JOINT STATEMENT ON THE OECD-BRAZIL TRANSFER PRICING PROJECT

11 July 2019

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 builds on Brazil's robust engagement in the OECD's tax work. Brazil has been actively participating in the OECD tax work since joining the Global Forum on Transparency and Exchange of Information for Tax Purposes in 2010 and since 2013 as a member of the G20/OECD BEPS Project, which had a substantial focus on transfer pricing. In 2017, Brazil also expressed interest in initiating the process to join the OECD.

The launch of the project is an important milestone in deepening the dialogue between the OECD and Brazil on transfer pricing matters.[1] In the light of the findings of this assessment, the project 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.

The 15-month work programme carried out by OECD jointly with *Receita Federal* (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 the strengths and weaknesses of that framework, possible options were explored for Brazil's alignment with the OECD internationally accepted transfer pricing standard (with reference to the OECD Transfer Pricing Guidelines). The work programme was structured 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.

Launch Event: "OECD Transfer Pricing Standard and Brazilian Approach: Challenges and Opportunities"

The launch event held in Brasília on February 28 - March 1 2018 marked the official start of the joint project. This event allowed OECD and RFB to collect input on the experience from both the business sector and government officials of some of Brazil's major trading and investment partners. 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 sector.

[1] See press release, OECD and Brazil launch project to examine differences in cross-border tax rules: http://www.oecd.org/tax/oecd-and-brazil-launch-project-to-examine-differences-in-cross-border-tax-rules.htm.The full keynote speech delivered by M. Ángel Gurría is available at http://www.oecd.org/fr/fiscalite/prix-de-transfert/launch-of-transfer-pricing-work-programme-brazil-2018.htm.

Stage 1 Report:
Preliminary Analysis of the Legal and Administrative Framework of Transfer Pricing Rules

Following the launch event, the project activities focussed on completing the preliminary analysis of the Brazilian legal and administrative framework, including primary and secondary transfer pricing legislation and administrative practices. This preliminary analysis allowed for the identification of key issues to focus on as part of the project. The report provides an overview of the Brazilian transfer pricing system, starting from its origins, and detailing its interaction with the arm's length principle. It also covers Brazil's position on OECD legal instruments and existing guidance related to transfer pricing. It also outlines the main differences between the Brazilian and the OECD approaches as well as the key policy issues for discussion.

Close co-operation between OECD and RFB was maintained throughout the project. This collaboration was enhanced by a series of technical workshops and bilateral meetings with high-level RFB officials. The project also involved sustained engagement with external stakeholders. The two key external stakeholders were the business community and Brazil's major trading and investment partners. The views of other stakeholders, such as representatives of academia, tax experts and specialised practitioners, were also considered.

Targeted input was collected on the basis of questionnaires to gather information on the Brazilian transfer pricing framework. Two tailored questionnaires were prepared to request specific answers with respect to how the transfer pricing rules and administrative practices are perceived by taxpayers (both multinational enterprise groups headquartered domestically and foreign-headquartered groups) and government representatives of key trading partners of Brazil, and in relation to their experience with applying them. The questionnaires were designed to capture as comprehensively as possible the views, concerns and issues pertaining to the Brazilian transfer pricing system, both from the perspective of trading and investment partner countries and multinational enterprises with operations and investments in Brazil.

The contributions of stakeholders was key to ensure the quality and comprehensiveness of the analysis. Engagement with stakeholders served the multiple purposes of collecting comprehensive and valuable input to feed the analysis, of constructively supporting the analysis of the issues already identified and additional issues identified in this way, and of exploring ideas and suggestions to improve the existing transfer pricing system in Brazil with a view to bringing it closer to the OECD standard. In this sense, the relevant contributions of knowledge and experience shared by the various stakeholders of the project are duly reflected in the reports.

Stage 2 Report:
Assessment of the Strengths and Weaknesses of Existing Transfer Pricing Rules and Administrative Practices

The Stage 2 report contains an in-depth analysis of the existing transfer pricing rules and administrative practices in Brazil and presents the findings of the assessment of its strengths and weaknesses. The first step of the analysis was the identification of the main areas in the Brazilian transfer pricing framework and the related rules and practices that constitute gaps and divergences from the OECD transfer pricing standard ("gap analysis"). The second step was to test the effectiveness of the existing rules and practices in view of the policy objectives of transfer pricing rules ("assessment of effectiveness").

The so-called "gap analysis" identified 30 issues in the Brazilian transfer pricing framework. For each chapter of the OECD Guidelines, the analysis considers whether the main elements, concepts and objectives of the guidance are reflected in the Brazilian transfer pricing framework. These 30 issues can be characterised as divergences or gaps (areas left unaddressed) in the Brazilian transfer pricing rules.

The "assessment of effectiveness" subsequently tested the issues identified against the policy objectives of transfer pricing rules. In order to determine how they interact with these policy objectives, the issues identified in the Brazilian rules were assessed according to objective criteria derived from the policy objectives of transfer pricing legislation, namely the primary dual objective of securing the appropriate tax base in each jurisdiction and avoiding double taxation (prevention of BEPS risks and prevention of double taxation) and other secondary objectives (ease of tax administration, ease of tax compliance, and tax certainty from a domestic and international perspective).

The assessment revealed that a large number of the gaps or issues identified lead to instances of double taxation. The assessment revealed that 27 out of the 30 issues identified in the Brazilian transfer pricing rules increase the risk of double taxation, and therefore hinder international trade and investment. The input collected from the business community and key trading partners of Brazil confirmed this conclusion.

The assessment revealed that a large number of the gaps or issues identified create BEPS risks, leading to potential loss of revenue. The assessment revealed significant weaknesses 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). It also revealed weaknesses in particular features of the system, such as the fixed margins approach. The inability to prevent BEPS practices and to protect its tax base results in loss of revenue for Brazil for 23 out of the 30 issues identified. The input collected from the business community and key trading partners of Brazil confirmed this conclusion.

Tax certainty is generally provided from a domestic perspective; however, significant tax uncertainty is observed from an international perspective. Tax certainty matters also from the cross-border perspective, in order to ensure that the existing divergences do not give rise to disputes and challenges raised by tax administrations in other jurisdictions. The assessment revealed that significant tax uncertainty results from the misalignment of the rules with the OECD transfer pricing standard given that out of the 30 issues identified, only three instances lead to positive outcomes regarding tax certainty from an international perspective.

Tax administration and tax compliance aspects of the Brazilian system are generally conducive to ease of tax administration and tax compliance. The Brazilian transfer pricing system is often characterised by its practicality, predictability and tax certainty (that is, 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 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 existing features, mainly the item-per-item approach, the strict standard of comparability, documentation in certain situations. Notwithstanding the unintended consequences of certain aspects of the transfer pricing legislation in Brazil as exposed in the assessment conducