not shifted to countries with overly harsh procedural rules.

970. It is worth noting that the OECD Guidelines discuss simultaneous tax examinations, a form of mutual assistance which may be used in a wide range of international issues that allows two or more countries to co-operate in tax investigations. While the OECD Guidelines do not include a discussion of joint audits, this practice has gained in importance, as it can allow tax administrations to operate efficiently and effectively in an increasingly global environment, co-operating ever more closely and frequently with each other to ensure compliance, tackle BEPS, and minimise the probability of costly and time-consuming disputes.\(^\text{503}\)

1.6.2. Current situation in Brazil

971. In Brazil, the compliance and examination practices for the enforcement of transfer pricing rules are currently less resource-intensive due to the specificities of the Brazilian transfer pricing system. Notably, the absence of a need to systematically perform a complete comparability analysis affects the compliance and examination practice. The consequences of the specificities of the existing rules and

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related compliance and examination practices lead to lower resource-intensity but, as is established in the previous chapters of this report, this also comes at significant revenue costs.

972. The main weaknesses in the existing tax compliance practice concern the statute of limitations and the penalty system. The five-year statute of limitations, which requires the audit to be completed and tax to be assessed within the five year period, already makes it difficult to conclude transfer pricing audits in due time under the current rules. When the rules will change and require additional information to be obtained through exchange of information or additional procedures, the requirement of having the tax reassessed within the five years will have negative implications on the ability of the tax administration to effectively administer the new system.

973. Penalties may vary from 20% to 225% on the tax amount due and not paid, plus interest for late payment calculated on the base amount of underpaid tax (without penalties) with the interest rate based on SELIC, which is the Brazilian basic interest rate provided by the Central Bank. It should be highlighted that this interest rate is significantly lower than the interest rate applicable on commercial credit, making it less effective in ensuring timely compliance of taxpayers and discouraging extended litigation proceedings. In addition, taxpayers may hope for concessions and amnesties, which could be part of their litigation strategy. The penalty system is also closely linked to the ability of the tax administration to request and obtain information from taxpayers, especially in respect of related-party taxpayers located abroad.

974. This weakness in accessing information on foreign related parties may turn especially problematic if the system changes because in many instances it may be the foreign related parties that will be chosen as the tested parties, and taxpayers should be reasonably motivated to comply with the information requests of the tax administration. The penalty system should be part of the motivation to provide information which could be otherwise not favourable to the taxpayer's tax position.

975. Brazil does not currently foresee simultaneous tax examinations and joint audits in its administrative practices. Finally, Brazil also does not offer co-operative compliance programmes.

1.6.3. Rationale for the change

976. The existing framework does not provide for tools and instruments to effectively identify and address BEPS risks. Taxpayers are able to exploit the existing system and shift profits outside of Brazil, to low or no tax jurisdictions, and shift the income to companies which benefit from exemptions or special regimes within Brazil. The current compliance framework also does not allow for as much administrative consideration and flexibility, which leads to potential cases of double taxation that may not be addressed or relieved. Considering that dealing with transfer pricing issues can be more burdensome when applying rules based on the OECD system than is currently the case under the Brazilian system (e.g., transfer pricing issues are fact-intensive and may involve difficult evaluations of comparability, markets, and financial or other industry information), the compliance framework should be adapted to the related administration needs, including procedural aspects of transfer pricing examinations (examination process, statute of limitations, penalties, etc.).

977. Separately, simultaneous tax examinations may be a useful instrument to determine the correct tax liability of associated enterprises in cases where, for example, costs are shared or charged and profits are allocated between taxpayers in different taxing jurisdictions or more generally where transfer pricing

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504 Article 44 of Law 9,430/1996.
506 The different rates are available at: https://www.bcb.gov.br/estatisticas/tjuros.
issues are involved. Among other aspects, taxpayers may also benefit from simultaneous tax examinations from the savings of time and resources due to the co-ordination of inquiries from the tax administrations involved and the avoidance of duplication. Additional advantages are mentioned in the OECD Guidelines.

978. Another procedure worth highlighting is the joint audit procedure. The key benefits of joint audits include:

- A joint approach to fact finding involving the participating tax administrations and the taxpayer, thus: (a) avoiding misunderstandings, different version of reality and ensuring that there is one conversation, rather than several conversations with potentially different outcomes; (b) achieving a holistic overview of taxpayers’ business structures as well as cross-border transactions due to a better quality of information that is exchanged during a joint audit procedure that allows more targeted examinations in the future; (c) a more efficient and faster process compared to separate audits followed by MAP; (d) reduced burdens for taxpayers and tax administrations compared to separate audits especially where they subsequently result into a MAP case; (e) compared to MAP following unilateral audits, no need to undo decisions that have already been taken, with positions that may have become entrenched and with the difficulties that this may entail;
- Ability to leverage off the auditing experience and expertise of other tax administrations that can also support the improvement of each tax administrations’ own case selection and auditing methods;
- A better understanding of the differences in legislation that can subsequently support better risk assessment and a better allocation of resources; and
- Enhancing the compliance of MNEs when early tax certainty can be achieved and a higher tax risk posture becomes increasingly unattractive.

1.6.4. Way forward

979. Together with other aspects of the existing transfer pricing system, the transfer pricing compliance and examination practice will need to evolve, in order to adapt to the OECD system. For this reason, it is essential that the tax authorities be well-equipped to address transfer pricing issues. Structural changes to the transfer pricing function and other specific features of the system, including the relevant procedural rules and examination practices, are thus needed.

980. In this context, the usefulness of simultaneous tax examination is also worth taking into consideration when implementing other changes to the system, as it may facilitate an exchange of information on multinational business practices, complex transactions, cost contribution arrangements, and profit allocation methods in special fields such as global trading and innovative financial transactions, in addition to other advantages previously highlighted.

981. Simultaneous tax examinations and joint audits can alleviate the difficulties experienced by both taxpayers and tax administrations. The use of simultaneous tax examinations can therefore be considered in the examination of transfer pricing cases and to facilitate exchange of information and the operation of mutual agreement procedures. Similarly, the use of joint audits can be considered as a means to improving the efficiency of transfer pricing audits and enhancing the compliance environment.

Table 1.7. Transfer pricing compliance and examination practice

<table>
<thead>
<tr>
<th>Issues/divergences/considerations</th>
<th>Way forward</th>
</tr>
</thead>
<tbody>
<tr>
<td>Diverging transfer pricing compliance and examination practice due to the configuration of the existing transfer pricing system</td>
<td>Align transfer pricing compliance and examination practices to the standard required to administer an OECD-compliant system including the procedural aspects of transfer pricing examinations (process, statute of limitations, penalties, etc.).</td>
</tr>
<tr>
<td>Absence of simultaneous tax examination procedure and joint audits</td>
<td>Consider putting in place the simultaneous tax examination procedure and joint audits.</td>
</tr>
</tbody>
</table>

1.7. Documentation and related penalties

982. The seventh area addresses the requirement for resident entities that are the ultimate parent of an MNE group to file a Country-by-Country report in accordance with the BEPS Action 13 minimum standard.

1.7.1. Documentation

983. This section focusses on elements regarding Country-by-Country Reporting (CbCR), which contains certain information relating to the global allocation of the MNE’s income and taxes paid together with certain indicators of the location of economic activity within the MNE group.

984. While the implementation of the master file and the local file are not required under the BEPS Action 13 minimum standard, they form the standardised approach to transfer pricing documentation. According to the OECD Guidelines, this three-tiered structure has been designed to achieve the objectives of transfer pricing documentation requirements, which are (i) to ensure that taxpayers give appropriate consideration to transfer pricing requirements in establishing prices and other conditions for transactions between associated enterprises and in reporting the income derived from such transactions in their tax returns; (ii) to provide tax administrations with the information necessary to conduct an informed transfer pricing risk assessment; and (iii) to provide tax administrations with useful information to employ in conducting an appropriately thorough audit of the transfer pricing practices of entities subject to tax in their jurisdiction, although it may be necessary to supplement the documentation with additional information as the audit progresses.

985. The adoption of clear obligations in the domestic legislation is required for the effective implementation of this guidance. Penalties also play an important role in achieving compliance. Penalties are designed to make non-compliance more costly than compliance. Many countries have adopted documentation-related penalties to ensure efficient operation of transfer pricing documentation requirements. As discussed in the OECD Guidelines, documentation-related penalties imposed for failure to comply with transfer pricing documentation requirements or failure to timely submit required information are usually civil (or administrative) monetary penalties. These documentation-related penalties are based on a fixed amount that may be assessed for each document missing or for each fiscal year under review, or calculated as a percentage of the related tax understatement ultimately determined, a percentage of the related adjustment to the income, or as a percentage of the amount of the cross-border transactions not documented.

508 See paragraph 5.41 of the OECD Guidelines.
1.7.2. Current situation in Brazil

986. Brazil has implemented CbCR and participates in the peer review of its implementation and operation. The conclusion of the peer review so far is that Brazil has rules (primary and secondary laws, as well as guidance) that impose and enforce CbC requirements on MNE groups whose ultimate parent entity is resident for tax purposes in Brazil and that Brazil meets all the terms of reference relating to the domestic legal and administrative framework. There were no concerns reported for Brazil in respect of the aspects related to appropriate use.

987. The documentation requirements under the current rules are limited to the information necessary for the application of the existing rules and the information requested is little if compared to the local file. Brazil has not implemented the master file and the local file, which are not part of the minimum standard but form part of the three-tiered approach to transfer pricing documentation developed as part of the BEPS Project to achieve the three main objectives of transfer pricing documentation requirements.

1.7.3. Rationale for the change

988. Many Brazilian MNEs already prepare a master file (containing a high-level overview of the MNE group business, including the nature of its global business operations, its overall transfer pricing policies, and its global allocation of income and economic activity in order to assist tax administrations in evaluating the presence of significant transfer pricing risk) because of obligations imposed in other jurisdictions to which Brazil does not currently have access. The local file (containing detailed information relating to specific intercompany transactions) would also be extremely useful to obtain information about the MNE group’s presence in the other country concerned, if the information is needed, e.g., in the context of a mutual agreement procedures. Associated compliance issues should also be considered, such as establishing the clear obligations in the domestic legislation and specific penalties (in case of failure to comply with transfer pricing documentation requirements, including omission of information or submission of inaccurate information, or failure to timely submit required information).

989. It is critical that tax administrations be able to access sufficient, relevant and reliable information at an early stage to conduct a transfer pricing risk assessment in order to make an informed decision about whether to perform an audit. It is also critical that tax administrations be able to access or demand, on a timely basis, all additional information necessary to conduct a comprehensive audit once the decision to conduct such an audit is made, notably because transfer pricing audit cases tend to be fact-intensive and often involve difficult evaluations of the comparability of several transactions and markets. Without proper transfer pricing documentation, tax authorities will not be able to effectively perform risk assessment and conduct a thorough audit in situations where a transfer pricing risk assessment suggests that a thorough transfer pricing audit is warranted with regard to one or more issues.

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510 The information required in the master file provides a high-level overview ("blueprint") of the whole MNE group and contains relevant information that can be group in the following five categories: a) the MNE group’s organisational structure; b) a description of the MNE’s business or businesses; c) the MNE’s intangibles; d) the MNE’s intercompany financial activities; and e) the MNE’s financial and tax positions.

511 The information in the local file supplements the master file and focusses on information relevant to the transfer pricing analysis related to transactions taking place between a local country affiliate and associated enterprises in different countries and which are material in the context of the local country’s tax system, including relevant financial information regarding those specific transactions, a comparability analysis, and the selection and application of the most appropriate transfer pricing method.
1.7.4. Way forward

990. The local file and the master file should be adopted and their preparation should be required. The potential administrative burden could be balanced with simplification measures for transfer pricing documentation.

991. Their implementation would strengthen tax administration by providing the framework necessary to empower the tax authorities to collect the necessary information contained in the local and master file in the future with a view to analysing transactions and effectively applying the arm’s length principle.

992. The concept would be useful already under existing rules, if reflected in the legislation in an empowering provision to effectively enforce the submission of the master file and local file in specific cases. Further, any company requesting a mutual agreement procedure (or advance pricing arrangements) should be required to submit the master file and local file to ensure that a complete transfer pricing analysis can be performed. If the system is changed, it will be critical that this type of information is available and the legislation should contain a clear obligation for taxpayers of a certain size to prepare and submit the transfer pricing documentation. Failure, omission, or misrepresentation, should lead to penalties to disincentivise such behaviour.

993. The tax administration must be able to obtain directly or through information sharing, such as through exchange of information mechanisms, specific information that extends beyond the country’s borders as it may be the case that documents and other information required for a transfer pricing audit will be in the possession of members of the MNE group other than the local affiliate under examination. The taxpayer may not be willing to share such information voluntarily.

Table 1.8. Transfer pricing compliance and examination practice

<table>
<thead>
<tr>
<th>Issues/divergences</th>
<th>Way forward</th>
</tr>
</thead>
<tbody>
<tr>
<td>Local file</td>
<td>Introduce an obligation to file a local file in line with BEPS Action 13 and the OECD Guidelines.</td>
</tr>
<tr>
<td>Master file</td>
<td>Introduce an obligation to file a master file in line with BEPS Action 13 and the OECD Guidelines.</td>
</tr>
<tr>
<td>Penalties</td>
<td>Design documentation-related penalties to make non-compliance more costly than compliance.</td>
</tr>
</tbody>
</table>

1.8. Tax rulings and advance pricing arrangements

994. The eight area concerns unilateral tax rulings or programmes of unilateral advance pricing arrangements (APA). It also considers whether bilateral or multilateral APAs are allowed.

1.8.1. Tax rulings and APAs

995. Advance pricing arrangements are endorsed in the OECD Guidelines as an alternative to the traditional administrative, judicial and treaty mechanisms for resolving transfer pricing issues. An advance pricing arrangement (APA) is an arrangement that determines, in advance of controlled transactions, an appropriate set of criteria (e.g., method, comparables and appropriate adjustments thereto, critical assumptions as to future events) for the determination of the transfer pricing for those transactions over a fixed period of time.
1.8.2. Current situation in Brazil

996. Brazil does not have an APA programme in place, meaning there is currently no procedure under which a taxpayer may enter into a unilateral, bilateral or multilateral APA with the tax authorities.

997. Brazil receives information on tax rulings under the transparency framework established through the implementation of the BEPS Action 5 minimum standard, which requires the spontaneous exchange of information on tax rulings. This information can be used for transfer pricing risk assessment, especially to identify issues where other jurisdictions issued tax rulings to reduce the tax base, which could facilitate BEPS.

1.8.3. Rationale for the change

998. APAs are intended to supplement the traditional administrative, judicial, and treaty mechanisms for resolving transfer pricing issues. APAs may be most useful when traditional mechanisms fail or are difficult to apply and present a number of advantages. In a large part, APAs contribute to the prevention and thus to a reduction in transfer pricing adjustment risks for MNE groups, especially under bilateral (or multilateral) APAs involving two (or more) countries.

999. Further, APAs provide the opportunity to horizontally monitor taxpayer practices and could effectively prevent transfer pricing disputes and contribute to effectiveness of tax administration, while also providing the opportunity to taxpayers to reduce their compliance costs. APAs are especially useful when facing challenges to determine the arm’s-length price and when there are difficulties in accessing comparables data.

1000. Therefore, the existence of a functional and effective APA programme would contribute towards more tax certainty both for domestic transactions and cross-border transactions, either through bilateral or multilateral APAs. As highlighted in the OECD Guidelines, the bilateral (or multilateral) approach is far more likely to ensure that the arrangements will reduce the risk of double taxation, will be equitable to all tax administrations and taxpayers involved, and will provide greater certainty to the taxpayers concerned.

1.8.4. Way forward

1001. The introduction of the APA mechanism, especially bilateral and multilateral APAs, should be contemplated due to the benefits highlighted above.

1002. APAs in Brazil can be implemented in different ways (no fee, minor fee, fixed fee or based on volume of transaction with maximum fee, etc.), together with effective checks and balances, as a tool for providing advance transfer pricing guidance to taxpayers and greater certainty, both domestically and in a cross-border context. An APA mechanism may require additional resources and in a way represents a “service” provided to taxpayers, which could justify establishing a fee. In turn, this fee would lead to additional resources necessary to cover the costs of providing this service.

1003. APAs can also be considered for the cases where designing safe harbour regimes will not be sufficient to address more complex situations.

1004. Finally, APAs raise considerations related to the exchange of information on tax rulings, and under the BEPS Action 5 minimum standard, any APA issued will be subject to this requirement. Equally, APAs received from other jurisdictions are valuable sources of information that need to be effectively processed and analysed for risk assessment purposes.

512 See paragraphs 4.153 to of the OECD Guidelines.
Table 1.9. Tax rulings and advance pricing arrangements

<table>
<thead>
<tr>
<th>Issues/divergences/considerations</th>
<th>Way forward</th>
</tr>
</thead>
<tbody>
<tr>
<td>Advance pricing arrangements (APA)</td>
<td>Consider introducing unilateral, bilateral and multilateral advance pricing arrangements.</td>
</tr>
</tbody>
</table>

1.9. Corresponding adjustments and mutual agreement procedures

1005. The ninth section covers corresponding adjustments and the mutual agreement procedure (MAP).

1.9.1. Corresponding adjustments and MAP

1006. This section considers whether corresponding adjustments are allowed in order to eliminate double taxation in transfer pricing cases as well as practices on the following issues:

- Possibility to make a corresponding adjustment in the absence of a paragraph 2 of Article 9-type clause in the relevant bilateral tax treaty;
- Policy for applying the arm’s length principle and eliminating double taxation in relation to countries with which a bilateral tax treaty has not been entered into.

1.9.2. Current situation in Brazil

Corresponding adjustments

1007. Brazil’s tax treaties do not include the necessary provision (paragraph 2 of Article 9 of the OECD MTC) to provide for corresponding adjustments between treaty partners. Although Brazil has put in place the legal framework, structure and resources in order to comply with the BEPS Action 14 minimum standard, concerns may remain in relation to the implementation of MAP outcomes, notably because paragraph 2 of Article 9 is absent and the domestic legislation does not provide for a mechanism to implement corresponding adjustments.

1008. Nonetheless, as Brazil committed to the BEPS Action 14 minimum standard, the absence of paragraph 2 of Article 9 in its tax treaties can be overcome should there be a will to ensure the elimination of double taxation, since a corresponding adjustment can be also agreed based on Article 25 of the OECD MTC.

Mutual agreement procedure

1009. Brazil took the necessary steps in order to grant access to MAP for transfer pricing cases, notably with the publication of rules, guidelines and procedures, identification of the information and documentation needed to request a MAP.

1010. However, it is not clear how a potential dispute related to transfer pricing would be resolved through a MAP procedure, especially considering the peculiarities of the domestic law – e.g., fixed margins, lack of comparability analysis and limitations to deductibility of certain expenses. There is also an absence of clear guidance on how a MAP outcome involving a possible downward corresponding adjustment would be implemented in Brazil.

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1011. The potential lack of relevant capacities and resources to perform proper comparability analyses based on the arm’s length principle can also put Brazil at risk that MAP outcomes will be negotiated in a way that may be detrimental to the tax base of Brazil. Considering that Brazil’s MAP caseload has increased significantly since 2016, and could be expected to continue increasing in particular with respect to transfer pricing cases, further capacity development and investment will be necessary in order to resolve MAP cases in a timely, efficient and effective manner.\(^{514}\)

1012. Separately, Brazil does not provide access to arbitration or any other effective dispute resolution mechanism which would provide sufficient certainty to taxpayers that their double taxation case will be effectively resolved. Brazil also does not levy additional tax as a result of so-called secondary adjustments.

**Rationale for the change**

1013. First, including paragraph 2 of Article 9 of the OECD MTC in tax treaties would constitute an explicit commitment to eliminate double taxation, with or without limitations of such adjustment in certain cases (e.g., fraud, aggressive tax avoidance, etc.), and thereby send a strong signal that Brazil is ready to discuss on the resolution of transfer pricing disputes with treaty partners. This aspect will be carefully evaluated by WP6 as part of the accession process. Countries may question the commitment of Brazil to eliminate double taxation based on any unwillingness to include this clause in future tax treaties.

1014. Second, the ability to prevent and resolve transfer pricing disputes – i.e. the effectiveness of the MAP process – is a critical question and Brazil needs to be prepared to discuss transfer pricing cases using the arm’s length principle as a reference. This would also require investments to develop appropriate MAP capacity and an effective mechanism, which will ensure that the dispute resolution is not merely a nominal process but that it leads to an effective outcome of elimination of double taxation. If Brazil is willing to make corresponding adjustments under MAP in any case, the position of Brazil regarding the inclusion of Article 9, paragraph 2 in tax treaties may be worth reconsidering. This would mean that the corresponding adjustment would not be only a remote possibility under a MAP mechanism, but that there should be a legal right for the taxpayer to request such adjustment and also an explicit commitment of Brazil to engage in such bilateral negotiations with a view to executing such corresponding adjustment.

1015. The introduction of an effective dispute resolution mechanism, which would supplement potential inefficiencies of the mutual agreement procedure, could be worth considering for Brazil given the fact that it lessens (directly and indirectly) the likelihood of double taxation and may proactively prevent transfer pricing disputes from occurring.

1016. Separately, secondary adjustments could be considered next to the primary transfer pricing adjustments if Brazil wishes to make the actual allocation of profits consistent with the arm’s length principle. While this would allow Brazil to levy additional tax revenue, it could also increase the tax burden for taxpayers. To the extent Brazil would start operating a system levying withholding tax on dividends, it could be considered as a mechanism which can motivate compliance.

**1.9.3. Way forward**

1017. The ability to prevent and resolve transfer pricing disputes with a view to eliminating double taxation is a requirement for full alignment. Brazil needs to be prepared to discuss transfer pricing cases

\(^{514}\) Specific recommendations, including on this aspect, were made at the outcome of Brazil’s peer review of the implementation of the BEPS Action 14 minimum standard, see OECD (2019), *Making Dispute Resolution More Effective — MAP Peer Review Report, Brazil (Stage 1): Inclusive Framework on BEPS: Action 14, OECD/G20 Base Erosion and Profit Shifting Project*, OECD Publishing, Paris, [https://doi.org/10.1787/12acb5ea-en](https://doi.org/10.1787/12acb5ea-en).
using internationally accepted standards as a reference in order to achieve full alignment (including being equipped with an effective MAP capability).

1018. The inclusion of Article 9, paragraph 2, in tax treaties is in line with this approach and would constitute a strong signal for treaty partners. Therefore, Brazil should be prepared or show willingness to include paragraph 2 of Article 9 in future tax treaties. Such corresponding adjustments could however be limited, for instance by limiting the potential corresponding adjustment to *bona fide* cases.515

1019. The arm’s length principle as provided in the domestic legislation would also be equally applicable to situations involving countries that have not concluded a bilateral tax treaty with Brazil, unless a special anti-avoidance measure applies.

1020. Finally, Brazil could contemplate the use of the arbitration procedure to enhance certainty in resolving double taxation cases as well as secondary adjustments, which could represent a suitable and appropriate mechanism to both ensure that Brazil collect revenues corresponding to outcomes where no profit shifting has occurred and motivate compliance.

Table 1.10. Corresponding adjustments and mutual agreement procedures

<table>
<thead>
<tr>
<th>Issues/divergences/considerations</th>
<th>Way forward</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corresponding adjustments</td>
<td>Include Article 9, paragraph 2, in bilateral tax treaties and commit to provide corresponding adjustments.</td>
</tr>
<tr>
<td>Mutual agreement procedure (MAP)</td>
<td>Ensure the effectiveness of the MAP process, including adequate capacity.</td>
</tr>
<tr>
<td>Absence of effective dispute resolution mechanism</td>
<td>Consider an effective dispute resolution mechanism to resolve transfer pricing disputes between countries.</td>
</tr>
<tr>
<td>Secondary adjustments</td>
<td>Consider whether to provide for the possibility to perform secondary adjustments in relation to the contemplated introduction of dividend taxation.</td>
</tr>
</tbody>
</table>

1.10. Determination of permanent establishments’ profits

1021. This section considers Brazil’s position regarding Article 7 of the OECD MTC and its Commentary. It also considers the approach followed to determine the profits of a PE.

1.10.1. Attribution of profits to a permanent establishment

1022. The current OECD approach to attribution of profits is reflected in the Recommendation of the OECD Council on attribution of profits to permanent establishments.516 The OECD Council recommends to the governments of member countries: (i) that their tax administrations follow, when applying the provisions of their bilateral tax conventions that are drafted on the basis of the pre-2010 Article 7 of the Model Tax Convention, the guidance in the 2008 Report to the extent that its conclusions do not conflict with the 2008 Commentary on Article 7; (ii) that their tax administrations follow, when applying the

515 A number of other OECD members expressed reservations on Article 9. See OECD MTC 2017, Reservations on Article 9, p. 230.

provisions of their bilateral tax conventions that are drafted on the basis of the 2010 Article 7 of the Model Tax Convention, the guidance in the 2010 Report.

1.10.2. Current situation in Brazil

1023. Brazil has reserved the right to use the previous version of Article 7, i.e. the wording that was included in the pre-2010 version, and will interpret Article 7 as it read before the 2010 update in line with the relevant Commentary as it stood prior to that update.

1024. Brazil included Article 7, paragraphs 1, 2 and 3, of the 2008 OECD MTC in all of its 33 tax treaties currently in force and also in the tax treaties signed but not yet in force with the United Arab Emirates, Singapore, Switzerland and Uruguay.

1025. With respect to paragraph 4 of Article 7 of the 2008 OECD MTC, Brazil has not reproduced this provision under its tax treaty network, except for the tax treaty concluded with China. Paragraph 5 of Article 7 is included in all tax treaties signed by Brazil, with few exceptions. Paragraph 6 of Article 7 is included in a few tax treaties, namely the tax treaties with China, Japan, Portugal, Russia and Uruguay. Finally, Brazil has included paragraph 7 of Article 7 of the 2008 OECD MTC in all of its tax treaties.

1026. Concerning the domestic framework, Brazil has a set of specific rules to tax non-residents that vary depending on whether the foreign entity operates in the country through a PE which is formally registered in the country, or whether it derives income from sources located in Brazil without formally registering a PE.

**Net taxation – following the same rules which are applicable to Brazilian taxpayers**

1027. In cases where the foreign entity is formally registered in Brazil through branches, representative offices and agencies, the law establishes that the foreign entity will be considered as a legal entity in Brazil, and, therefore, its profits will be taxed like the profits of a resident in Brazil. This means that net taxation is applicable, and the foreign entity is subject to the actual profit regime or the presumed profit regime with the respective income tax rates applicable. The Brazilian transfer pricing legislation would be triggered in transactions between the registered PE and its head office or other parts of the enterprise.

1028. This net taxation is also applicable to transactions which are equivalent to an agency PE in cases where the income is earned by the foreign principal domiciled abroad as a result of the operations performed by commissionnaires (comissários) or representatives (mandatários) in Brazil. In this context, there may also be cases where a deemed profit approach may be triggered, i.e. where some conditions are not met by the intermediary in Brazil, or where the taxable income is derived by the non-resident principal from sales concluded by agents or representatives but invoiced directly from the non-resident seller to the domestic purchaser.

**Withholding income tax on income derived by sources located in the country**

1029. Where there is no formal registration of the PE in the country, the income derived by the non-resident from the sources in Brazil may be subject to a withholding income tax. Generally, there is no special regime of taxation on net basis foreseen by the income tax law, the income derived by the non-resident from its activities in Brazil may be taxed by way of withholding income tax, with rates that vary

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517 The newly signed tax treaties with Singapore, United Arab Emirates and Uruguay do not contain Article 7, paragraph 5, of the 2008 OECD MTC.

518 Even though the PE is not registered, the tax authorities could make an *ex officio* assessment if there are elements to characterise the presence of the activity as an economic or professional unit based on Article 126, item III, of the Tax Code in combination with Article 23 of Normative Instruction 1.863/2018.
from 15% to 25%, subject to a reduced rate or exemption when performing specific activities. The definition of “income from sources” in Brazil provides that “income paid, credite
delivered, employed and remitted by source
situated in the country, to physical or legal person which are resident abroad, are subject to withholding income tax”.

Nexus rules

1030. Concerning the nexus rules, the current framework in Brazil, i.e. both the domestic law and the tax
treaty provisions, does not sufficiently address situations of avoidance of the PE status addressed by
BEPS Action 7, such as commissioner arrangements, the exploitation of the specific exceptions to the
PE definition and practices related to the splitting-up of contracts between closely related enterprises.

1.10.3. Rationale for the change

1031. In situations where net taxation applies, the tax base will be determined also in accordance to the
existing transfer pricing rules, which will also apply to transactions between the head office and PEs.
Because of the limitations in the existing transfer pricing rules, the tax base may not be appropriate. This
approach may lead to different outcomes if the PE would have been treated as a separate and independent
enterprise engaged in the same or similar activities under the same or similar conditions. In other words,
all the weaknesses and problems arising from the existing transfer pricing rules in Brazil would be equally
relevant in the situations involving a PE, which leads to potential losses of revenues for Brazil, but also to
potential double taxation.

1032. Where the deemed profit approach is triggered (i.e. in the case of agency PEs and where the
foreign entity directly invoices the purchaser in Brazil), such prescriptive approach, which foresees the
application of different rates to determine the profits depending on the situation, may not correspond to the
commercial reality. Therefore, issues similar to those mentioned above may arise, even though this rule
may provide some protection of the tax base.

1033. In scenarios where the foreign entity did not formally register in the country and a withholding tax
is applied, the withholding tax may provide reasonable protection of the tax base, but such approach would
in many cases violate the principles contained in Article 7 of Brazil’s tax treaties and would likely lead to
double taxation. A mechanism making it possible to determine the net taxation should be considered and
the provision that currently foresees net taxation also in cases where the business activities of an enterprise
have not been registered could be considered as a possible legal basis, which could make it possible
already under the current law to achieve such outcome. Otherwise, the failure of the taxpayer to comply
with the rules by registering a PE in the country where the conditions for the PE are met would lead to the
application of the withholding tax as the final tax.

1.10.4. Way forward

1034. By refining the nexus rules with the implementation of the recommendations contained in the Final
Report of BEPS Action 7 in the domestic legislation and tax treaties, Brazil can enforce its taxing rights,
which are especially relevant to prevent the use of certain common tax avoidance strategies that have
been used to circumvent the existing PE definition.

1035. Reviewing and refining the existing source rules could also be considered in order to prevent any
ambiguity and lack of clarity in their interpretation, with the objective of enhancing compliance.

1036. Where the PE of a non-resident taxpayer is subject to tax on a net basis according to the same
rules that would apply to a resident taxpayer, there may be discrepancies resulting from the previously
discussed gaps and limitations found in the existing transfer pricing rules. These gaps and limitations would

519 Although it should be noted that negotiation efforts are underway to address this weakness.
in many cases lead to attributing less profits to the permanent establishment than under the application of the principles established in Article 7. Therefore, the alignment of the existing rules with the principles established in Article 7 may have a positive effect on revenue collection in Brazil.

1037. A mechanism which makes it possible to adjust the profits that should be attributable to the PE according to the principles established in Article 7 could be considered.

Table 1.11. Determination of permanent establishments’ profits

<table>
<thead>
<tr>
<th>Issues/divergences/considerations</th>
<th>Way forward</th>
</tr>
</thead>
<tbody>
<tr>
<td>Absence of comprehensive rules to tackle BEPS concerns related to the avoidance of PE status</td>
<td>Refine the nexus rules in Brazil with a view to implementing the BEPS Action 7 recommendations both in the domestic law and bilateral tax treaties.</td>
</tr>
<tr>
<td>Absence of a mechanism to adjust the attribution of profits to a PE in the context of a tax treaty scenario where withholding tax is applicable domestically</td>
<td>Consider whether to provide for a mechanism to adjust the profits of the PE.</td>
</tr>
<tr>
<td>Limitation on the current transfer pricing framework to allocate the appropriate profits to a PE in Brazil</td>
<td>Align net taxation with the principles established in Article 7, in line with Brazil’s treaty policy.</td>
</tr>
</tbody>
</table>
Conclusion

1038. The Brazilian transfer pricing system presents a number of divergences from the OECD standard. These divergences are often interrelated with key concepts and principles that are missing from or are not being reflected in the existing rules. As previously explained, the evolution of these rules has not comprehensively followed the clarification and strengthening of the application of the arm’s length principle through extensive guidance incorporated over time in the OECD Guidelines.

1039. Key divergences identified in the ten areas of transfer pricing must be addressed to effectively align Brazil’s outdated transfer pricing rules to the OECD Guidelines. In particular, the concepts of accurate delineation of the actual transaction, the elements of the comparability analysis, aligning existing methods with the OECD-recognised methods and introducing those that are missing (i.e. the profit split method, the transactional net margin method and the possibility to use “other methods”), enhancing the tax administration tools available and the ability to collect transfer pricing information based on the documentation requirements set out in the OECD Guidelines (and addressing the associated needs to build capacity), introducing special considerations for intangibles, intra-group services, cost contribution arrangements, restructurings, financial transactions, and finally, aligning the rules on the attribution of profits to permanent establishments with the OECD guidance.\textsuperscript{520} In the process of addressing these key divergences, special attention must be given to retaining simplicity in the system, providing ease of tax administration and tax compliance, and enhancing tax certainty. The development of safe harbours and rebuttable presumptions that will transform the fixed margins into regimes in line with the arm’s length principle and based on sound economic analysis to ensure appropriate outcomes in line with the primary dual objective of transfer pricing rules, while also ensuring simplicity and meeting the secondary policy objectives, should be contemplated.

Table 1.12. Summary of issues/divergences/considerations and way forward

<table>
<thead>
<tr>
<th>Issues/divergences/considerations</th>
<th>Way forward</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1. OECD Council Recommendation on the Determination of Transfer Pricing between Associated Enterprises and future BEPS Recommendations</strong></td>
<td></td>
</tr>
<tr>
<td>Aligning transfer pricing outcomes with value creation (BEPS Actions 8-10)</td>
<td>Implement BEPS Actions 8-10 recommendations, including guidance on accurate delineation of transactions, framework for analysis of risk, non-recognition of transactions and guidance on location savings and other local market features, assembled workforce, and MNE group synergies, intangibles, including hard-to-value intangibles, low value-adding intra-group services and cost contribution arrangements.</td>
</tr>
<tr>
<td>Guidance on transfer pricing documentation (BEPS Action 13)</td>
<td>Implement the remaining of the BEPS Action 13 recommendations, namely the master file and the local file.</td>
</tr>
<tr>
<td><strong>2. Statement and application of the arm’s length principle</strong></td>
<td></td>
</tr>
<tr>
<td>Restatement of the arm’s length principle</td>
<td>Restate the arm’s length principle in the primary law.</td>
</tr>
<tr>
<td>Deviations from the arm’s length principle</td>
<td>Change or refine elements in the system that deviate from the arm’s length principle (e.g., fixed margins, comparability issues, etc.) – see relevant sections.</td>
</tr>
<tr>
<td>Scope of application of transfer pricing rules</td>
<td>Refine the scope as necessary by addressing issues related to the personal, material, and territorial scopes.</td>
</tr>
<tr>
<td><strong>3. Transfer pricing methods</strong></td>
<td></td>
</tr>
<tr>
<td>Freedom of selection of the transfer pricing method</td>
<td>Adopt the most appropriate method criterion.</td>
</tr>
<tr>
<td>Traditional transaction methods with fixed margins</td>
<td>Align the existing methods to the OECD-recognised traditional transaction methods.</td>
</tr>
</tbody>
</table>

\textsuperscript{520} In the case of Brazil, the relevant guidance based on the Recommendation of the Council on the Attribution of Profits to Permanent Establishments, would be the 2008 version of the Commentary on Article 7 of the OECD MTC.
## Issues/divergences/considerations

<table>
<thead>
<tr>
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<tr>
<td>Absence of transactional net margin method (TNMM)</td>
<td>Introduce the OECD-recognised TNMM.</td>
</tr>
<tr>
<td>Absence of profit split method</td>
<td>Introduce the OECD-recognised profit split method.</td>
</tr>
<tr>
<td>“Other methods” not permitted</td>
<td>Permit the use of “other methods”, including valuation techniques, if demonstrated to be the most appropriate method and the five OECD-recognised methods are shown to be less appropriate or nonworkable in the circumstances of the case.</td>
</tr>
</tbody>
</table>

### 4. Comparability issues

| Limited comparability analysis | Introduce the complete comparability analysis in line with the adoption of the OECD-recognised transfer pricing methods. |
| Fixed margins | Transform the fixed margins into carefully designed safe harbours or rebuttable presumptions in line with the arm’s length principle and based on sound economic analysis. |
| Process of performing a comparability analysis | Introduce the 9-step process (or a similar process) of performing a comparability analysis in line with the OECD Guidelines. |
| Item-per-item approach | Eliminate the strict item-per-item approach and allow basket or package deal approaches. |
| Comparability adjustments | Consider allowing further comparability adjustments in line with the OECD Guidelines. |
| Other | Provide for other necessary elements as part of the complete comparability analysis, including aggregation of transactions, arm’s length range, effect of government interventions, statistical tools and databases, etc. |

### 5. Special considerations

| Intangible property | Adopt concepts related to intangibles, including a broad definition for transfer pricing purposes, DEMPE functions and income allocation based on their performance and control of related risk, and the concept of hard-to-value intangibles, and provide special considerations for intangibles. |
| Intra-group services | Adopt concepts related to intra-group services, notably the benefits test, and provide special considerations for intra-group services. |
| Cost contribution arrangements (CCA) | Provide guidance for determining whether the conditions established by associated enterprises for transactions covered by a CCA, including a development CCA, are consistent with the arm’s length principle. |
| Financial transactions | Provide guidance for the application of the arm’s length principle to all types of financial transactions. |
| Thin capitalisation rules | Refine the existing thin-capitalisation rules and consider adopting BEPS Action 2 and BEPS Action 4 recommendations to address the BEPS challenges related to financial transactions and hybrid mismatches. |
| Business restructurings | Provide guidance on transactions comprising business restructurings. |
| Safe harbours | Revise, refine or abolish safe harbours. |
| Special measures | Carefully review the existing deductibility limitation rules and ensure they do not violate international commitments in tax treaties. If negative side-effects are identified, consider relevant modifications and refinement. |
| Other simplification measures | Consider adopting further simplification measures, such as the simplified approach for low value-adding services, and the development of new safe harbour regimes. |

### 6. Transfer pricing compliance and examination practices

| Diverging transfer pricing compliance and examination practice due to the configuration of the existing transfer pricing system. | Align transfer pricing compliance and examination practices to the standard required to administer an OECD-compliant system. |
| Absence of simultaneous tax examination procedure. | Consider putting in place the simultaneous tax examination procedure and joint audits. |

### 7. Documentation and related penalties

| Local file | Introduce an obligation to file a local file in line with BEPS Action 13 and the OECD Guidelines. |
| Master file | Introduce an obligation to file a master file in line with BEPS Action 13 and the OECD Guidelines. |
| Penalties | Design documentation-related penalties to make non-compliance more costly than compliance. |
### Issues/divergences/considerations

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<tbody>
<tr>
<td><strong>8. Tax rulings and advance pricing arrangements</strong></td>
<td></td>
</tr>
<tr>
<td>Advance pricing arrangements (APA)</td>
<td>Consider introducing unilateral, bilateral and multilateral advance pricing arrangements.</td>
</tr>
<tr>
<td><strong>9. Corresponding adjustments and mutual agreement procedures</strong></td>
<td></td>
</tr>
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In light of the findings of the assessment, possible options were explored for Brazil to converge with the OECD transfer pricing standard. Two options which both contemplate how to achieve full alignment, either immediately or gradually, are discussed in this chapter. The reasoning for rejecting a number of other possible approaches is also included. Constitutional constraints and other policy considerations are discussed as well.
Introduction

1040. Based on the findings of the assessment of the strengths and weaknesses of the Brazilian transfer pricing framework and further discussions between OECD and RFB on Brazil’s possible alignment with the OECD standard, two options emerged that both aim to achieve full alignment of the Brazilian transfer pricing rules with the OECD Guidelines. One option entails immediate alignment and the second option entails a gradual alignment.

1041. A third option contemplating a partial alignment was considered but rejected because alignment only in certain areas or for certain types of transactions would create more complexity, considering that transactions are often interrelated/interconnected. For example, a partial alignment could be mean that new rules fully in line with the OECD guidance will be introduced to address transactions involving intangibles. This type of approach would lead to a scenario where the existing rules continue to apply to transactions involving physical goods or services (including the fixed margins), while rules based on the OECD guidance apply to transactions involving intangibles. This could lead to outcomes where the value of intangibles embedded in the goods and services would be disregarded and only few transactions involving the transfers of intangibles and payments for the use of intangibles in the form of isolated royalty payments would be subject to the new rules. Such outcomes would clearly not be in line with the arm’s length principle.

1042. Full alignment is also necessary because, otherwise, significant gaps would remain in the system with negative effects on tax certainty, the compliance burden, as well as risks of persisting double taxation and loss of tax revenue. A partial alignment that would address only the missing elements in the current framework but would maintain all the other features which create divergences and therefore lead to double taxation and losses of revenue would make it difficult for Brazil to both integrate global value chains and to accede to the OECD. A partial alignment in the form of allowing for the possibility of opting-out of the current regime to apply rules that follow the arm’s length principle would lead to transfer pricing “system shopping”, and consequently to a loss of revenue. It would allow continued BEPS practices, as taxpayers would cherry-pick the regime they wish to apply with the motivation to pay less tax.

1043. Maintaining the current regime as an “opt-out safe harbour” may contribute to achieving one element of the dual policy objective of transfer pricing rules, as taxpayers that currently face double taxation could opt out of the system and apply the arm’s length principle. However, it would fail to achieve the second element, which is to prevent BEPS and under-taxation, as taxpayers that currently benefit from under-taxation would not opt out, and this would mean continued revenue losses and BEPS issues for Brazil. This would also create an additional burden on the tax administration, which would have to maintain and administer two different systems, the interaction of which would create an additional layer of complexity. It is therefore desirable to consider how the positive notions in the existing system could be transformed into a single transfer pricing system fully aligned with the OECD standard.

1044. Full alignment is defined as the adoption and commitment to the OECD transfer pricing standard, including the arm’s length principle and the guidance for its application contained in the OECD Guidelines and other relevant guidance. In that sense, the issues previously exposed will eventually have to be resolved by implementing solutions that are consistent with the OECD Guidelines.

1045. Full alignment does not have to come at the expense of losing or failing to achieve the objectives of simplicity, ease of tax administration and tax compliance, and tax certainty. Such objectives can be achieved by transforming the fixed margins into safe harbours designed in line with the arm’s length principle, including carefully considered entry criteria, to ensure that transfer pricing outcomes will be broadly consistent with the outcomes produced by complete comparability analysis according to the OECD Guidelines.
The main benefits of convergence include:

- Avoiding and eliminating double taxation, which mainly results from the absence of a common understanding regarding the application of the arm’s length principle;
- Preventing BEPS and loss of revenue;
- Increasing tax certainty from an international perspective;\(^{521}\) and
- Integrating Brazil in global value chains and fostering trade and investment in Brazil.

The relative simplicity of the existing system is mainly attributed to a potential reduction of the tax compliance burden (e.g., because of the absence of comprehensive comparability analysis and the adoption of fixed margins), a potential reduction of tax administration efforts (i.e. these efforts are limited to the enforcement of rules that are generally more prescriptive) and potential tax certainty from a domestic perspective (i.e. taxpayers are able to rely on predictable outcomes as long as they comply with these more prescriptive rules). However, this perceived simplicity is not always verified in reality. Complexity is not completely avoided, as evidenced by the item-per-item approach and associated documentation burden, a strict standard of comparability and other difficulties related to the practical application of inadequate rules (e.g., to transactions involving intangibles and intra-group services).

On the other hand, the key features under the current rules that contribute to simplicity undermine the dual objective of transfer pricing rules, meaning that double taxation and BEPS may prevail.\(^{522}\) The implications of double taxation include the negative impact on trade and investment flows (which are mostly limited to market- and resource-seeking investments) and on the integration of Brazil in global value chains. Significant loss of revenue is also caused by the gaps in the existing rules and the possibility to manipulate transfer pricing outcomes offered by these features (e.g., freedom of selection of the method, limited consideration of functional and risk profiles as well as profit drivers, application of inappropriate methods to complex transactions, etc.).

Full alignment does not mean that Brazil will lose the “positive” elements of simplification of its current transfer pricing system. Both scenarios consider simplification, ease of tax administration and tax compliance, and tax certainty as critical objectives, in order to ensure that significant features of simplification will be part of the system as there is merit in having elements which provide these benefits, as is currently the case. Notably, retaining an approach similar to the fixed margins approach – for example, in the form of carefully tailored safe harbours or rebuttable presumptions, in line with the arm’s length principle and based on sound economic analysis – presents a number of advantages in terms of simplification. Simplicity and certainty remain high on the agenda of priorities for developing the design of the new system.

Therefore, the key policy consideration that remains to be considered is whether Brazil should make this process immediate or gradual and therefore the considerations of making it gradual versus immediate are being considered in more detail.

\(^{521}\) Currently, taxpayers have “certainty” that their tax planning arrangements in accordance with the Brazilian transfer pricing rules will not be challenged and that double taxation disputes will not be resolved, so they may resort to involving third-party jurisdictions in their tax planning arrangements to mitigate the uncertainty, accept double taxation as an inherent cost of doing business in Brazil or, rather than relying on bilateral dispute resolution mechanisms, primarily rely on domestic administrative and judicial appeal mechanisms.

\(^{522}\) The outcomes of the technical analysis of the Brazilian transfer pricing framework show that out of the 30 issues identified, 27 create potential risks of double taxation and 23 lead to potential BEPS risks.
2.1. Immediate alignment versus gradual alignment

1051. The two options that emerged are the following:

- The first option for consideration seeks to immediately align the Brazilian transfer pricing rules with the OECD Guidelines ("immediate alignment");
- The second option for consideration seeks to gradually align the Brazilian transfer pricing rules to the OECD Guidelines ("gradual alignment").

1052. In other words, the scale of the implementation is essentially the same, but the timing of the implementation is different. Section 2.1.1 provides a comparative description of the two alternative options. Their advantages and disadvantages are discussed in Section 2.1.2.

2.1.1. Comparative description

1053. Convergence with the OECD transfer pricing standard requires full alignment with the OECD Guidelines, with a focus on the key areas outlined in Part I, but bearing in mind the need to retain and ensure simplicity, limit tax compliance costs and to ensure effective tax administration. The key consideration is how alignment should occur – immediately or gradually – and the related implications with respect to each option.

Immediate versus gradual

1054. The main difference between the two options relates to the timing of the implementation. A similar amount of preparatory work will be necessary to achieve full alignment, but if alignment is achieved under the first option, the new rules will become applicable for all taxpayers immediately, meaning that the lead-up to the entry into force of the new system will need to occur within a short timeframe with all different aspects of the system being rolled out simultaneously.

1055. It is envisaged under the first scenario that the adoption of the new system in conformity with the OECD standard will occur in one time and replace in whole the existing framework with a directly effective and operational framework, as opposed to a staged approach in the second scenario.

1056. The second option seeks full alignment of the Brazilian transfer pricing rules with the OECD Guidelines, but on a gradual basis. The approach is staged into three periods – short-term, mid-term and long-term – for the purpose of identifying separate stages. It takes into account the magnitude of the changes required by the alignment and proposes a more progressive, phased-in approach.

1057. Gradual alignment could follow two different alternatives:

- By setting the conditions for a progressive transition of taxpayers into the new system in the short-term, which could be based on the size of the MNE group and concern only the largest MNE groups operating in Brazil, and thereafter, by lowering the threshold based on an analysis of the population of taxpayers, as many times as deemed necessary (in the longer-term); or
- By defining a narrow scope of transactions to which the new rules will apply in the short-term, namely transactions involving the use or transfer of intangibles, intra-group services, and transactions that comprise business restructurings, before extending the scope to all transactions in the long-term.

1058. The threshold alternative targeting the largest MNE groups (Alternative 1) follows a horizontal approach for the application of the new rules because it would gradually affect different categories of taxpayers; yet, for the taxpayers that are subject to the new rules, it would address all the horizontal issues of transfer pricing. This approach would apply to the category of taxpayers consisting of MNEs which are part of an MNE group, and not to the single taxpayer category.
The other alternative focussing on specific transactions (Alternative 2) follows a vertical approach because it would affect all taxpayers immediately; yet, it will not address all the horizontal issues of transfer pricing but only have an impact on some categories of transactions, which may create similar issues as those outlined in the option for a partial alignment.

These two alternatives also raise different questions in terms of implementation.

Alternative 1 turns on the consideration of setting the threshold for the application of the rules to a smaller group of taxpayers. The threshold could be based on turnover, which would indicate the size of the MNE group and meaningfully distinguish between large and small MNE groups. The threshold could be developed based on an analysis of the population of taxpayers in Brazil. Inspiration could also be drawn from the threshold set in the European Union context for small and medium enterprises (SMEs).

Alternative 2 implies that all taxpayers will become subject to the new rules, most of which are unlikely to be prepared for the change, whereas Alternative 1 only concerns the largest groups of taxpayers, which are more likely to be able to cope with the change because they already apply rules based on OECD guidance when interacting with other companies of their group located in different jurisdictions. In parallel, the gradual approach will allow for the capacities of tax authorities to be gradually built up.

**Impact on tax administration and taxpayer preparedness**

The date of entry into force of the new rules in both scenarios would have to be carefully determined. If the immediate option is selected, the date of entry into force should consider matters of preparedness for both tax authorities and taxpayers. The date of entry into force will need to take into account the importance of the changes foreseen. This also means that a transition period will need to be managed between the announcement and the coming into force of the new rules, with its own challenges.

A gradual alignment would allow more time for the implementation of the system, and the entry into force of different elements of the new system in a carefully timed manner. It will leave sufficient time for small and medium enterprises to prepare for the application of the new rules; and, equally, to the tax authorities to build capacities in different areas before the new system is rolled out in full as well as to design the necessary safe harbours to make this transition as smooth as possible, considering that their transition costs would be higher than that of the large MNE groups which already apply similar rules in other jurisdictions.

However, issues related to the transition period could arise if the new rules are to be applied to specific transactions as a first step (Alternative 2). In this scenario, the rules will have to apply to all taxpayers (and carefully consider whether they would be prepared). Another important consideration will be the types of transactions to which new rules should apply and for which the existing rules should continue to be effective. It should be noted that these types of transactions are the most challenging to apprehend for tax authorities. Another complexity relates to transactions that combine both tangible and intangible property or services, for example tangible goods with embedded value of intangible assets or services involving valuable intangibles. It will be even more difficult to address these types of transactions under the new rules if this approach is followed and potential abuse and related disputes can be expected. The transition phase may be difficult to manage in terms of the interaction between the two co-existing systems, which could give rise to tax avoidance and tax planning, while also creating potential double taxation issues. It is also uncertain whether a dual system focussed on specific types of transactions would be functional in practice.

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523 The main factors determining whether an enterprise is an SME are: (i) staff headcount (fewer than 250 persons employed), and (ii) either turnover or balance sheet total (annual turnover not exceeding EUR 50 million or an annual balance sheet total not exceeding EUR 43 million).
In conclusion, the vertical approach (Alternative 2) is not considered to be feasible due to the numerous challenges it raises. The horizontal approach (Alternative 1) is thus favoured.

Prioritisation

The speed at which the changes will be implemented implies that various workstreams will need to take place either simultaneously if immediate alignment is sought, or they could be organised and prioritised in stages in the case of a gradual alignment. These workstreams notably cover:

- The policy design (key design features and rationale behind the changes);
- The drafting of the legislation (i.e. primary and secondary law framework and administrative guidance and manuals);
- Tax administration and tax compliance aspects, including capacity building; and
- Ensuring effective simplicity and tax certainty through the development of safe harbours, rebuttable prescriptive rules and other best practices on tax simplification.

The associated implementation considerations will significantly differ under each option and lend themselves to further reflection.

2.1.2. Evaluation of advantages and disadvantages of immediate versus gradual alignment

The advantages and disadvantages of the two options are explored according to their strengths and weaknesses and to the opportunities and threats they present.

Table 2.1. SWOT analysis of the option for immediate alignment

<table>
<thead>
<tr>
<th>Strengths</th>
<th>Opportunities</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Comprehensive and compact approach that addresses all existing issues at once;</td>
<td>- Positive impact on the tax base with capturing the revenue from profits which are currently shifted abroad;</td>
</tr>
<tr>
<td>- Quickly achieving full alignment;</td>
<td>- Could be combined with the implementation of other BEPS recommendations to addressing other BEPS issues, such as hybrids, exit tax, BEPS Actions 3, 4, and 7.</td>
</tr>
<tr>
<td>- Favourable to the accession process.</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Weaknesses</th>
<th>Threats</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Higher demand for resources, both to implement faster and to build up capacities faster;</td>
<td>- Risk of huge workload if the system cannot be properly administered;</td>
</tr>
<tr>
<td>- Short-term and mid-term demand for resources, including high upfront cost;</td>
<td>- Risk of inconsistent application of the new rules if unable to secure necessary capacity and resources.</td>
</tr>
<tr>
<td>- Heavy burden on taxpayers with limited leeway and time to prepare, especially on small and medium sized taxpayers which may not have capacity to comply.</td>
<td></td>
</tr>
</tbody>
</table>
Table 2.2. SWOT analysis of the option for gradual alignment

<table>
<thead>
<tr>
<th>Strengths</th>
<th>Opportunities</th>
</tr>
</thead>
<tbody>
<tr>
<td>• More controlled process and transition;</td>
<td>• Gradual broadening of the tax base;</td>
</tr>
<tr>
<td>• Progressive build-up of the necessary capacity (costs can be spread out over a longer period of time);</td>
<td>• Potential elimination of risk of abuse or loss of tax revenues;</td>
</tr>
<tr>
<td>• More time to develop the safe harbours;</td>
<td>• Acceptable option in terms of accession prospect.</td>
</tr>
<tr>
<td>• Gradual increase of the compliance burden on some categories of taxpayers;</td>
<td></td>
</tr>
<tr>
<td>• Possibility to apply the new rules first to taxpayers with the ability to comply with the new system.</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Weaknesses</th>
<th>Threats</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Longer-term commitment, which will require good planning and co-ordination of the different implementation steps;</td>
<td>• Risk of having an incomplete system if the process is derailed or delayed;</td>
</tr>
<tr>
<td>• Changes will not be directly applicable to all taxpayers;</td>
<td>• Risk of losing momentum if efforts are not sustained.</td>
</tr>
<tr>
<td>• Taxpayers which may not fall in the foreseen category applying the system may suffer double taxation in the regime, which could be managed by allowing to opt-in the system during transition period.</td>
<td></td>
</tr>
</tbody>
</table>

1070. Alternative 2 under the option for alignment on a gradual basis also presents additional weaknesses and threats.

Table 2.3. Additional weaknesses and threats of Alternative 2 (applying the rules to a narrow scope of transactions – intangibles, intra-group services, business restructurings)

<table>
<thead>
<tr>
<th>Weaknesses</th>
<th>Threats</th>
</tr>
</thead>
<tbody>
<tr>
<td>• All the taxpayers will be immediately exposed to the new rules, making it challenging to monitor them;</td>
<td>• Risk of having a dual system that is not functional in practice;</td>
</tr>
<tr>
<td>• These transactions are the most challenging to apprehend for both taxpayers and tax authorities;</td>
<td>• Risk of creation of new tax opportunities from the interaction of the two systems;</td>
</tr>
<tr>
<td>• Complexity related to the treatment of hybrid transactions for targeted transactions;</td>
<td>• Loss of revenue and double taxation due to the rigidity of the fixed margins in the existing regime, which would continue to apply;</td>
</tr>
<tr>
<td>• Issues arising from the interaction of the two systems.</td>
<td>• Missing out on voluntary compliance by large taxpayers;</td>
</tr>
<tr>
<td></td>
<td>• Problems and disputes arising from the administration of the two systems;</td>
</tr>
<tr>
<td></td>
<td>• Significant demand in terms of capacity of tax administration immediately rather than gradually;</td>
</tr>
<tr>
<td></td>
<td>• Complications arising from the introduction of a dual system.</td>
</tr>
</tbody>
</table>
2.2. Constitutional constraints

1071. The options for alignment need to take into account the Constitution as the supreme law of Brazil, which contains specific principles that should be respected when designing the system.

1072. The constitutional principles which may be relevant include, among others, the following:

- The principle of strict legality according to which no one should be obliged to do or refrain from doing something, except by virtue of law and all taxes must be imposed or increased by law;
- The principle of equality according to which taxpayers in equivalent situations cannot be treated unequally, and no distinction should be established by reason of professional occupation or function; and
- The principle of ability to pay according to which taxes should have an individual character and be graded according to the economic capacity of the taxpayer.

1073. These constitutional constraints have implications regarding the legislative implementation of the changes. However, there is no reason to believe, at this stage, that there would be obstacles to this implementation. Importantly, no need to amend the constitution was identified.

2.3. Other policy considerations

1074. Some of the BEPS risks potentially affecting Brazil’s tax base can be addressed through other measures outside of the transfer pricing framework. This section provides an overview of different policy options based on OECD recommendations, the implementation of which could be contemplated to strengthen Brazil’s tax system alongside the changes highlighted in Part I of this report. Their implementation would lead to increased protection against a broader range of various BEPS practices.

2.3.1. Special measures in relation to financial transactions

1075. The implementation of special measures in line with the BEPS Action 2 Recommendations,524 aimed at addressing mismatches resulting from differences in the tax treatment of hybrid financial instruments, can be contemplated to prevent BEPS risks related to payments made under these instruments.

1076. Special measures in line with the BEPS Action 4 Recommendations,525 developed to address the use of third party and related party interest, in particular, the deductibility of interest expense that may give rise to base erosion and profit shifting practices in both inbound and outbound investment scenarios, can also be introduced to prevent BEPS risks connected to intra-group financing arrangements.

1077. On top of the enforcement of redesigned transfer pricing rules, these two types of targeted measures would provide additional layers of protection against BEPS risks related to financial transactions.


2.3.2. Special measures in relation to branches and changes to the definition of PE in tax treaties

1078. As mentioned above, BEPS Action 2 recommendations target mismatches resulting from differences in the tax treatment of financial instruments or entities. The work on hybrid mismatches was subsequently expanded to deal with similar opportunities that arise through the use of branch structures, resulting in a 2017 OECD report Neutralising the Effects of Branch Mismatch Arrangements.\footnote{OECD (2017), Neutralising the Effects of Branch Mismatch Arrangements, Action 2: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, \url{http://dx.doi.org/10.1787/9789264278790-en}.} The introduction of such measures can be contemplated as well.

1079. Changes to the definition of PE in both the domestic law and bilateral tax treaties, as recommended under BEPS Action 7,\footnote{OECD (2015), Preventing the Artificial Avoidance of Permanent Establishment Status, Action 7 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, \url{https://doi.org/10.1787/9789264241220-en}.} could be considered hands in hands with the proposed changes concerning the determination of a PE’s profits, in order to address strategies used to avoid having a taxable presence in a country under tax treaties.

2.3.3. More effective CFC rules

1080. Even though this area was not part of the core analysis, it was observed that Brazil’s existing CFC rules present a number of weaknesses related to the scope and mechanics of their application, which could otherwise (if well-designed) rectify some of the weaknesses of the transfer pricing framework. It is also noted that some of the bilateral tax treaties concluded by Brazil contain specific provisions which prevent the application of CFC rules by Brazil. The recommendations in the form of building blocks for effective CFC rules set out in the BEPS Action 3 Final Report\footnote{OECD (2015), Designing Effective Controlled Foreign Company Rules, Action 3 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, \url{https://doi.org/10.1787/9789264241152-en}.} could serve as a basis for a systematic revision and enhancement of Brazil’s CFC rules.

Conclusion

1081. In light of the evaluation of the advantages and disadvantages of the two options, the gradual option in its horizontal conceptualisation (i.e. applying to an established group of taxpayers rather than a group of transactions) appears to be the most sensible way forward for the following reasons:

- It allows to address the specific challenges of small and medium enterprises by distinguishing them based on their ability and likely preparedness to apply a new set of rules;
- It allows small and medium enterprises to continue applying the existing rules until specific safe harbours and simplification measures are designed and implemented;
- It avoids the challenges related to the interaction between types of transactions (e.g., interrelated, embedded transactions) and similar issues as in the case of partial alignment that would have arisen until full alignment is achieved; and
- It provides the opportunity to prioritise and sequence the rolling-out of the new system.

1082. The specific implementation considerations for each option will need to be considered further and the system will need to be carefully designed regardless of which option is selected. For the purpose of informing the decision-making process, the preparation of an implementation blueprint and roadmap detailing with these considerations could be contemplated. It could cover the key aspects of the implementation under four workstreams: (i) a policy workstream outlining the policy rationale and the key design features; (ii) a legislative drafting workstream to establish the new legal framework; (iii) a capacity building workstream to ensure adequate administration of the rules; and (iv) a workstream dedicated to simplification and special measures.

1083. The policy rationale will need to be developed to explain the necessity of the changes, combined with an impact assessment quantifying the potential implications of such changes, will help decision-makers to understand the benefits of alignment. Following from this, a special focus will be required on policy design, i.e. on the key design features of the system.

1084. Drafting the legislation represents step in the implementation process, as significant efforts will be required to comprehensively establish all of the elements of the transfer pricing system in the law. Such activities should include both the drafting of the primary law and the secondary law. It will also require taking into consideration the relevant specificities and limitations of the broader framework in Brazil, such as constitutional principles.

1085. Changes to the structure of the tax administration and concerning the way human resources are currently allocated will evidently be necessary to ensure the adequacy of the transfer pricing function and the effective administration of the new rules. A capacity building component addressing all aspects of the system relevant to transfer pricing, including the tax administration functions but also functions related to effective dispute resolution, should thus be included in the implementation considerations.

1086. Ensuring simplicity will be a crucial objective along with achieving the objectives of ease of tax compliance, ease of tax administration and tax certainty. Simplification measures aimed at reducing the compliance burden of taxpayers and tax authorities will need to be developed, and this will include carefully designed safe harbour regimes and rebuttable presumptions, effectively turning the fixed margins into a series of safe harbours in line with the arm’s length principle and based on sound economic analysis to also ensure the simultaneous achievement of the dual objective of transfer pricing rules.
Annex A. Summary of business comments

Characteristics of participating MNEs

Representation by country and industry sector

1. The structured contribution of business stakeholders was made possible with a questionnaires, jointly developed with RFB, to collect input from Brazilian-headquartered MNE groups and foreign-headquartered MNE groups with operations in Brazil.

2. The questionnaire was distributed with the assistance of Business at OECD, which also ensured co-ordination with professional and trade associations, including the Confederação Nacional da Industria (CNI), Grupo de Estudos Tributários Aplicados (GETAP), Fórum das Empresas Transnacionais (CNI-FET) and Fórum de Competitividade das Exportações (CNI-FCE). Through the sectorial industry associations represented by CNI (e.g., automotive, chemicals, pharma, extractives, etc.) the questionnaire reached hundreds of MNEs. Co-ordination with Business at OECD ensured that the questionnaire reached the appropriate headquarters abroad, not only through direct engagement with MNEs which actively participate in Business at OECD. Accordingly, it is understood that the questionnaire was delivered to the tax departments of most, if not all, major MNEs worldwide.

3. The questionnaire submissions come from 51 MNEs headquartered in 11 different jurisdictions. The breakdown by country is: 16 MNEs headquartered in Japan, nine in the United States, six in Brazil, six in Switzerland, four in Germany, four in the United Kingdom, two in France, and one in Chile, Denmark, Spain and Luxembourg.

4. This summary of business comments was shared with the respondents, who were provided with the opportunity to raise additional comments, or to raise any issues regarding confidentiality.
5. Representation by industry sector is also broad. It includes the industries of food, electronic and IT, chemical, automotive, mining and metal, financial, steel, oil and gas, technology, construction material, insurance, pharmaceutical, air space, entertainment, power and automation technologies, service, retail, support services and machinery.

Figure A.2. Representation of MNEs by industry sector
Country-by-country Reporting obligations

6. All the MNEs responded that the group to which their company belongs is required to file a Country-by-Country report.

Scope of transfer pricing legislation

Chapter I of the OECD Guidelines addresses the scope of transfer pricing legislation. Under domestic rules, this scope may be narrower or broader in relation to the types of transactions (material scope) and categories of taxpayers who are considered related parties (personal scope).

In Brazil, there are specificities for both the personal scope and the material scope. For example, the personal scope encompasses transactions with entities in low-tax jurisdictions or beneficiaries of preferential tax regimes, and the material scope excludes certain types of outbound payments, which are not subject to transfer pricing legislation.

Personal scope and material scope

7. The majority of MNEs indicated that the personal scope of the existing transfer pricing rules in Brazil is broader and the material scope narrower, as compared to the OECD Guidelines. In respect of the personal scope, MNEs highlighted that the transfer pricing legislation in Brazil is broader because it sets out very specific situations in which one will be considered a related party, including direct and indirect ownership, management control, situations involving companies in low-tax jurisdictions or benefitting from privileged tax regimes, exclusive agents, exclusive distributors or dealers, and association based on family relations.

8. Concerning the material scope, most companies indicated that transactions involving outbound royalty payments and technical, scientific, administrative or similar assistance fees were excluded from the scope of transfer pricing legislation.

9. In addition, the legislation in Brazil may deem a transaction as being a controlled transaction even when the transaction is carried out between unrelated parties (e.g., transactions with entities located in low-tax jurisdictions). One MNE stressed that the personal scope under the Brazilian legislation might not capture some situations where a link between companies exists, meaning that in some situations a transaction under the Brazilian legislation that would be considered as being performed between unrelated parties, might be considered a controlled transaction under the OECD Guidelines. However, this comment was isolated and not reflected in the input provided by other MNEs.

10. One MNE raised a different point of view regarding the personal scope, stressing that the OECD definition of a related party could be considered broader than the one contained in the Brazilian legislation. According to the OECD Guidelines, one has to analyse each concrete case to verify whether a person influences the price and therefore could be considered as a related party. On the contrary, the Brazilian legislation provides an exhaustive list of situations in which one could be considered as a related party and therefore does not allow any flexibility.

Disadvantages

11. Some MNEs commented on the resulting inconsistencies and conflicts between tax authorities in different jurisdictions (e.g., caused by the exclusion of outbound royalty payments, or the “grey/black lists”), which were said to lead to cases of double taxation.

12. Especially in regard to the personal scope, companies commented that if a tax adjustment were to be made in Brazil it was likely that the other jurisdiction would not provide relief due to the application of
the transfer pricing rules in a scenario where the transaction would not be subjected to transfer pricing control abroad – also undermining the objective of avoiding double taxation.

13. Some companies stressed that transactions carried out with third parties which are residents in listed countries were systematically subject to transfer pricing adjustments, even when carried out under arm’s-length conditions. In this sense, one MNE reported that it was facing significant adjustments when undertaking import transactions of natural oil with a low-tax jurisdiction. The company indicated that the product (a raw material produced locally) was listed on the local stock exchange. In such a case, the transaction price was the actual market price (i.e. the result of a transaction undertaken with an unrelated party) but since the country was considered a low-tax jurisdiction, the company faced significant adjustments.

14. A major concern raised by some MNEs was that by having to provide supporting documentation for transactions carried out with unrelated parties located in low-tax jurisdictions as if they were related parties, the selection and application of transfer pricing methods become more difficult, and could even be constrained, which could then lead to transfer pricing adjustments in Brazil and create double taxation. For example, a company that imports services from service providers that are residents in a “grey-listed” or “black-listed” jurisdictions will face difficulties with the application of the CPL method (broadly equivalent to the OECD-recognised cost plus method for imports), which requires using data on manufacturing costs incurred by the supplier, as this information is unlikely to be disclosed by an unrelated party.

15. With regard to the material scope, the limitation on the deductibility of royalty fees (e.g., license fees) paid to foreign parent companies was considered to be a major disadvantage for some MNEs. One MNE indicated that the fixed deductibility limitation for royalties does not capture the market and economic conditions of a royalty payment, which may involve significant investment to develop intangible property, and which cannot be properly compensated by a Brazilian subsidiary. One other concern (that will be explored in more detail in a further section) is the fact that patents and trademarks are first required to be registered and approved by the INPI (Brazilian Patent Office) before license payments can be made.

Advantages

16. One company commented that the personal scope under the Brazilian legislation brings more certainty and less subjectivity since the definition of related parties is determined by reference to an exhaustive list.

Transactions with entities located in countries included in Brazil’s lists of low-tax jurisdictions or preferential tax regimes

17. Companies were asked whether they carried out transactions with entities located in countries or involving tax regimes included in the list of low-tax jurisdictions or the list of preferential tax regimes. The majority of MNEs reported that they perform transactions with entities – related and/or unrelated – concerned by Brazil’s lists.

18. As a follow-up question, MNEs were asked to indicate the materiality of these transactions, including, if they relate to sales activities, the percentage of total sales turnover, or if they relate to purchases, the percentage of total purchases. For the larger part of the respondents, the transactions were characterised as being insignificant, if compared to the total number of transactions carried out. Some
MNEs that regularly undertake transactions with related parties provided further details concerning the volume of such transactions, which gave a range of results, from significant to insignificant.529

19. In addition, one MNE that had carried out transactions with a related party in a country included in Brazil’s lists of low-tax jurisdictions or preferential tax regimes, indicated having set up offshore structures to export products. The company explained the commercial rationale, describing that it undertakes export transactions of commodities from its own producer and commodities purchased from other local producers in Brazil, and subsequently exports the product to its customers. The company indicated that the offshore structure was used as a commercial shield to standardise prices. It also pointed out that there was no tax efficiency or inefficiency, as the transfer pricing rules would normally apply in such circumstances.

20. More specifically, MNEs were asked whether these transactions, if any, were carried out with related or unrelated parties. At least 13 companies indicated that their businesses involve carrying out transactions with unrelated parties located in jurisdictions which are included in Brazil’s lists of low-tax jurisdictions or concerned by the list of preferential tax regimes, but most of them indicated that the materiality of these transactions was not significant. At least four of these companies indicated that their transactions were of relevance to their business, but they did not specify to what extent.

Relevance of the comparability analysis in the application of transfer pricing methods

As stated in Chapter I of the OECD Guidelines, the “comparability analysis” is at the heart of the application of the arm’s length principle. The application of the arm’s length principle is based on a comparison of the conditions in a controlled transaction with the conditions that would have been obtained had the parties been independent and undertaking a comparable transaction under comparable circumstances. There are two key aspects in such an analysis:

- the first aspect is to identify the commercial or financial relations between the associated enterprises and the conditions and economically relevant circumstances attaching to those relations in order that the controlled transaction is accurately delineated;
- the second aspect is to compare the conditions and the economically relevant circumstances of the controlled transaction as accurately delineated with the conditions and the economically relevant circumstances of comparable transactions between independent enterprises.

Importance of the identification of commercial or financial relations between associated enterprises regarding the relevance of the comparability analysis

21. MNEs generally share the view that the concept of comparability in Brazil is completely different from what is described in the OECD Guidelines.

22. Most MNEs pointed out the absence or very limited importance of the functional analysis and other comparability factors, including the underlying commercial or financial relations, economically relevant circumstances, and the different business models and business strategies; as well as a disregard for value creation. For example, the Brazilian rules do not differentiate between a distributor with relevant marketing and sales functions and one that simply carries out logistics functions.

529 For example, 5% of total sales of services and commission turnover; 50% of imports of goods; 96% of total exports amount and 16% of total imports amount; 100% of transactions; 45% of total importation of goods; one MNE indicated that the percentage is material for exports (to offshore entities) when compared to the total transactions of the year.
23. Instead of performing such a comparability analysis, MNEs highlighted the need to calculate arithmetic average prices of goods, services or rights to establish the transfer price of transactions between related parties, the terms of which must be equal for comparison purposes, especially for methods requiring the items to be closely “similar and identical”, with the same nature and function. They stressed that the important factors under this standard of comparability were the contractual terms and the characteristics of property or services.

24. Some companies indicated that the PIC and PVEx methods (broadly equivalent to the OECD-recognised CUP method) were the only methods which required a comparability analysis similar to the comparability analysis applied in the context of the OECD Guidelines, and that these methods were rarely adopted by taxpayers in Brazil due to their complexity and to a lack of comparables.

**Differences between Brazilian and OECD versions of resale price and cost plus methods (PRL for imports and PVA/PVV for exports; CPL for imports and CAP for exports) regarding the relevance of the comparability analysis**

25. Concerning the relevance of the comparability analysis, the main difference between the Brazilian and OECD versions of the resale price and cost plus methods reported by MNEs is related to the difference of outcomes. In other words, companies generally shared the view that when fixed margins apply the comparability analysis becomes considerably less relevant than under the OECD-recognised methods.

26. One MNE pointed out that the lack of comparability analysis for the methods that broadly correspond to the resale price and the cost plus method is critical, because limited-risk models should not be remunerated in the same way as full-fledged models given that functions performed, assets used and risks assumed are significantly reduced. Similarly, some companies stressed that the Brazilian transfer pricing rules may require using the same profit margins regardless of the business model, the role of the parties involved in the transaction, the volume, contractual terms or other relevant factors.

27. Some of the examples provided by the respondents included the following:

- To apply the PRL method (RPM-equivalent for imports), the margin for pharmaceutical companies is 40% regardless of their functional profile, i.e. whether the company in Brazil sells innovative or generic medicine, whether it sells to distributors in charge of promotion or if the company has its own sales force, etc.;
- The fixed margin of the CAP method (CPM-equivalent for exports) is 15%, without taking into account whether the Brazilian company is a full-fledged manufacturer or if it just resells a product manufactured by third parties;
- The fixed mark-up on service fees (15%) for the CAP method is applied regardless of the type of service (i.e. low- or high value-adding services), which can often be considerably lower or higher than what can be found in comparable transactions when applying the equivalent OECD-recognised method;
- The fixed margin in the PRL method (RPM-equivalent for imports) does not allow for fluctuations due to market factors, the economy or the product’s lifecycle as would be considered under the OECD approach.

**Differences between Brazilian and OECD versions of the comparable uncontrolled price method (CUP) regarding the relevance of the comparability analysis**

28. Most companies stressed that the methods inspired by the OECD-recognised CUP method available in Brazil do not fully conform or align with the OECD Guidelines, but considered the comparability analysis to be “more relevant” for such methods.
29. However, MNEs noted that the PIC and PVEx methods (CUP-equivalents) do not require an appropriate functional analysis, since the comparison mainly observes the properties of the goods, services or rights and commercial or financial relations are not fully considered.

30. Some companies stated in more general terms that some comparisons that technically would not make sense under the OECD approach were permitted, and conversely, comparisons that would be acceptable were not.

31. Issues concerning supporting documentation for the application of the PIC and PVEx methods were also raised.

**Strengths of the fixed margins approach**

32. The major strength of the fixed margins approach for companies relates to the fact that no extensive transfer pricing analysis is required under the Brazilian transfer pricing legislation.

33. The approach is also considered by some to be objective because it relies based on a mathematical approach. Since the fixed margins avoid the need for specific comparables and benchmark studies, it also provides certainty and provides predictable returns on investment, but some respondents also suggested that there are instances where part of the profits are not fully taxed as a consequence.

**Weaknesses of the fixed margins approach**

34. The main weakness described by respondents was that as a result of fixed margins, the concept of comparability in the OECD Guidelines is largely irrelevant, and not required, notably because the same profit margins apply regardless of the business model and the role of the parties involved in the transaction (i.e. functional profile).

35. In this context, the key weaknesses raised by companies were related to:
   - The lack of reflection of the economic reality;
   - Distortions of competition;
   - Double taxation; and
   - Tax uncertainty.

36. A number of MNEs pointed out that the margins were, in some situations, too high or too low compared with a comparability analysis based on the OECD Guidelines, which leads to taxation not in accordance with profitability or distortion of their tax liability. In some cases, over-taxation or under-taxation of transactions may occur because the margin imposed is higher or lower than the profit actually derived by the company.

37. The consequence of such inappropriate reflection of the economic reality may also have an impact on the competitiveness of the company according to some of the submissions.

38. With respect to the impact on competitiveness, one MNE provided the following practical example. In this scenario, the Brazilian producer sells its product for 100, which would mean that the MNE would not be able to sell in Brazil for a price that would diverge too significantly from 100 or it could be out of the market. The MNE imports the product in Brazil for a total of 85 and can sell it for 100 with a profit margin. If the MNE has to apply a minimum 30% margin when applying the Brazilian version of the resale price for imports (PRL method), it would either sell for a price above the 100, or sell for a lower value but then immediately adjust its tax base. The MNE pointed out that the application of the fixed margin prescribed by the legislation leads to a clear disadvantage in the business they are carrying on, as it is disconnected from the reasonable market practice in their segment.
39. Another MNE indicated that the fixed margins do not work for certain products with very low profit margins for importation activities, and consequently, the fixed margins trigger transfer pricing adjustments.

40. Concerning tax certainty, the use of the PRL method (RPM-equivalent for imports) and the CAP method (CPM-equivalent for exports) usually result in transfer pricing adjustments in Brazil due to the absence of a functional analysis and risk analysis and due to the application of a margin achieved at a product level.

41. Some comments also raised a concern with more practical aspects, especially difficulties related to supporting documentation and the calculation of the ratios.

**Outcome of the application of the Brazilian transfer pricing framework with respect to imports and exports as compared to the OECD Guidelines**

42. One comment pointed out that outcomes differ with respect to both import and export transactions. For important transactions, the company’s experience is that the transfer pricing adjustments derived from the application of the PRL method (RPM-equivalent for imports) are usually very high (with difficulties to achieve a 30% margin for all products imported) and result in double taxation from a group perspective. For export transactions, the company reported an inclination to apply the CAP method (CPM-equivalent for exports), and highlighted that under the application of this method it is required to sell products with a cost plus 15% mark-up, which is substantially high for most manufacturing companies. In addition, the MNE stressed that it was possible to face situations where the Brazilian company is only distributing the product (i.e. no production activities are performed in Brazil) to related companies abroad, and it would require the application of the margin of 15% for a limited-risk distributor, which is extremely high taking into account its function and risk profile.

43. The same entity indicated that this prevents Brazilian legal entities to work as intermediate manufacturers, since tax adjustments lead to a scenario where business judgment is not reasonable. For example, in the case of an internal project that aimed to bring a production phase from Europe to Brazil, the semi-finished products would be exported from Brazil to other countries within the South American region and margins on such business transactions are normally low, so the application of both the PRL (import of raw materials to Brazil) and CAP (export of semi-finished goods from Brazil) methods made the cost unsustainable.

44. Another MNE stressed that it experienced significant differences in terms of outcomes for imports, especially due to the fact that no offsetting is permitted between products with positive and negative margins. Additionally, the company indicated that this leads a scenario where there is an increase in the tax base for the products with margins below the statutory ones (in the PRL method, for example) and products with high margins are simply disregarded in the calculation of an adjustment. In the export scenario, the company reported that they would apply safe harbours that generate an exemption or no adjustment in many cases.

45. Some other companies indicated that the outcome under the Brazilian transfer pricing framework with respect to imports is not close to the outcome that would result from the application of the OECD-recognised methods. There will be a significant difference in the final allocation of profits, especially due to the fact that Brazil presents only (i) transactional methods and does not allow transactional profit methods, (ii) follows a transaction-by-transaction approach, and (iii) imposes fixed margins regardless of the specificities of the business activity.

46. One company pointed out that the outcome would be different under the Brazilian approach due to the lack of reliable comparables and the incidental application of the fixed margins, which are not based on economic reality.
47. Another MNE stressed that, historically, the Brazilian legislation favoured export transactions as compared to import transactions. The minimum requirement of profits on imports, the documentation requirements if the taxpayer wishes to use uncontrolled transactions, and the lack of safe harbour for imports were said to demonstrate this bias toward exports transactions.

Implications of the differences in respect of the comparability analysis from the perspective of achieving the dual and other objectives of the transfer pricing rules

48. Several companies perceived that the comparability analysis under the Brazilian transfer pricing rules shows no concern in respect of securing an appropriate tax base in each jurisdiction, although some recognised that its application does not avoid double taxation (e.g., outcomes do not lead to an arm’s-length result).

49. Some MNEs stated that with respect to the other policy objectives of the transfer pricing rules, the Brazilian legislation and its fixed margins highly reduce the tax compliance burden. One company also indicated that the fixed margins provide tax certainty.

Transfer pricing methods

The guidance in Chapter II of the OECD Guidelines recognises “traditional transaction methods” and “transactional profit methods” that can be used to establish whether the conditions imposed in the commercial or financial relations between associated enterprises are consistent with the arm’s length principle. Traditional transaction methods are the comparable uncontrolled price method or CUP method, the resale price method, and the cost plus method. Transactional profit methods are the transactional net margin method and the transactional profit split method. Not all of these methods are recognised under the Brazilian transfer pricing framework.

<table>
<thead>
<tr>
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<td>Transactional net margin method (TNMM)</td>
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<td>Profit split method (PSM)</td>
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Note: This table is provided for reference purposes.

Challenges raised by the unavailability of transactional profit methods

50. MNEs mainly stressed that the absence of transactional profit methods makes it difficult to ensure that their tax base remain consistent across jurisdictions in order to avoid double taxation. Such absence notably reduces the possibility to align outcomes across jurisdictions, combined with the fact that the available methods in Brazil do not allow for the proper allocation of risks and functions on a global basis.
A number of companies identified difficulties in finding appropriate methods for some operations carried out in Brazil (e.g., transactions in the financial industry). Among these companies, some indicated that the absence of the TNMM affected their group’s global transfer pricing policy. They indicated that in the absence of the TNMM or a similar profit-based method, there was no other choice but to apply the traditional transaction methods, even if less suitable/appropriate, mostly the PRL method (RPM-equivalent for imports). It was further reported that such absence increased the likelihood of non-arm’s length transfer pricing adjustments because it is not possible to apply the PRL method by product group, nor is it possible to offset the adjustments for products with insufficient margins with those with excess margins.

MNEs also generally reported that the absence of the transactional profit methods led to a product-by-product approach, which greatly increased the taxpayer’s compliance burden, is more difficult to apply in practice, results in difficulties in regard to defining the cost (calculation/ratio and documentation) as well as difficulties in obtaining disclosure of the information from other parties, and creates double taxation.

One MNE group in particular explained that many of its entities faced challenges with the application of the Brazilian versions of the cost plus method, as they cannot be applied for any manufacturing process. This is due to the fact that actual production costs need to be documented and evidenced by the supporting documentation, which is almost impossible in most manufacturing processes where actual production time and input material can vary from one production run to another.

One respondent pointed out that in a situation involving a distributor in which the most appropriate method applicable under the OECD Guidelines is one of the transactional profit methods, one may face the outcome that the distributor’s net profit margin will fall within the arm’s length range, but a transfer pricing adjustment will be due on the Brazilian side of the transaction because Brazil does not recognise the result of the method applied by the foreign entity. For example, if one company applies the TNMM on the European side (i.e. following the OECD approach) and the CAP method (CPM-equivalent for exports) on the Brazilian side, the distributor in Europe does not have any transfer pricing issue; however, the manufacturer in Brazil suffers a transfer pricing adjustment. In this example, the fact that in Brazil one cannot define which party will be tested (meaning that the entity located in Brazil will have to be tested in any case) was also identified as a challenge.

A further challenge reported by one MNE relates to a scenario where an associated distributor located in a jurisdiction that follows the OECD Guidelines is selected as the tested party for the application of the TNMM. Assuming that the Brazilian subsidiary is selling two different products to a related party, and considering the product-by-product approach found under the Brazilian legislation, the entity could be forced to apply the CAP method (CPM-equivalent for exports) for one product and the PVEx method (CUP-equivalent for exports) for the other product. The result is a clear conflict created by the absence of the TNMM in the Brazilian framework.

Some MNEs even indicated that they avoided cross-border transactions with related parties in Brazil to the extent possible.

Key differences in the application of the existing transfer pricing methods in Brazil compared to their equivalents in the OECD Guidelines

The principal differences identified by companies were the irrelevance of the functional analysis as developed by the OECD Guidelines, and the fixed margins, which are imposed by law for the PRL, CAP, CPL, and PVA/PVV methods.

Companies indicated that the idea of “comparability” was only used to some extent for CUP-inspired methods (PIC and PVEx methods), but that such methods lost their identity in relation to the OECD-recognised CUP method by requiring the calculation of average prices while ignoring important comparability factors, which diverges from the intended aim of establishing the transfer price according to the OECD Guidelines.
59. Another key difference mentioned by some respondents was the fact that all the methods in the OECD Guidelines are applicable to either import or export transactions, whereas under the Brazilian rules, specific methods are applied to import and export transactions. Besides, it was highlighted that it is mandatory to use specific methods for commodities under the Brazilian law.

60. One company commented that although standard methods appeared similar on the surface, their application in practice differed significantly as compared to the OECD Guidelines. The company indicated that many firms faced challenges, for instance, regarding the Brazilian version of the resale price method, which demands individual gross margins calculated per product considering only the import costs over an apportioned revenue based on the same costs (e.g., if 70% of the product cost comes from an intra-group operation, only 70% of the sales price is considered in the analysis), which demands a strict control and analysis of all production orders for all products sold.

61. Other general comments addressed differences in the application of the methods, such as:
   - The number and types of adjustments that are allowed;
   - The duration of the tested period, which is only one year (i.e. it is not possible to use three- or five-year averages);
   - The detailed calculations used to determine the year average comparable price and actual prices for each product, based on actual invoices and other fiscal documents, rather than simpler margin comparisons and testing (i.e. a burdensome process);
   - The tested party, which is imposed by each method, so it is not possible to choose the most appropriate tested party as recommended by the OECD Guidelines;
   - The calculation/formula used (e.g. for gross margins). For example, applying the PRL method is not as simple as determining the gross margin as would be the case under the equivalent OECD-recognised method, which generally accepts the statutory financial statements as the data source for testing. Instead, the Brazilian transfer pricing system prescribes the formula and specific costs, justifiable through the electronic reporting system; and
   - The selection of profit level indicators, which is imposed under the Brazilian system for the PRL method, whereas the broadly equivalent OECD-recognised resale price method allows operating margins, gross margins, costs, and return on assets.

Implementing the outcomes of transactional profit splits

62. Many MNEs reported that it was not possible to implement the outcomes of the profit split method in Brazil. They stressed that in the case where a foreign related party applies the profit split method, the Brazilian entity will be forced to apply one of the Brazilian methods. It will either choose a traditional transaction method exclusively for Brazil (which would also double the compliance work), or calculate the appropriate adjustment according to the domestic rules.

63. One of the companies indicated that for the importation of goods for resale (when applying the profit split method), the Brazilian entity would switch to the PRL method, and adjust any transaction that did not achieve the 20% profit margin in the resale operation, even when the profit split method concluded that the transactions were carried out at arm’s-length. Double taxation issues were raised in this context.

64. One MNE explained that it was forced to adapt to one of the existing methods available in Brazil. It indicated that the MNE group members worked together to establish the prices to be performed in transactions with Brazil in order to avoid transfer pricing adjustments in Brazil. One MNE indicated that it determines the pricing of a controlled transaction based on the profit split method and calculates the parameter price based on the Brazilian PRL method afterwards. By doing this, the company indicated that it might have a visibility as to whether a transfer pricing adjustment in Brazil would be necessary.
Challenges arising from “other methods” not being permitted

65. Some companies stressed that to the extent that they are prevented from relying on “other methods”, it becomes difficult to ensure that the tax base is consistent across jurisdictions in order to avoid double taxation. Another company also mentioned that it is a challenge to apply existing methods to transactions involving intangibles and the existence of “other methods” would help reduce the existing difficulties. One MNE specifically pointed out that problems are more evident in the financial industry.

66. Some companies indicated that such absence represents a challenge particularly in transactions that are typically priced with internationally accepted valuation methods, including transactions that are not in the scope of the Brazilian transfer pricing legislation or transactions for which there is no guidance. For example, transactions involving intangibles (such as buy-in payments for the purchase of intangible property, transfers of intangible assets), in the context of cost-contribution arrangements, the purchase of a company’s equity, or complex transactions like a payment for a license that allows the exploitation of a specific market, or transactions for which no acceptable comparables exist (e.g., importation of fixed assets), among others. One comment in particular suggested to align the existing rules with the guidance on hard-to-value intangibles (HTVI) in the OECD Guidelines and to consider the use of valuation methods to determine the value of intangibles.

67. One MNE group pointed out that reliable comparables were rare in the IT industry. Their submission stated that the lack of “other methods” is a problem in cases where the parties are not able to achieve the fixed margins required by the Brazilian legislation.

68. Another company indicated that the absence of “other methods” creates double taxation because the industry is not allowed to use methods that could be better suited to their own circumstances. It was also highlighted that this creates problems for business when they try to locally develop new business models, set up new strategies, finance transactions, develop intangibles and other innovations, and to be properly remunerated for the activities performed.

Freedom of selection of the method – more suitable outcomes than the most appropriate method criterion?

69. For the vast majority of companies, the freedom of selection of the transfer pricing method does not achieve a more suitable outcome than the outcome produced by following the most appropriate method criterion prescribed by the OECD Guidelines.

70. A number of companies pointed out that the freedom of selection of the method leads taxpayers to apply the method that yields the lowest taxable income or the greatest level of security for the company to calculate, prove and document the reported price – which does not seem to lead to a more appropriate outcome.

71. Some companies indicated that even though they benefit from this freedom of choice, the most commonly used methods are the CAP method (CPM-equivalent for exports) and the PRL method (RPM-equivalent for imports), because these methods can be applied by using information that is available to both taxpayers and tax authorities (e.g., tax invoices and financial statements). It was also stated that although more methods exist under the Brazilian law, they are hardly applicable because of the associated documentation requirements, in particular the CPL method (CPM-equivalent for imports) and the PVV/PVA methods (RPM-equivalent for exports).

72. It was also stated that although Brazilian entities can freely select a method, there are challenges that jeopardise this freedom, such as practical difficulties for some methods, including calculation/ratio and documentation, high fixed margin and difficulties in accessing information from other parties.

73. Two advantages of the freedom of selection of the method are reportedly the ability to change the method within 30 days after it has been refused by the tax administration at the beginning of a tax
assessment. The second advantage raised by another company is that the freedom of selection of the method removes the subjectivity and uncertainty associated with the methods prescribed in the OECD Guidelines, assuming the outcomes are acceptable to all affiliated parties.

74. Other companies which responded that the freedom of selection leads to more suitable outcomes than the most appropriate method criterion did not provide further explanation.

**Freedom of selection of the method – achieving the dual objective of transfer pricing rules**

75. A number of companies highlighted that the freedom of selection of the method in the context of the Brazilian rules creates room for tax planning and for finding the method that, although divergent from the company policy, creates the less significant tax adjustment, if any. The taxpayer may choose to switch from one method that is better suited to one that reduces the risk of double taxation on an annual basis.

76. Other respondents stated that the freedom of selection of the method eased the tax compliance aspects, but did not always lead to the actual arm’s-length transfer price. Some companies pointed out the fact that cases of double taxation may be reduced, but not necessarily avoided. In addition, it was stated that the freedom of selection of the method prevents further distortions in the application of the rules from occurring due to the absence of a complete comparability analysis (including functional and risk analyses).

**Other issues or challenges related to the application of the existing transfer pricing methods in Brazil**

77. It was reported by some MNEs that it is hardly possible to apply the PRL method (corresponding to the RPM for imports) or PIC method (corresponding to the CUP method for imports) for service transactions. The only option is the CPL method (corresponding to the CPM for imports), which one company indicated is often not accepted due to Brazilian accounting/tax rules. The main issue with respect to the application of the CPL method is that all the production cost information must be calculated in accordance with Brazilian Generally Accepted Accounting Principles (GAAP). Therefore, some of the expenses (e.g., royalties, Selling General and Administrative Expenses, SG&A, etc.) originally registered as costs for the producing company under local GAAP must be excluded from the cost basis for Brazilian purposes.

78. One company indicated as an issue the possibility of “arbitrage” by the tax authorities, when it is not possible to apply all requirements of the Brazilian versions of the CUP or cost plus methods. In this context, another company highlighted that there are some transactions for which none of the methods might be properly applied, which brings uncertainty about the tax authorities’ approach in case of a tax assessment.

79. Some companies identified issues in relation to documentation, notably to demonstrate the margins of foreign entities (required in some situations even for unrelated parties), to provide proof in cases of cost-based methods (CAP and CPL methods) and CUP methods (PIC and PVEx methods), where the tax authorities require justification for raw material costs, detailed calculation of overhead charges, standard cost versus actual costs, the translation and notarisation of several pages of evidence, instead of relying on assessments of audit firms.

80. One company stressed that with respect to the equivalent of the resale price method, one major challenge is the foreign exchange rate fluctuation. With the level of volatility in Brazil it is impossible to plan transfer prices, and the PRL method (Brazilian version of the RPM for imports) will result in high transfer pricing adjustments and double taxation. Ideally, according to the company, there should be a mechanism to soften foreign exchange fluctuations.
Another challenge is related to the equivalent of the cost plus method for imports (CPL method), and the level of scrutiny of the foreign tested party’s production costs. Brazilian tax authorities demand an extreme level of detail to accept production costs or costs of providing a service, down to the level of invoices to prove the cost of raw materials or time sheets to prove allocation of hours, which makes it unfeasible to apply the equivalents of the cost plus methods in the majority of cases.

**Freedom of selection of the method through the lens of ease of tax compliance and tax certainty**

82. A number of MNEs responded that the freedom of selection of the method does not bring ease of tax compliance because such freedom amounts to creating the need to run calculations under all available methods to achieve low or no adjustment(s).

83. As regards tax certainty, companies indicated that it was not uncommon for the tax administration to reject the application of methods for reasons related to documentation, even minor documentation issues. A related argument concerned challenges and difficulties to reach the required data and documentation, such as information necessary for the calculation, and additional documents requested by tax authorities during an inspection.

84. Two companies specified that the tax authorities also benefit from the freedom of selection, which may cause more disputes and accordingly more uncertainty.

85. Another group of companies responded that the freedom of choice contributes towards certainty and ease of compliance because such feature allows companies to opt for methods that can be calculated with the information that is already available and is the most reliable, thus easing the burden in terms of tax compliance and providing more certainty. It was also stated that a taxpayer knows better what are its margins and the available market information which can support the application of a specific method.

**Frequency of the application of the equivalents of the CUP method or cost plus and resale price methods**

86. Based on the input provided, it appears that the frequency of application of the methods varies depending on the industry sector.

87. MNEs operating in the automotive industry reported the use of methods that require only in-house information, such as the PRL method (RPM for imports) and CAP method (CPM for exports). If positive results are not met, the companies resort to alternative methods based on external data, such as the PVA/PVV methods (RPM for exports) and CPL or PIC methods (CPM or CUP for imports). One MNE highlighted that CUP-equivalent methods are only used when a particular transaction does not meet the required margins of the cost plus- and resale price-equivalent methods. Another MNE indicated the application of the PIC method for up to 5% of their imports (for merchandise resales only) and the PVEx method sporadically if they were to have the same item sold in the domestic market; while the PRL method is applied in approximately 95% of their imports and the CAP method applied in practically 100% of their exports.

88. MNEs operating in the chemical industry indicated a high frequency of the application of the cost plus method for export transactions (CAP method) – especially for exportation of services. One company highlighted a low frequency concerning the application of CUP-like methods, which was confirmed by other MNEs that reported the use of the PIC method in just 3% of transactions. The company indicated the application of the CPL method in 97% of its imports and the application of the CAP method in 100% of its exports (services). Another MNE explained that it initially applied the resale minus method for all import transaction, then identified among the highest adjustments those that have uncontrolled prices available for the CUP method, which is normally applicable for 59% of the total cost of the products imported.
89. In the food industry, one MNE reported difficulties in the application of the CUP-equivalent methods because of the lack of reliable comparables. Another respondent indicated that for exports the company used the PVA method with a ratio of 65%, 35% for CAP, while the PVEx method when used is less than 1%. For imports the MNE used the PRL method in a ratio of 75% and 25% for the PIC method. Other entity generally indicated the use of the equivalents of the CUP methods, cost plus methods and resale price methods, and stressed that the CPL and PVV/PVA methods were never used because of the difficulties to obtain information from the company abroad.

90. MNEs operating in the technology, electronic and IT industry highlighted that the CUP-equivalent methods (PIC or PVEx methods) were hardly applied by the industry. For imports, companies generally indicated the application of the equivalents of the resale price method and the cost plus method (PRL and CPL respectively) – and the PRL as the most used. For exports, the industry appears to favour the use of the equivalent of the cost plus method (CAP method).

91. MNEs from the financial industry indicated the application of the methods corresponding to the cost plus methods. One particular company from the insurance sector stressed that in their cross-border reinsurance transactions, the CUP method is applied – the entity has access to data on their comparable transaction with unrelated parties for this type of transaction.

92. The input provided by MNEs in the pharmaceutical industry generally pointed towards the application of the CUP method for imports (PIC method).

93. In the mining, metals and oil sector, the majority of the operations are subjected to the application of the commodity methods (PCI and PECEX methods). Some MNEs reported that a small part of their acquisitions was subject to the CUP-related methods. Other MNEs reported that the usual pathway was: (a) the application of the resale price related methods (PRL or PVA/PVV methods) based on information available in-house; and if any adjustments, then (b) application of CUP correspondents (requiring information from global peers, and following a "logical" and to some extent "defendable" set up of supporting documentation; if still giving rise to some adjustment then the company would move to (c) the application of the cost plus-related methods (CLP and CAP methods), the substantiating of their application being difficult and uncertain.

94. One MNE operating in the power and automation technology industry indicated the application of the PRL and CAP methods for nearly 95% of their products, and the PIC method for around 5% of their products (no use of CPL, PVEx, PVV/PVA methods).

95. One MNE that did not disclose its industry, but qualified itself as being a trading company, generally pointed out that the resale price for imports (PRL method) was applied with respect to their import transactions. For exports, since the entity only exports services, the cost plus method (CAP method) for exports is applied.

Experience with applying the mandatory methods designed for commodity transactions (PCI and PECEX methods)

96. Some companies indicated that the legislation requires the PECEX to be applied not only to commodities quoted on international futures and exchange markets, but also to products that have prices indicated by publications through research agents even if they are not actually negotiated on an “established market”, which creates distortions as these publications compile data based only on research instead of actual market data. One company indicated that such provisions, for situations in which Brazilian entities would adjust prices using as a reference the prices published in specialised magazines, create distortions because the prices referenced therein are not based on the same commercial conditions. The entity stressed, for instance, that it may need to use publications listing prices from Asia in case this is the only publication available for their commodities, even though the transactions refer to exports or imports.
to/from the United States or Europe. As a consequence, entities usually end up facing transfer pricing adjustments.

97. MNEs identified issues in the lack of clarity of the rules, especially related to Normative Instruction 1,312/2012. Some comments revealed that companies needed to use the exchange rate of the “transaction date”, but that there was no further guidance about the definition of a transaction date. In addition, they pointed out that the legislation does not provide any definition of the term “premium paid”, which creates uncertainties about how to adjust the price to be compared with the market price provided by commodities exchange institutions.

98. One particular reference was made to the stock exchange price, in the sense that it is necessary to use the average price, but during the day, this price can fluctuate and it can reach higher or lower peaks than the one used, which constitutes a challenge.

99. Another experience shared by companies relates to the limited comparability adjustments. One company indicated that the methods do not take into consideration many of the variables and specificities of an actual negotiation, such as the risks and tasks undertaken by the parties and other market parameters. Another company stressed that the legislation does not take into account the particularity of each market, treating all commodities in the same way (agricultural, mineral, steel, etc.). A particular comment stressed that the PECEX method completely disregards any transfer pricing adjustment eventually performed by the other party on its home country, which leads to a disconnection between the real price being applied to the operations and what will be the parameter for transfer pricing purposes in Brazil.

100. General practical difficulties with the PECEX method were reported, particularly the obligation to apply the method to goods which are not “real” commodities because the concept of commodity is not dictated by the market as per the OECD approach, but is established by RFB through an annex in the relevant Normative Instruction, and the inexistence of listed prices for many products. In other words, Brazilian transfer pricing rules qualify some products as commodities for tax purposes, but in reality, these products are not quoted on the stock exchange market, which makes it difficult to have reliable comparables data. The other comments made were the following:

- Some MNEs highlighted that the rules are extremely difficult and complex. For example, in a case in which the foreign party supplying the commodity was buying the commodity under a long-term contract and rebilling Brazilian affiliates plus a small mark-up for the purchasing efforts. The complexity was then avoided by removing Brazil from this intercompany arrangement and having it purchased directly from unrelated parties.

- One company reported difficulties for a trader negotiating the company’s product, since at 10 a.m. in a given day the price of the same product may be different than the price at 2 p.m. Such difference in the average of the day can lead to a tax adjustment as each transaction is assessed individually. Accordingly, the company indicated that the method could be improved for an average of a given period. In the same context, the MNE pointed out that it may also happen that the negotiation is not made in the same units (pounds, tons, m³) as the units indicated in the public listing, which requires adjustments for transfer pricing purposes. In this sense, the company often approves a transaction without knowing that it has a transfer pricing inefficiency as these assessments involve complex calculations.

- One company stressed that the PCI and PECEX methods only use the external CUP of the OECD Guidelines, not the internal CUP. The company indicated that if the pricing was decided with reference to unrelated party transactions in which the transaction price did not equal to the market quote, transfer pricing adjustments would be inevitably made, though no adjustment under the OECD Guidelines would be required.

- One company highlighted that the regulation concerning the PECEX method does not take into consideration the general marketing strategy adopted by the exporter from a global perspective. It
was highlighted that there are many cases in which MNE groups that operate with different commodities will have a centralised marketing team that takes on all the selling effort in order to obtain the best possible prices from the market. These teams are usually close to customers (outside Brazil) and they add a very relevant part of the value to the production chain. Accordingly, the company indicated that with the way the PECEX method operates, there is no possibility to accommodate this type of structure.

101. Several companies also shared positive experiences. Some MNEs are satisfied with the methods. One MNE indicated that the method was fair, since the company tends to be able to sell its products at market value, in a competitive scenario. The same company concluded that using the public prices is a good idea and useful in practice, easier to comply with, to demonstrate and to meet tax authorities’ expectations. In the same context, one MNE pointed out that, in general, the application of the methods for commodities is simpler and easier than the application of other available methods.

102. One company made specific comments (in the “other remarks” section of the questionnaire) about the methods for commodities, noting that they are not clear regarding some points, including the transaction date, the conception of the price average and also the adjustments allowed on the parameter price. They considered that it would be reasonable to have more flexibility regarding the margin that the companies would like to allocate abroad.

Comparability analysis and comparability adjustments

Based on a preliminary analysis of the Brazilian transfer pricing rules, it appears that the comparability analysis is only partially relevant for the purposes of the application of the methods equivalent to the CUP method (PIC and PVEx methods).

The OECD Guidelines recognise that for the purposes of the comparability analysis the data on comparable uncontrolled transactions can be found either in respect of a comparable transaction between one party to the controlled transaction and an independent party (“internal comparable”) or between two independent enterprises, neither of which is a party to the controlled transaction (“external comparable”).

The OECD Guidelines recognise the possibility of making comparability adjustments to increase the comparability of available comparable data. Based on a preliminary analysis of Brazilian transfer pricing rules, it appears that the comparability adjustments are limited only to the set of adjustments foreseen in the legislation in relation to the application of the methods which are equivalents of the CUP method.

While the OECD Guidelines indicate preference for the use of the transaction-by-transaction approach in the comparability analysis to arrive to the most precise approximation of arm’s length conditions, the OECD Guidelines also acknowledge that there are often situations where separate transactions are so closely linked or continuous that they cannot be evaluated adequately on a separate basis and instead the guidance provides that such closely linked or continuous transactions should be evaluated together using the most appropriate arm’s length method. Based on a preliminary analysis, it appears that the Brazilian transfer pricing rules require to strictly follow the transaction-by-transaction approach.

Comparability analysis for purposes of the application of the methods corresponding to the CUP method

103. The majority of MNEs agreed that the comparability analysis is more relevant for the purpose of the application of the methods corresponding to the OECD-recognised CUP method, though with important
differences. Comments highlighted that the notion of comparability is much more focussed on the product type.

104. A particular respondent inferred that the comparability analysis of the methods equivalent to the CUP method was underdeveloped, since they require similar or identical items and allow only limited adjustments that only take into account volume, contractual terms, payment terms, guarantee and other factors. In this sense, it was reported that the comparability dimension was much more focussed on the features of the product.

105. Another MNE also stated that for the PIC and PVEx methods (CUP equivalents) the comparability analysis is performed using transactions involving identical or similar products. Accordingly, it indicated that the comparability is limited to comparing the similarity of the good, service, or right that is under analysis (and no economic or functional analysis is required to evaluate the degree of real comparability).

Internal and external comparables – limitations on the use of both types of comparables under the Brazilian system

106. Companies identified obtaining data from independent enterprises (i.e. external comparables) as one of the main challenges, as there is no information on available databases. Therefore, access to such external comparables is limited for the application of the CUP-equivalent methods in Brazil. In addition, taxpayers indicated that external comparables must be of the same fiscal year or, the previous year (with conditions), which brings even more difficulties in the application of the external comparable.

107. It may be more difficult to provide supporting documentation for some methods. For example, the PIC method is reportedly substantially more difficult to apply since tax authorities may request all invoices used to establish the parameter price depending on the tax auditor.

108. One respondent described the legislation as permitting the following comparisons: (i) the same intercompany supplier selling the same product to a third party (internal comparable); (ii) the same Brazilian entity buying the same product from a third party (internal comparable); (iii) operations carried out between independent enterprises among them (external comparable).

Limitations in terms of comparability adjustments

109. The great majority of MNEs agreed that comparability adjustments are limited only to the set of adjustments provided in the legislation. Accordingly, it was stated that such adjustments are technically too broad and do not suffice to establish comparability between operations carried between different functions (no consideration of functional and risk analyses, industry specifics, business strategies, etc.). In this sense, a respondent stressed that a sale performed under a contract manufacturing agreement could be compared to a sale under a distribution setup as if they were the same type of transaction, because the legislation does not mention any type of differentiation for such transactions.

Whether the list of allowed comparability adjustments is sufficient

110. One MNE operating in the chemical industry and is engaged in manufacturing for exportation with significant imported content reported that the foreseen adjustments were not sufficient to meet its specific needs. Constraints like the impossibility to offset transfer pricing adjustments among different products and not being able to adjust the exchange variation within the year are necessary factors that should be considered for the industry.

111. Some companies generally pointed out that the legislation should at least allow for additional adjustments to the parameter price, such as quality premiums/discounts, compensation for risks and functions of the parties, and any other adjustment that corresponds to usual market practices.
112. It was stressed by a company that the comparability adjustments are not detailed enough in the Normative Instruction. The company indicated that in cases where the traded quantities are different between the practiced and parameter prices calculated by methods such as the CUP related methods, there is no formal forecast on how these adjustments should be made. Often, it can be common within a company’s business to negotiate different prices depending on the volume sold to some customers, and depending on the conditions of sale (commercial discounts). In this context, an entity belonging to the food industry indicated that certain types of products are exclusively targeted to certain customers, and such kinds of products normally can be considered similar to others, but can actually be different in terms of cost.

113. One comment in the context of the automotive industry observed that a defined method for foreign exchange rates conversion, flexible margins according to the nature of the goods and destination countries, would contribute to a more realistic comparison.

114. One entity belonging to the pharmaceutical industry reported that the adjustments are sufficient, but should allow to make comparisons directly in the foreign currency, as in the Brazilian transfer pricing rules one needs to convert the third party price to Brazilian currency at the transaction date, and then compare to the actual average import price of the tested price. The company explained that this could distort the analysis in favour of or against the taxpayer, if, as frequently happens, there is a strong volatility of the Brazilian foreign exchange rate during the fiscal year.

115. It was reported by a company in the food industry that under the Brazilian system, to apply the PIC method (CUP-equivalent for imports), the company must compare intercompany average prices of a certain product to the average price of the same or similar product of uncontrolled transactions and no range of prices that can be considered “market prices” exist. Such characteristic may create challenges when international sales of parts of animals are sold to different countries. The company sells chicken breasts to Europe, where it has a high value for European consumers, and to China, where it is not as valued by Chinese consumers, since the Chinese prefer dark chicken meat, legs and wings. The company highlighted that in such a scenario, in which only controlled transaction involving sales of chicken breasts to China and uncontrolled transactions involving sales of chicken breasts to Europe exist, there is no room to determine an adjustment to increase the comparability when applying such method.

**Transaction-by-transaction approach – practical challenges**

116. Some companies indicated that strategic decisions were usually taken considering products that are grouped under the same category, and that a transaction-by-transaction approach combined with the application of fixed margins often led to double taxation. One company provided an example in which if a company was subjected to the 30% gross margin and had products sold with a 60% margin and others with a 20% margin, these margins could not be compensated, which meant that transfer pricing adjustments would be fully paid for the low margin products, even if general gross margins are higher than 30%. Along the same lines, one company added that in its case the processing of a raw material can result in different products being sold, and it is possible that one product generates a high gross margin whereas the other product obtained during the manufacturing process generates a low gross margin.

117. Some companies described that in many cases there are two or more products that are sold together to the customer as a package, and it is difficult to test both products separately as required by the Brazilian transfer pricing rules. The example given provided that in some cases for a product (such as an equipment) that is sold together with consumables and spare parts that the customer uses with this product it would make more sense to test all components together, but this is not allowed under the current Brazilian rules.
118. A recurrent challenge raised by companies in their submissions relates to the impossibility to offset negative and positive transactions. Some companies indicated that it was not possible to compensate an intercompany export transaction made at a lower price with an export transaction made at a higher price.

119. In addition, another company pointed out that in the situation where the manufacturing of a product automatically results in a second product, the sale price of both products obtained during the same manufacturing process are usually dependent of one another. A result closer to the arm’s-length conditions would be achieved if the margins of the two products obtained during the manufacturing process could be compensated under the Brazilian rules.

120. Another respondent stressed that the transaction-by-transaction approach was extremely challenging in applying the resale minus methods for exportation (PVA/PVV methods). The company reported that once the adjustments are made on an imported product basis, it is required to identify through production orders all imported raw materials within all products sold, which significantly increases the amount of compliance work. Consequently, the company stated that if an imported raw material is used in ten different products, it is necessary to make ten different calculations to later obtain an average gross margin. If a sold product is manufactured with five imported materials, it is necessary to break down the gross margin for each one of them within the product. In conclusion, the number of calculations required and transactions analysed demand system adaptations, acquisition of external calculation tools and also documentation checks.

121. Some MNEs also more generally pointed out the challenge of the volume of documentation and analysis required in cases where multiple products or items are subject to the transaction.

Transfer pricing adjustments and prevention/elimination of double taxation

Where the outcome of the controlled transactions where the conditions differ from those that would be agreed between independent parties acting in the same or similar circumstances leads to a lower tax base, the transfer pricing legislation of most countries following the OECD Guidelines requires and upward adjustment (“primary adjustment”) to the tax base.

The tax compliance costs can have a significant effect on business operations. Therefore, the ease of tax compliance constitutes one important factor to consider when evaluating the effectiveness of a transfer pricing system.

The OECD Guidelines specifically recognise the usefulness and relevance of safe harbour regimes, if they are designed in line with the arm’s length principle. Safe harbours may help to reduce the tax compliance burden for taxpayers and also can improve ease of tax administration.

Experience related to upward adjustments (primary adjustments) to the tax base in other countries than Brazil

122. Many MNEs reported having never experienced primary adjustments to their tax base in other countries. Other MNEs confirmed that they may have been subject to such adjustments.

Transfer pricing adjustments for the purpose of complying with Brazilian transfer pricing rules

123. MNEs shared different experiences regarding the necessary adjustments to be made in order to comply with the transfer pricing approach in Brazil depending on the industry sector. For confidentiality reasons, the details of these experiences are not reproduced in this summary.
Transfer pricing adjustments in Brazil – adaptation of business models

124. A number of companies indicated that, while most transfer pricing discussions and policies are done following a market-driven transfer pricing analysis, they have adjusted their business model to accommodate the Brazilian transfer pricing regime.

125. They indicated that some procedures are implemented in the business model in order to comply with the Brazilian transfer pricing rules and reduce transfer pricing adjustments, evaluate the more appropriate transfer pricing method to document intercompany transactions, assess the possibility to increase prices in order to reduce or minimise possible adjustments, if the company is able to meet one of the safe harbour criteria, forecast transfer pricing adjustments, advantage in products that are between the divergence margin to reduce prices, and study about the impact of the exchanges rates on the adjustments.

126. A company from the automotive industry highlighted that the Brazilian rules are compatible with their global requirements, and accordingly, they have a global policy that requires Brazil and all other affiliates to adjust prices as needed. Another company from the electronic and IT industry stated that no adjustments to their business model had been made, since the 20% resale profit margin was not difficult to achieve in their industry.

Double taxation as a consequence of a transfer pricing adjustment in Brazil – a sunken cost

127. The general perception of MNEs is that double taxation arising from transfer pricing adjustments in Brazil is treated as a sunken cost that cannot be recovered. Some MNEs stressed that such sunken cost did not affect the product prices and did not potentially affect direct investments in Brazil. The majority of the companies, however, indicated that this sunken cost affected their pricing and consequently all Brazilian products, which led to less competitive prices when compared to other countries. It was stressed that such sunken costs affect the net present value (NPV) of new projects and/or deals in Brazil, potentially affecting the approval of these projects.

128. For example, for an exclusive distribution and promotion deal with a local third party, the margin of the Brazilian subsidiary of the MNE is split in favour of the local partner to compensate its efforts with logistics and promotion of the deal's products. Overall, if the deal is successful, the Brazilian subsidiary will end up with total sales and gross margins greater than what it would have obtained before (no deal scenario). However, as the Brazilian subsidiary has to compensate the local partner, it may not achieve the minimum 40% gross margin as required by the Brazilian version of the resale price method. This lack of margin times the corporate income tax rate (34%) is included in the project NPV as a sunken cost, hence decreasing the expected return of the project, and if the return is negative the project is not approved.

129. They also pointed out that higher profit margins required for Brazil's exports may prevent other countries from using Brazil as a service provider, meaning that countries prefer to locate their centres of excellence and/or shared services centres in locations which have greater alignment with OECD rules and requirements, and that the necessary transfer pricing adjustments on imports increase the cost to the Brazilian end-customer.

Implications of Brazilian transfer pricing adjustments in terms of financial accounting to company's financial statements

130. Some MNEs reported that transfer pricing adjustments would only generate an adjustment to the income tax calculation, without implications on financial statements (i.e. accounting effects).

131. Other companies stated that in case of transfer pricing adjustments, it is necessary to measure the amounts on the financial statements. The transfer pricing adjustment is treated as a permanent difference in the income tax return, increasing the income tax charge or generating a deferred tax liability,
in case the company has tax losses in the current year. Another comment generally indicated that it could affect the Net Operating Loss and Deferred Tax Asset reduction, or it could impact Profit and Loss statement directly.

**Transfer pricing audits and assessments**

132. At least 17 companies stated to have faced or to be going through audits and/or tax assessments.

133. The grounds for the audit or assessment varied from regular inspection, which is frequently pursued by tax authorities for transfer pricing purposes, documentation to demonstrate the listed prices used, verification of the application of the method (e.g., formula used in applying the PRL, PIC methods, etc.), transfer pricing calculation in general, information about financial data from foreign related parties and some cases of the resale minus method calculation in Normative Instruction 243/2002 vs. provisions Law 9430/96 – PRL 60% or 20% margin for repackaging in Brazil.

134. The main challenge facing MNEs during transfer pricing audits is related to documentation. It was reported that during some tax audits a number of unrealistic documents were required (e.g., 2.000 copies of invoices from abroad, detailed cost and price information necessary for the calculation of the PRL method, high amount of consularised documents that are required, etc.) and, several companies indicated that tax auditors do not have a common, standardised approach for a transfer pricing documentation layout, which raises issues.

135. Almost all the companies indicated that additional resources were needed in order to address the questions raised during the audit, especially because of external advisory and the involvement of people from different departments and countries. Companies were not consistent when indicating the length of their audits/assessments.

136. In nearly all the cases, the companies indicated that the tax assessment would lead to an increase of the tax base after the judicial dispute. Several companies reported that their judicial disputes were still ongoing in Brazilian courts.

**Experience with fixed margins approach**

137. MNEs shared that they had experienced a number of cases where the fixed margins were not in compliance with the reality of their sector and did not reflect their business strategy. Many MNEs indicated that the presumed margins did not provide an appropriate achievement of the arm’s length outcome to the transactions, which naturally lead to transfer pricing adjustments being needed, and accordingly, double taxation.

138. In this context, it was described by one company that the animal protein industry (chicken, pork and beef) faces a lot of volatility in terms of prices and margins, because profitability and prices in this industry are connected to domestic and international commodity prices, especially corn and soy prices. Therefore, according to the company, a fixed margin will be easily out of market ranges in scenarios where commodity prices change rapidly, thereby leading to an unrealistic margin for the industry.

139. In another case, a MNE had a contract termination with a company in respect to an exclusive distribution of a certain product, in which there was a clause in the contract determining that no unit could be sold from the termination of the contract. In order to comply with the contract, destroyed the products also used them to manufacture other products. Since the margin of the product did not reach the margin of 20%, there were no comparables and the entity did not have access to the cost in order to apply the cost plus related method. The company stated that if they were able to support the operation taking into account the economic facts and circumstances of the transaction, it would be possible to have an appropriate outcome in respect to the pricing of the transaction.
One MNE stated that it is hard to achieve the desired economic outcome since the obligation to apply the 40% profit margin to its transactions (added to the absence of other methods) would not leave a sufficient margin to remunerate all the value chain.

Chemical products, as indicated by one MNE, may have a very comprehensive range of profitability according to the segment, but Brazil transfer pricing rules fixed the margin at a flat rate of 30%.

Some MNEs stressed that the fixed margins were defined by the government, but without any explanation as to how they were determined.

One experience in the automotive industry with respect to the fixed margins was more positive. It was stressed that a reasonable global outcome was reached. One comment from the oil and gas sector also indicated that for the export services to related company abroad the cost plus method with the fixed margin of 15% over costs was not an issue.

**Challenging the existing fixed margins in Brazil**

Most of the MNEs have contemplated challenging the existing fixed profit margins. However, it was clearly highlighted that the mechanism in place to do so is not clear, too burdensome, and requires providing complex documentation. The absence of any positive precedent was also mentioned as a deterring factor.

**Elements of tax compliance under the Brazilian transfer pricing rules**

MNEs pointed out that tax compliance for transfer pricing purposes in Brazil is more burdensome in comparison to other countries. They specified that the legislation was completely different in Brazil, which requires extra work, as the MNE group will usually apply the OECD Guidelines on a consistent basis to set its intra-group prices. It was also highlighted that due to the high volume of data required for calculation purposes under the Brazilian transfer pricing rules, it is necessary to hire external consultants to provide support (including software costs).

Some MNEs supported the view that transfer pricing legislation is less burdensome – i.e. lower compliance costs – when compared with other countries, especially because (i) there are less transfer pricing methods under the Brazilian legislation; (ii) taxpayers have the freedom of selection of the method; and (iii) the existence of fixed margins contributes to a simplified calculation.

**Personnel dedicated to transfer pricing matters in Brazil**

Companies provided an average of three persons dedicated to transfer pricing matters in Brazil. It was stated that the time spent by these individuals to ensure that the Brazilian transfer pricing policies are observed without causing material issues in other jurisdictions is significantly longer compared to other countries. The biggest cost relates to the differences in the rules, which requires additional studies tailored for Brazilian purposes; and the involvement of external consultants, which further increases the compliance cost.

Almost all respondents indicated that they hired external advisors/consultants to comply with the Brazilian transfer pricing rules.

**Tax certainty under the Brazilian transfer pricing rules**

Some companies reported that Brazil’s existing transfer pricing rules provide reasonable degree of tax certainty under the domestic scenario, generally indicating that the rules are less subjective then the ones from the OECD Guidelines. Their main argument is that the margins are fixed and few methods are allowed under the legislation. On the other hand, these MNEs pointed out that in an international context,
it may conflict with the OECD rules and outcomes, which could lead to a lack of certainty from the counterpart’s perspective.

150. The majority of MNEs stated that the Brazilian transfer pricing rules do not provide a reasonable degree of tax certainty. The main reasons for such statement were:

- Differences in the transfer pricing rules that are applied internationally and the ones in Brazil;
- Bureaucratic process to apply alternative margins through complementary elements of proof/evidence;
- Issues related to how to apply each method, how to make calculations;
- The lack of specific guidance for intangible transactions; and
- The lack of guidance for cost contribution arrangements.

Safe harbours

151. The majority of MNEs indicated that they used the “de minimis” safe harbour available for export transactions, according to which a Brazilian taxpayer is not subject to transfer pricing control for export operations when it is shown that net export revenues are equal to or less than 5% of its total net revenues.

152. MNEs also use the safe harbour providing that a taxpayer will be deemed to have an appropriate transfer price when the average export sales price in controlled transactions is at least 90% of the average sales price in uncontrolled transactions with unrelated parties in the Brazilian market (except for commodities).

153. One company expressed concerns with the existing safe harbour rules. In the company’s view, the current safe harbours do not properly reflect the economic reality, which leads to inefficiency and potential risk of under taxation and double taxation. The MNE supports the view that the 90% test does not vary in accordance with the industry, market level, functions, risks and other elements, and therefore such safe harbours are not based on economic reality. In addition, the same company believes that the minimum profitability test safe harbour produces artificial results because the minimum profitability of 10% is perceived as being artificial.

154. Another comment pointed out the absence of safe harbours for import transactions.

Transfer pricing documentation

Chapter V of the OECD Guidelines recommends that the countries establish reasonable transfer pricing requirements in their domestic law framework. Specifically, there are three objectives of transfer pricing documentation, which include:

(i) to ensure that taxpayers give appropriate consideration to transfer pricing requirements in establishing prices and other conditions for transactions between associated enterprises and in reporting the income derived from such transactions in their tax returns;

(ii) to provide tax administrations with the information necessary to conduct an informed transfer pricing risk assessment; and

(iii) to provide tax administrations with useful information to employ in conducting an appropriately thorough audit of the transfer pricing practices of entities subject to tax in their jurisdiction, although it may be necessary to supplement the documentation with additional information as the audit progresses.
Transfer pricing documentation in Brazil and the three policy objectives established by the OECD Guidelines

155. Comments received can be divided into three different groups: the comments that indicated that the transfer pricing documentation requirements in Brazil meet the three policy objectives prescribed by the OECD TPG, comments that stressed that the objectives are not fulfilled with the current rules and the comments that say that the current transfer pricing documentation requirements in Brazil meets partially the policy objectives established by the OECD Guidelines.

- The first group of MNEs indicated that they prepared transfer pricing documentation in a specific format to be included in the Brazilian Corporate Tax return (ECF – tax digital bookkeeping) and this information would be enough for tax authorities to determine the correctness of the information according to the current Brazilian legislation, and therefore, confirmed that the transfer pricing documentation requirements meet the policy objectives described by the OECD.

- The second group of respondents generally commented that the transfer pricing documentation requirements in Brazil do not meet the policy objectives established by the OECD Guidelines. The reason for that is an absence of clear transfer pricing documentation rules in Brazil. The only information officially required is very concise and does not provide tax authorities details in terms of comparability or absence of comparability between products and how grouping of products are done – only list of products and adjustments are provided in the income tax return (ECF). The issue raised in this context is that in an audit, several reports are demanded in order to demonstrate the calculation of the adjustments, which have no standard form and each auditor may require such documents in a different way.

- The third group stated that the transfer pricing documentation in Brazil partially meets the three objectives, especially from the perspective of the risk assessment, since Brazilian legislation does not involve a functional analysis, the documentation does not necessarily test all methods and documents, and does not demonstrate whether or not they are appropriate.

Key differences between the transfer pricing documentation requirements in Brazil and the requirements of other countries where MNEs carry out their operations

156. An important difference observed by MNEs is the fact that the Brazilian transfer pricing documentation is heavily based on transaction-by-transaction invoices, demanding a high level of details. In this circumstance one company stressed that specific processes had to be established, including the purchase of software which can only be applied in Brazil, and the need of customised big data processing systems and big spreadsheets with a lot of information.

157. Some companies highlighted that unlike the OECD approach, the Brazilian transfer pricing documentation requirements do not include information about the entity, such as functions, risks or assets nor market or competitor information or legal entity statutory financial information, as no master-file apply, and only few elements of the local-file requirements apply – they indicated that the OECD rule is more complex because the local file provides the justification for the method chosen, the technical rationale for applying the method, the risks assumed and functions performed, for example.

158. It was also pointed out that the lack of comparability analysis reduces the need of documents in Brazil since most documents required by Brazilian transfer pricing methods can be obtained within the company (e.g., books, invoices and regular ancillary obligations).

159. Some MNEs indicated that a key difference is that in Brazil the transfer pricing documentation is based on the Fiscal Digital Bookkeeping (ECF), which contains five specific forms requiring taxpayers to disclose detailed information regarding their main intercompany import and export transactions. They stressed that as part of these contemporaneous documentation requirements, taxpayers need to disclose
the total transaction values for the most traded products, services or rights, the names and location of the related trading partners, the methodology used to test each transaction, the calculated parameter price, the average annual transfer price and the amount of any resulting adjustment.

**Experience concerning transfer pricing documentation in Brazil – reasonability or excessiveness**

160. Some MNEs indicated that the transfer pricing documentation in Brazil is in general reasonable according to the transfer pricing methods available in the country. A specific reservation was raised towards the documentation requirements during audits, since the procedure demands a lot of work and it is excessive – a lot of data need to be provided by the taxpayers.

161. A major concern stressed by the MNEs is the excessive transfer pricing documentation related to the transfer pricing analysis on the product level calculation basis (transaction by transaction), which creates a huge volume of data that must be managed in order to conclude the required documentation. Since the law establishes a product-by-product calculation basis, the disclosure of information requires a high level of control of the stock keeping units.

162. Some MNEs indicated that the requirement to prepare the transfer pricing files in a specific format to be included in the Brazilian Corporate Tax return (ECF) and that only to comply with the Brazilian requirements is excessively burdensome, as a qualified IT system would be needed. In this context it was stressed that a separate transfer pricing documentation approach needs to be developed to document the transactions with Brazil.

163. A specific comment was made about the CPL and PIC methods. The MNE stressed that it is necessary to present hard copies of documents, such as invoices, “consularised” and translated, and therefore the workload necessary to prepare CPL documentation on a product by product level is highly burdensome, since they have to prove raw material costs, detailed calculation, standard cost vs. actual costs, etc.

164. Another MNE indicated that the documentation required is excessive and incompatible with reality when dealing with the cost plus related methods, since it is necessary to detail the cost and confidential information is often necessary.

**Intangibles**

Chapter VI of the OECD Guidelines contains guidance addressing the specific issues related to intangible assets in relation to the transfer pricing analysis. Most recently, the concepts of development, enhancement, maintenance, protection, and exploitation (DEMPE) functions and risk control have been included in the OECD Guidelines along with the special approach to deal with hard-to-value intangibles (HTVI).

Based on a preliminary analysis, certain limits to deductibility of intra-group royalty and technology transfer payments exist.

**Business experience with the treatment of transactions involving intangibles for transfer pricing purposes in Brazil**

165. Respondents with experience in dealing with transactions involving the transfer or use of intangibles pointed out that the Brazilian transfer pricing legislation does not provide any specific treatment or very limited guidance for transactions involving the transfer or use of intangibles. Companies noted that
the rules applicable to transactions involving intangibles were the same rules applicable to goods or services.

166. Companies also noted that royalty payments were out of the scope of the Brazilian transfer pricing legislation and were subject to fixed deductibility limits (ranging from 1% to 5%) depending on the type of production or activity.

Specific issues or challenges facing business in relation to transactions involving intangibles

167. Most companies brought up the issue related to the deductibility ceilings that are applicable for the payment of royalties. Some companies indicated that such limitations are not at arm's length and result in cases of double taxation.

168. Some companies indicated that the absence of clear guidance on how to measure the value of intangibles in the Brazilian legislation leads to a scenario in which the methods available are not appropriate and as a consequence its application brings difficulties in obtaining information on the prices practiced under the international scenario.

169. One of the MNEs described a challenge that arises from the Brazilian approach to payment of royalties, namely the fact that patents and trademarks are first required to be registered and approved by the INPI before license payments can be made, and the respective limitation on the life of patents, which creates a burdensome and time-consuming process.

Cross-border remittance taxes and deductibility ceilings: actual or double taxation as a sunken cost

170. Many respondents confirmed that cross-border remittance taxes and the deductibility ceilings are considered sunken costs of doing business in Brazil.

171. MNEs stressed the occurrence of double taxation for such costs, indicating that the remittance taxes and deductibility ceilings result in double taxation, since taxes imposed on cross-border royalty payments are non-recoverable, even when there is an income tax treaty. One of the MNEs shared that these costs have an impact on the return on equity (ROE) of the company. Another MNE stressed that cross-border remittance taxes act like a forced transfer pricing adjustment over intellectual property technical services.

172. One MNE raised concerns that the payment of CIDE is discriminatory, mainly because it only applies to foreign payments.

Relevance of DEMPE functions and risk control for intangibles in Brazil

173. The great majority of MNEs stressed that the DEMPE functions and risk control in the case of intangibles were irrelevant to determine the return for intangibles under the current legislation in Brazil.

174. One MNE indicated that the DEMPE analysis would actually result in a Brazilian entity paying more than what is allowed by royalty limitations, since its functions are limited as compared to the MNE.

175. Another MNE highlighted that the DEMPE functions and the concept of risk control for intangibles would be extremely relevant in Brazil, as most of companies have a limited-risk distribution entity in Brazil that should be treated accordingly, but the Brazilian transfer pricing legislation does not allow for such approach.
Application of the available Brazilian methods and rules

176. Some MNEs highlighted the fact that in Brazil companies have limitations of royalty payments – when the intangible is owned by a foreign entity, and therefore, no transfer pricing rules are applicable in such situations. Other MNEs indicated that in such a scenario, they used the PRL/CPL methods (resale price and cost plus related methods for importation). One specific entity justified the application of the PRL method, stating that in its particular case (software), the license fee was considered a “right”.

177. Some MNEs highlighted that transactions with royalties are relevant for transfer pricing purposes in Brazil if the intangible asset is owned by the Brazilian company. In that case, the entities indicated that the CAP method – 15% mark-up (cost plus related method for exports) would be applicable. One specific company stressed that in the case of using the CAP method, it was not always the period where the costs were incurred that would match the period where the intangible was licensed. One MNE stressed that it provides R&D services to the benefit of another company of the group located abroad. The services are limited to clinical trials and observational studies involving drugs and molecules, and the company charges a mark-up on these services and does not apply any other specific rule involving intangibles.

178. A small number of MNEs generally indicated the use of CUP related methods, emphasising the difficulties to identify similar operations and conditions for their application.

Application of the Brazilian methods and rules in the context of hard-to-value intangibles (HTVI) transactions

179. Few MNEs that actually provided input indicated that for locally developed and owned intangibles, most taxpayers would apply the CAP method with its 15% mark-up (cost plus related method for exportation) or PVEx (CUP related method for exportation) despite all the limitations, as such methods are the only ones available in this context.

180. One specific MNE stated that if the Brazilian company has to pay for the intangible developed by a foreign related company, the path is to register the license agreement in the Brazilian Patent Office (INPI) and consequently be subject to the deductibility ceilings or include the return on the intangible in the cost basis of the imported products, and then apply the PIC, PRL or CPL methods.

181. Other implications and potential issues from the absence of specific transfer pricing guidance in Brazil related to intangibles.

182. Some entities stressed that the absence of specific guidance could potentially lead to the reallocation of intangibles/hard-to-value intangibles to other jurisdictions for very low prices, and difficulties in using intangibles developed abroad in Brazil, which leads to a lack of access to newer technologies, since it is not possible to pay an adequate remuneration for them as a consequence of the royalty ceilings.

183. One MNE stated that in case of intangibles developed in Brazil the country may not be receiving the proper remuneration, which causes a decrease of the Brazilian tax base.

184. Besides the issue of double taxation resulting from the inconsistency between the Brazilian and other jurisdictions’ legislation, MNEs generally reported that in the absence of specific guidance in this matter, implications were:

- The lack of competitiveness regarding transactions with intangibles;
- Uncertainty due to the inexistence of clear regulation;
- High tax burden;
- Incompatible adjustments with the effective market practice; and
- The decrease of development activities/investments in Brazil, due to the lack of economic intellectual property ownership and reward principle duly established in the law.
185. Another MNE stressed that there is a clear conflict between transfer pricing rules and deductibility rules in Brazil. The entity provided the example of the use in Brazil of a high valued intangible, stating that even if under an OECD transfer pricing point of view the remuneration paid to the IP owner is arm’s length, it does not mean that payments will be considered deductible in Brazil.

Companies making royalty payments or fees for technology transfers to local or foreign group members – treatment for transfer pricing purposes in Brazil and abroad

186. A majority of MNEs indicated that they made royalty payments or payment fees for technology transfers to local or foreign group members. The companies again highlighted that the transfer pricing legislation did not apply to such payments.

187. A particular MNE stated that due to the formulaic approach applied to royalties in Brazil, taxpayers’ ability to treat such payments in a similar manner as in other jurisdictions was hindered. For example, while these payments may be considered royalties in Brazil due to the nature of the local rules, the functional profile of a transaction may be different in the jurisdiction of the related party.

188. In this context, one MNE provided as an example a subsidiary that uses valuable trademarks, business models and administrative processes from its parent company. It stressed that according to the current rules, the subsidiary can deduct royalty payments up to 1%, and this can be questioned by the tax authorities of the parent company, which accordingly could lead to double taxation issues.

Brazil’s deductibility ceilings or cross-border taxes – gross up of fees paid abroad

189. The great majority of companies did not provide input on this topic. Some companies indicated that the deductibility ceilings or the cross-border taxes could result in gross up fees paid abroad, especially the tax levied on the payments for technical services or administrative assistance (CIDE) since the existence of a tax treaty would not compensate such payment.

Intra-group services

Chapter VII of the OECD Guidelines contains specific guidance addressing the issues arising from intra-group services transactions. Most recently, following the BEPS Project, the simplified approach dealing with low-value-adding services was included into the OECD Guidelines.

Based on a preliminary analysis, certain limits to deductibility of intra-group services payments exist.

Experience with the treatment of intra-group services transactions and challenges of the guidance in Brazil

190. In general, the majority of the MNEs reported that intra-group services were governed by the Brazilian transfer pricing rules, but that none of these rules included specific guidance on controlled services transactions. This was described as a major issue in the Brazilian transfer pricing framework. One of the consequences of the absence of guidance is the difficulty in applying one of the available transfer pricing methods. For example, one MNE indicated that since most of its services were technical services, they were not part of a product, and not resold to third parties, meaning that it would be able to use only one method in practice.

191. Some MNEs indicated the absence of a low value-adding service provision as a concern. Specifically, a point was raised in relation to the fact that the mark-up of 15% applied for the exportation of
services (CAP method) was in general too high for low value-adding services and could be rejected in the country where the service is being paid for.

192. Regarding the importation of services, some MNEs indicated that the problem concerned the justification of the cost base incurred abroad, since the Brazilian tax authorities reportedly do not accept general allocation keys, and request specific documentation and details, such as time sheet allocations, payroll stubs to prove salary costs, etc. Similarly, other MNE indicated that it was difficult to prove the accuracy of the allocation of indirect costs when the RPL or the CPL is applied. According to the company, when applying the CPL with a non-Brazilian company as the tested party for the provision of a service by the non-Brazilian company, too much evidence is required. In this respect, the company stated that when it started to offer IT related services to Brazilian related parties, the company's consultant, recommended the preparation of documentation for each expense item, such as system development costs, and to explain the allocation percentage of the expense to the amount billed to the Brazilian company.

193. Some other MNEs pointed out that there was inconsistent treatment of import and export services in terms of the methods applied to each type. No further details were provided in this respect.

Application of the available transfer pricing methods to transactions involving intra-group services

194. Almost all the respondents indicated that the most practical methods to apply when carrying out intra-group service transactions were the methods broadly equivalent to the cost plus method (CAP and CPL methods). It was mentioned that when the entity located in Brazil is providing services the applicable method should be the cost plus 15%, supported by inter-company agreements.

195. Another MNE highlighted that unless internal comparables exist to apply the PIC method (CUP related method), the only realistic options would be the application of the CPL method for imports and the CAP method for exports (cost plus related methods).

196. Another MNE indicated the use of the PRL method (resale related method for imports), but others emphasised that services are not resold and therefore, the resale price method would not be applicable. Thus, the taxpayer needs to apply either the CUP related method or the cost plus method (which requires the accounting records of the foreign entity to be available).

Payments for technical services and tax treatment for transfer pricing purposes in Brazil and abroad

197. A few respondents provided input in this section and highlighted that technical services were treated as royalties and not subject to the Brazilian transfer pricing rules. It is noted that the same challenges related to intangibles would arise with respect to such transactions.

Business restructurings

Chapter IX of the OECD Guidelines contains specific guidance addressing the transfer pricing issues arising in relation to intra-group business restructuring transactions. Such transactions may involve a change of the functional profile – e.g. restructuring from full-fledged manufacturer or distributor to the limited risk manufacturer or distributor.
Experience with intra-group business restructurings in Brazil and sufficiency of existing rules and transfer pricing guidance to deal with such issues

198. The great majority of MNEs responded that they did not have any experience in dealing with business restructurings from the perspective of the Brazilian rules.

199. The respondents that had some experience pointed out that the current methodology in the Brazilian transfer pricing legislation did not address this kind of operation since potential changes of the functional profile of the company do not affect the transfer pricing calculations in Brazil – the profit margins will not change if the risk profile of the company is altered, only if there is a change in the legal flow of the transactions.

200. One particular MNE group highlighted that they had recently gone through a reorganisation and the local entity became a limited-risk distributor (previously, it was simply a limited-risk ancillary service provider). The MNE pointed out that in such reorganisation operations, there was no transfer pricing implication since the local authorities and legislation generally did not focus on changes in functions and agreements.

201. All the MNEs that provided input on business restructurings stressed that there was no clear rule to evaluate the transactions comprising these operations in Brazil.

Additional comments

The arm’s length principle serves the primary dual objective of securing the appropriate tax base in each jurisdiction and avoiding double taxation, thereby minimising conflict between tax administrations and promoting international trade and investment.

Brazilian transfer pricing rules and the dual objective of the arm’s length principle

202. Almost all of the respondents indicated that the Brazilian transfer pricing rules do not achieve the dual objective of the arm’s length principle. The main reason mentioned was the fact that the Brazilian transfer pricing legislation differs too widely from the OECD Guidelines, which leads to double taxation. According to their experience, the fact that the legislation in Brazil prescribes the use of fixed margins, forbids the application of methods at the product level, and the absence of a functional analysis and risk analysis, also lead to double taxation or double non-taxation and an inappropriate allocation of the tax base in the jurisdictions involved in the transactions.

203. Other issues raised by MNEs which were said to influence the pursuit of the objectives are the (i) lack of a more comprehensive list of adjustments for purposes of the methods broadly equivalent to the CUP method in Brazil, (ii) the absence of methods based on net profitability (comparable profits methods, profit split method), and (iii) the restrictions/ceilings for deduction on transactions involving intangibles.

204. One particular company from the electronic and IT industry commented that the transfer pricing rules applicable to their businesses today are adequate, but highlighted that new methods that could bring more fairness would be welcome.

Existing rules and minimisation of conflicts between tax administrations – absence of transfer pricing cases under MAP in Brazil

205. The vast majority of the MNEs commented that the Brazilian rules do not contribute to minimising conflicts between tax administrations and that the absence of MAP is an issue that prevents such minimisation of conflicts. The main point highlighted regarding MAP in relation to transfer pricing is the
novelty of the regulation that was introduced in 2016 through Normative Instruction 1,669/2016 – even though some companies were of the view that there is no clear practical guidance on MAP yet.

206. Some companies indicated that the absence of MAP cases is in most instances due to the fact that the decisions require a long and difficult process to be resolved, and Brazilian taxpayers are not familiar with the notion of requesting MAP.

207. Some other MNEs stressed that the absence of MAP was either linked to the fact that Brazil does not have a tax treaty with important trading partners (United States and Germany) and that in the past Brazil refused to relieve double taxation due to the lack of provisions allowing for corresponding adjustments in their treaties.

208. Few MNEs responded positively when asked if the existing rules in Brazil minimised conflicts between tax administrations. One of the justifications given was the fact that the fixed margins approach does not leave room for conflicts – i.e. there is no option other than achieving the fixed margins.

**Spillover effects of the existing Brazilian transfer pricing rules**

209. The majority of the respondents confirmed that the existing Brazilian transfer pricing rules generate spillover effects. Comments observed that the current legislation jeopardises projects and capital investments in Brazil, especially because it raises issues such as uncertainty and contributes to a heavy tax burden, but also because of the discrepancy between the current legislation and international practices.

210. The fixed margins approach was also identified as an issue that could lead to spillover effects, since it may diminish export competitiveness and discourage external investments. In this sense, one MNE highlighted that the approach differing from the OECD standard means that less functions have to be carried out in Brazil because the exports require higher profit margins to be achieved and, therefore, there is a cost associated with making capital investments in Brazil.

211. Some companies stressed that activities that require intangibles generated abroad become more expensive in Brazil, which reduces investment and impedes the co-development of intangibles, since the Brazilian legislation imposes ceilings to the payment of technology developed abroad that would be used for further product development locally.

212. One comment reported that distribution entities of MNE groups usually carry out significant marketing functions, representing a case in which the 20% gross profit margin is probably too low (many local distributors keep on accruing losses for many years).

213. One comment suggested that the answer would depend on the business activities of each entity. If the business has enough margin to comply with Brazilian transfer pricing regulation, it is likely that the Brazilian methodology will have an attraction effect.

214. A few companies commented that although the Brazilian transfer pricing system is absolutely unique, differing from the international standards, it could still generate some tax payments to be in compliance with the rules and requirements, and some investments in the country may not be affected due to the current legislation. The same companies stressed that the effect of the existing Brazilian transfer pricing rules is not considered as a significant factor for business activity decisions.

**Other remarks**

215. This section contains others remarks either provided by the companies in response to that specific question, or other potential issues raised by companies that were not covered by the questionnaire.


**Transfer prince and customs interaction**

216. At least three companies reported issues with customs legislation. One of them stressed that there is a total disconnection between transfer pricing and domestic customs rules in Brazil, and provided an example indicating that while the customs regulation aims to maximise the import/export price to increase the taxable base based on the market price, the transfer pricing rules define a limit for the market price on imports. It also pointed out that adjustments for transfer pricing purposes are disregarded for customs purposes. In this regard, one of the MNEs highlighted that retrospective adjustments are not admitted in Brazil for customs reasons and this makes it difficult for Brazilian subsidiaries to fully adhere to global transfer pricing policies.

217. In addition, another company emphasised that a change in the transfer pricing legislation will have no effect for taxpayers if business disruptions continue to occur due to challenges faced with customs legislation/administrations.

218. Another practical challenge raised is related to the adherence to both transfer pricing and customs valuation rules due to the strict transaction-by-transaction approach. For example, if the volume of a specific transaction increases significantly from one given year to another, it is likely that the MNE will have to reduce the transfer price of this specific transaction, which may lead to customs valuation exposure.

**Intra-group financing**

219. One company raised a particular comment in respect to intercompany loans. It was stressed that in case of intercompany debt, Brazil limits the deductibility of the interest based on the government bonds and on the London Interbank Offered Rate (Libor), rather than on the interest rates usually applied by the market in similar conditions. In this respect, one company also pointed out that there are doubts about the application of the government bounds, for instance, whether the primary market or secondary market, and which specific bound should be used to test the transaction.

**Transfer pricing rules on interests and interaction with thin capitalisation rules**

220. One MNE, when making a distinction between transfer pricing and thin capitalisation rules, stressed that the former rules require companies to conduct a study to verify if the interest rates applied in contracts between group companies are in line with market interest rates (Libor or sovereign bond), and the latter rules aim to analyse the company’s indebtedness. However, in Brazil it is not clear how both sets of rules would interact, and taxpayers may face a scenario in which the same operation could violate one of the imposed limits.

**Recommendations and suggestions**

221. The majority of the MNEs expressed that harmonisation between the Brazilian transfer pricing rules and those adopted by following the OECD Guidelines would be beneficial, since it would result in reduced compliance costs (from a group policy perspective), enhanced tax certainty for MNEs (also from an international perspective) and reduced risks of double taxation.

222. One suggestion made was to allow taxpayers to opt for either the Brazilian special rules (with fixed margins and basket approach applied), or the OECD Guidelines – the documentation requirements would then follow the rules chosen.

223. One MNE suggested that a better outcome in order to reduce transfer pricing adjustments and double taxation, would be achieved with a larger range of margins in the legislation or, studies for different margins should be better accepted by tax authorities.
224. Some MNEs highlighted the importance of introducing advanced price agreements in Brazil to make the country more attractive for investments. Others highlighted the importance of adopting additional methods such as the TNMM and the profit split method.

225. One MNE pointed out that for any intra-group service charged to a Brazilian entity, the Brazilian entity incurs disproportionately high withholding taxes. Therefore, it is far from beneficial when intra-group services are performed by foreign entities for the benefit of the Brazilian entities. Another MNE pointed out that it would be important that no differences exist in the methods for imports and exports services.

226. It was indicated by one MNE that based on the current rules it is impossible to completely satisfy local and international rules at the same time.
Annex B. Summary of the input provided by Brazil’s major trading and investment partners

Perception of the Brazilian transfer pricing system from MTIP’s perspective

General view

1. Brazil’s key trading partners were asked to share their general view about the Brazilian transfer pricing system. They consider that the existing system is not entirely consistent with the arm’s length principle (enshrined in Article 9 of the OECD MTC) as interpreted and appropriately applied by OECD member countries, or the OECD Guidelines; and possesses a number of distinctive features that depart from the internationally agreed standards and principles in the area of transfer pricing (e.g., fixed margins, a different standard of comparability, absence of proper functional analysis, among other elements); and more particularly that:

- It fails to take into account the particular facts and circumstances of each case (in contrast to comparability analysis set out in the OECD Guidelines), due to the strict application of fixed margins and limited comparability analysis;
- It is limiting in terms of the methods available (as transactional profit methods have not been implemented), which raises difficulties for pricing many transfer pricing situations in line with the arm’s length principle;
- It provides the opportunity for taxpayers to apply the method that results in the lowest tax burden in Brazil (in the absence of the most appropriate method criterion or of a hierarchy of methods);
- Even though it is to some extent inspired by previous transfer pricing work carried out by the OECD and by general practices of OECD member countries, it has failed to incorporate more recently developed guidance on the application of the arm’s length principle, resulting in significant differences between the Brazilian and OECD approaches;
- Is likely to create conflicts around taxation issues with other jurisdictions because it is not bound by the OECD Guidelines;
- Has the potential to create difficulties for MNEs residing in OECD member countries that follow the OECD Guidelines;
- Is not harmonised with the internationally applied transfer pricing standard and, therefore, does not favour appropriate allocation of income between different jurisdictions and does not secure the appropriate tax base in each jurisdiction;
- May be subject to substantial loss of tax revenues from the perspective of Brazil as a result of the application of the fixed margins;
- Does not favour the prevention and elimination of double taxation, including through the mutual agreement procedure (MAP), notably due to dispute resolution mechanisms that do not operate well;
- Does not provide for any mechanism in the domestic law to resolve cases of double taxation resulting from transfer pricing adjustments, which exacerbates other issues identified in the system; and
Generally affects the business and investment climate, influences business and investment decisions (e.g., it leads to inconsistent transfer pricing policies), and does not promote, and even hinders, international trade and investment for reasons including those indicated above.

2. They also recognise that the existing system:

- Provides ease of application for both the Brazilian tax authorities and taxpayers through simple and objective rules, particularly in contrast to the perceived complexity that derives from the implementation of the guidance contained in the OECD Guidelines, which is exacerbated by operational and capacity limitations in certain tax administrations that have insufficient resources, a limited number of personnel, and may not have access to reliable information to perform a comparability analysis;
- Is designed in the best interest of Brazil, factoring in practicality and limited resources to administer transfer pricing rules; and
- Shows other strong advantages, such as certainty and low complexity.

**Endorsement of the OECD Guidelines**

3. Key trading partners of Brazil were asked to express their opinion on the fact that Brazil does not fully endorse the OECD Guidelines. The information received highlights the concerns resulting from the absence of full endorsement of the OECD Guidelines, in particular:

- Lack of harmonisation with international standards and principles and misalignment with commonly, internationally agreed principles;
- High probability of double taxation;
- Inability to prevent conflicts in the area of transfer pricing in many cases as well as to resolve transfer pricing disputes, based on a common understanding of the arm’s length principle;
- Uncertainty for taxpayers and tax administrations in alleviating instances of double taxation or non-taxation;
- Uncertainty for taxpayers specifically in the treatment of their cross-border transactions (e.g., diverging approaches to the apprehension of transactions involving the transfer or use of intangibles);
- Difficulties in ensuring compliance with the relevant provisions of tax treaties;
- Higher/additional compliance and litigation costs for taxpayers which are part of an international MNE group;
- Roadblock in the accession process to the OECD; and
- Difficulties and concerns with respect to the fact that Brazil plays an active role in the work of reviewing and updating the OECD Guidelines whilst stating that it does not actually apply the Guidelines.

4. Nonetheless, it was acknowledged that the implementation of the OECD Guidelines is a process that is not immediate and could take many years (as is reported to be the case for most of the countries situated in the same region), especially for a country like Brazil, which has a large economy. The view that the way in which a jurisdiction administers its tax system is the exercise of a jurisdiction’s sovereign right was also expressed.

**Potential divergences of the Brazilian transfer pricing rules from the OECD Guidelines**

5. The consequences of potential divergences were underlined from a theoretical (rather than practical) point of view by the majority of key trading partners. Namely, they noted that transfer pricing rules should be harmonised in line with the OECD Guidelines, in order to avoid double (non-)taxation,
minimise tax planning opportunities and prevent unnecessary MAP disputes, which are not conducive to efficient tax administration and global trade.

6. The following views of certain jurisdictions provide further insight regarding these divergences:
   - They are actual and evident divergences (rather than potential);
   - They cause difficulties for taxpayers operating in OECD member countries that have transactions with Brazilian resident companies and result in additional compliance costs;
   - They create tax uncertainty in terms of the expected pricing of transactions carried out between OECD member countries and Brazil and do not secure a safe tax environment for taxpayers and jurisdictions alike;
   - They are exacerbated by the absence of corresponding adjustments, and the perception that dispute resolution mechanisms are not allowed in the area of transfer pricing;
   - Double taxation costs may be effectively “absorbed” by the parties to the transaction, which can reduce the number of transfer pricing disputes for certain jurisdictions; and
   - One specific country’s experience is that many of the cross-border transactions involving resident enterprises are actually carried out indirectly with Brazil, with one or more related party(ies) located in third-party jurisdictions (e.g., for marketing, logistics, management).

**Use of fixed margins approach for certain transfer pricing methods**

7. Based on the views expressed by key trading partners, the use of the fixed margins approach raises the following concerns:
   - The fixed margins approach disregards controlled parties’ actual functions, risks and assets (including intangible assets) and the economic circumstances/reality of a taxpayer, which could result in profits that are greater or lesser than the profits estimated if the arm’s length principle were to be applied;
   - The fixed margins approach ignores the actual value contributed by each of the parties and for this reason, it is seemingly incompatible with the negotiated allocation of taxing rights between jurisdictions, does not contribute to a level playing field for enterprises, and influences international trade and investment decisions; and
   - The fixed margins approach cannot be claimed to be in accordance with the arm’s length principle.

8. These elements increase the risk that the approach lead to non-arm’s-length outcomes and double taxation, also exacerbated by the absence of dispute resolution mechanisms to reduce the negative impact of double taxation.

9. The fixed margins approach is perceived by some as a “safe harbour” or “simplification” regime:
   - It provides the benefit of relieving the tax administration burden and provides simplification for both taxpayers and tax administrations;
   - However, because it is not agreed bilaterally or multilaterally, it presents the risk of causing double (non-)taxation.

10. If they were based on an international consensus, the use of fixed margins could be a means to simplify transfer pricing and enhance tax certainty for both taxpayers and tax administrations; but
    - It would only be effective if adopted by a large number of OECD member countries on a minimum standard basis; and
    - It would require recognition of the economic circumstances of parties to a transaction and that the fixed margins be adjustable in certain circumstances.
11. Unless the pricing “formula” is agreed by all parties to the transaction, the fixed margins approach is not conducive to resolution of transfer pricing disputes, and its similarities with formulary apportionment (which is discussed in Chapter I of the OECD Guidelines) mean that similar concerns exist, such as inability to protect against double taxation as well as to ensure single taxation, and the use of arbitrary benchmarks that results in profit allocation inconsistent with the specific facts surrounding the transaction (which is perceived as presumably being the case in Brazil).

12. Positive aspects of the fixed margins approach that were mentioned include their objectiveness, the legal security and certainty it provides, its simplicity of application, and the fact that administering the application of methods incorporating fixed margins is less resource-intensive. It was noted, however, that taxpayers and practitioners spend considerable resources to determine how to classify transactions and apportion income under the fixed margins approach, but without necessarily achieving certainty.

13. Several comments pointed to the fact that the fixed margins would have to be improved to effectively achieve the objective of avoiding double taxation.

14. One respondent did not provide an opinion on the use of the fixed margins approach because no detailed review of the approach had been undertaken. Another shared that it did not have strong feelings about the approach because it had observed that most transactions were carried out indirectly between that jurisdiction and Brazil.

Potential challenges to trade and investment related to the transfer pricing framework in Brazil

Influence on composition and nature of investment

15. Key trading partners were asked if the composition or nature of investment in Brazil was influenced by the specific aspects of Brazilian transfer pricing rules (such as the absence of a complete comparability analysis, the use of fixed margins, the absence of transfer pricing control for royalty payments, etc.). Four categories of answers can be distinguished.

16. The first category of answers refers to comments made by a number of trading partners that provide indications or insight with respect to the influence of the specific aspects of transfer pricing rules on the composition or nature of investment:

- The composition and nature of investments in Brazil is influenced by the specific aspects of Brazilian transfer pricing rules, notably because some enterprises put in place strategies just to avoid double taxation, which deters investment, lowers attraction and does not favour the development of business and trade;
- The Brazilian transfer pricing rules degrade the investment climate in Brazil in addition to the fact that the system does not recognise different aspects of various transactions;
- Investments into Brazil are driven by economic factors and by commercial rationale, and avoiding double taxation while having tax certainty are important considerations for enterprises when choosing to invest in a country; that said, no evidence shows that there is any influence of the Brazilian transfer pricing rules on the composition or nature of investments, which however does not necessarily mean that no such influence exists;
- By not recognising the specific economic circumstances of a particular taxpayer, transaction or business through its transfer pricing system, Brazil may give business pause before investing in the country (e.g., a company in a start-up phase unable to achieve target fixed margins or whose initial losses would not be recognised); and
- In consideration of the complexity of the investment climate (which involves the legal framework as a whole and should account for the certainty provided): a focus on royalties rather than intangible
pricing aspects seems to have been favoured in Brazil; nonetheless, there could be merit in realizing the importance of identifying and evaluating the value chain of intangible assets and the role played by resident enterprises in this chain.

17. The second category of answers refers to a few comments that represented the view that the composition and nature of investments in Brazil is not influenced by the transfer pricing rules:

- Transfer pricing rules do not have any major influence on investment and there are no known cases of enterprises (according to this specific jurisdiction) that expressed their intentions to invest and desisted because of the concerned rules; and
- The role occupied by transfer pricing rules in the decision process for investment purposes is only of secondary nature.

18. The third category concerns assumptions made where it was also specified that no evidence or data supports the claims:

- The assumption that the special features of the Brazilian transfer pricing system will have an effect on the nature of investment in Brazil; an example that was included relates to the perception that Brazil’s transfer pricing rules seem to favour the tax treatment of export transactions and should presumably attract export related investments to Brazil;
- It would be reasonable to expect that the composition and nature of investment is influenced by many factors, including tax issues, and particularly transfer pricing aspects;
- It should not be assumed that the effects in question are negligible despite signs that enterprises from a specific country invest significantly in Brazil in various business sectors, and it was also noted that it remains uncertain how these enterprises find ways to adapt and minimise double taxation risks; and
- The assumption that investors take the high risk of double taxation into account when they analyse potential investments in Brazil and thus, that situations exist where the composition or nature of investments in Brazil are influenced by the Brazilian transfer pricing rules.

19. The fourth category concerns jurisdictions that were unable to comment for the following reasons: they have not undertaken a detailed review of Brazil’s transfer pricing approach, they did not have evidence and empirical data, they do not have a tax treaty with Brazil and the related inability to speak to factors that might influence the composition of investment, or they did not specify the reason for the absence of answer.

**Practical issues or difficulties arising from the fact that Brazilian transfer pricing rules are not aligned with the OECD Guidelines**

20. Key trading partners were asked to provide evidence of issues or difficulties caused by the misalignment of the Brazilian transfer pricing rules. Six jurisdictions were able to provide comments. They provided (to a various extent) forms of evidence of:

- The practical difficulty – that is, of complying with the Brazilian transfer pricing system while applying the arm’s length principle for the tax purposes of a specific country – raised by taxpayers doing business in Brazil, with concerns regarding unrelieved double taxation;
- Results from a recent survey conducted by business representative bodies in one of the responding countries indicated that over 50% of companies headquartered in that specific country and carrying out business in Brazil have faced issues and difficulties in the determination of transfer prices with their Brazilian subsidiaries;
- Additional costs borne by taxpayers to accommodate to the specificities of the Brazilian transfer pricing system;
Significant practical issues or difficulties that could not be evidenced by specific instances for the reason that collecting this information would require additional time than provided to answer the questionnaire, and because of a circumstance that complicates the gathering of information on this issue, which is that it seems as if taxpayers often do not contact the competent authority in relevant cases since the Brazilian transfer pricing system does not seem to provide access to dispute-resolution mechanisms;

Practical difficulties informally raised by taxpayers (without specifying which); and

Problems related to pricing conditions for transactions that involve the use of intangibles and cases where a Brazilian MNE would limit its royalty payments to a non-arm’s-length level due to the fact that Brazil has deductibility limitation rules regarding outbound royalty payments, although not substantiated by actual cases.

For jurisdictions that did not provide evidence, the reasons for this were that the specific country did not have any material international related party transactions where Brazil was a counterparty, that there was no known case or no information was available, or because taxpayer experience was limited due to the absence of a tax treaty, or the reason was not specified.

**Transfer pricing controversies and double taxation**

22. Key trading partners were asked if any of their taxpayers had experienced any transfer pricing controversy involving Brazil that led to double taxation. The following observations can be made:

- Most jurisdictions reported that their taxpayers had not experienced any transfer pricing controversy that led to double taxation, or at least it had not been brought to attention;
- In one specific jurisdiction, enterprises reported to have experienced transfer pricing controversies related to the Brazilian rules as well as the deductibility of service charges (which was denied), and less than 5% of those which requested access to MAP were granted a satisfactory solution while others that did not, considered the procedure too cumbersome and unlikely to lead to a satisfactory solution regarding the elimination of double taxation;
- In another jurisdiction, controversies that have not been resolved yet were reported;
- Provided that an enterprise may have chosen to bear the cost of double taxation without informing the tax administration of a specific country, no information is available on whether transfer pricing controversies leading to double taxation could have arisen;
- Limited experience where double taxation was a concern of taxpayers operating in Brazil was shared by another jurisdiction, and among the cases, some were rectified through action in Brazil and others led to double taxation either because they were unable to correspond or the correspondence did not lead to an agreement;
- Cases of double taxation occurred but they were not related to transfer pricing.

**Risks of potential double non-taxation or under-taxation and potential spillovers**

23. In response to whether there may be risks of potential double non-taxation or potential under-taxation, key trading partners shared the following views:

- Some concerns arise in cases involving low-risk distributor models and manufacturers;
- Potential double non-taxation can result from the divergences of the Brazilian rules from the OECD Guidelines;
- Experience with Brazilian MNE groups shows that the Brazilian transfer pricing rules can create loopholes which lead to double non-taxation under some circumstances, due to mismatches between the Brazilian rules and the application of the arm’s length principle;
• Differences pertaining to the application of the fixed margins approach, which notably disregards certain economic considerations, and the application of the arm’s length principle potentially lead to over- or under-taxation;
• Transfers of intangibles constitute large risks for transfer pricing and Brazil does not seem to effectively deal with these transactions, which may mean that transfers of intangibles escape taxation, and which has the spillover effect of providing competitive advantages to some companies; and
• The absence of guidance in areas such as cost contribution arrangements and intra-group services leads to potential over-taxation or potential under-taxation;
• The absence of corresponding adjustments was also mentioned.

24. It is worth noting that a small number of jurisdictions did not perceive any risk of potential double non-taxation or potential under-taxation.

Brazil’s position in not adopting Article 9, paragraph 2 as a deterring factor for investment in Brazil

25. Key trading partners were asked if Brazil’s position in not adopting Article 9, paragraph 2 of the OECD MTC in its tax treaties constituted a deterring factor for investment in Brazil. The different answers provided are summarised in the following way:
• The commitment of a Contracting State to eliminate double taxation, as reflected in Article 9, paragraph 2, is considered relevant to the making of investment decisions;
• Not adopting Article 9, paragraph 2 is one of a number of factors that may have a deterring effect on the level of investments into Brazil; however, the extent of this negative effect remains uncertain;
• The absence of Article 9, paragraph 2, in Brazil’s tax treaties creates uncertainty for taxpayers considering investments in Brazil and is thus a deterring factor;
• It could contribute to providing a strong legal framework and influence the investment decisions of MNE groups (depending on the nature and materiality of the transactions), but cannot be considered as a decisive factor by itself;
• Investors may prefer to invest in countries where they can benefit from flexibility and the possibility to resolve disputes, including regarding the elimination of double taxation;
• The transfer pricing framework may not individually be considered to deter investments, although it could be a contributing factor in addition to others; and
• Lack of data or evidence does not allow to determine whether this is a factor.

Avoiding and resolving transfer pricing disputes

Opinion on the fact that Brazil has not included Article 9, paragraph 2 in its tax treaties

26. The views of key trading partners on the absence of Article 9, paragraph 2 are summarised below:
• The inclusion of paragraph 2 of Article 9 is not absolutely necessary and a corresponding adjustment could be granted to the extent that the primary adjustment was at arm’s length; however, in Brazil’s case, including paragraph 2 is imperative based on the understanding that Brazil does not share this view;
• It does not necessarily lead to a situation where corresponding adjustments are not granted;
• Article 25 of tax treaties can also be invoked to address transfer pricing issues;
Recent developments in relation to the adoption of MAP guidance may represent a more effective instrument to encourage possible corresponding adjustments;

- The commitment would be supportive of the overall objective of promoting cross-border trade and investment;
- It raises a higher risk that possible double taxation will not be eliminated;
- It is misaligned with the international commitments of preventing and eliminating double taxation as well as promoting dispute resolution;
- It shows a lack of willingness for discussing double taxation issues between competent authorities, which creates a significant risk of double taxation, and consequently goes against one of the main purposes of entering into a tax treaty (i.e. avoiding double taxation); and
- It appears coherent with Brazil recognising that its transfer pricing legislation diverges from the OECD standard, and the consequence is the absence of an effective elimination of resulting double taxation.

27. One specific jurisdiction perceived that the Brazilian tax authorities hold a position according to which they cannot enter into MAP negotiation to resolve double taxation caused by transfer pricing adjustments due to the fact that paragraph 2 of Article 9 is not included in Brazil’s tax treaties.

28. Two other responses also acknowledged that it is in every country's sovereign right to administer their tax system how they choose.

29. A small number of cases involving transfer pricing disputes were reported by two trading partners. However, the majority of responses indicated that there was no evidence of issues related to the impossibility to request a corresponding adjustment and that they were not aware of any particular case. According to the responses submitted by two other trading partners, taxpayers were said not to request MAP because they anticipate that the request will be refused by the competent authority or remain unresolved. One of them also noted that enterprises notoriously face problems in relation to transfer pricing adjustments in Brazil.

Mechanism under the domestic law

30. Key trading partners were asked if instead of revising their tax treaties to include paragraph 2 of Article 9 it would be sufficient to achieve the objective of avoiding double taxation if Brazil introduced a mechanism, which would be implemented under the MAP, to eliminate double taxation by committing to provide corresponding adjustments under their domestic legislation. The responses are summarised below.

31. Introducing this mechanism would help to achieve this objective and could be sufficient; but

- It would depend on the scope of the mechanism and how the mechanism is administered (e.g., it would have to be easily accessible and lead to an efficient way of dealing with cases of double taxation in practice);
- The domestic legislation would have to be in accordance with Article 9 and Article 25 of the OECD MTC and have the same legal force;
- It would have to cover both situations where Brazil has made a primary adjustment and where a treaty partner of Brazil has made a primary adjustment;
- Even if helpful, it would still fall short of an international commitment to eliminate double taxation and there are concerns that this domestic rule could be amended or replaced without the consent of Brazil's treaty partners.
32. Domestic legislation or Article 25 are not sufficient to guarantee elimination of double taxation with certainty and stability because Article 9, paragraph 2 provides an obligation of result (i.e. granting a corresponding adjustment when the primary adjustment is consistent with the arm’s length principle).

33. It would be expected that paragraph 2 of Article 9 be included in future tax treaties concluded by Brazil.

34. Finally, renegotiating all the treaties that Brazil has concluded would take a long time.

**MAP requests**

35. Key trading partners were asked if any of their taxpayers submitted a request for MAP, in their jurisdiction in the case of a domestically headquartered MNE (if a treaty with Brazil exists) or in a jurisdiction with a tax treaty to which Brazil is a Contracting State in the case of associated enterprises present in other jurisdictions, either because of taxation not in accordance with the treaty or difficulties and doubts arising from the interpretation or application of the treaty.

36. A limited number of MAP requests were reported in the country responses and concerned taxation not in accordance with a treaty, including transfer pricing adjustments made by one specific jurisdiction (some of which were withdrawn and others which are still pending). It was also reported that in response to requests to enter into MAP negotiation in cases involving judicial procedures, the Brazilian competent authority had responded that it would not be able to do so in the cases where the decisions had already been rendered.

37. Some of the responses indicated that there had not been any request for MAP submitted by taxpayers involving Brazil.
TRANSFER PRICING IN BRAZIL
Towards Convergence with the OECD Standard

This report is an outcome of the joint project on transfer pricing between the Organisation for Economic Co-operation and Development (OECD) and Receita Federal do Brasil and contains the findings of the in-depth analysis of similarities and differences between the transfer pricing framework currently in place in Brazil as compared to the OECD guidance (OECD Transfer Pricing Guidelines for Multinational Enterprise and Tax Administrations), which is the international consensus on transfer pricing. The report also explores the options for Brazil to converge with the OECD transfer pricing standard while enhancing the positive attributes of the existing framework.

The executive summary contains the highlights of the assessment and its findings. The introduction provides an overview and the background of the project, followed by a detailed analysis of the Brazilian transfer pricing rules and administrative practices as compared to OECD guidance. The report concludes by exploring the options for alignment while ensuring simplicity, tax certainty, ease of compliance and tax administration.

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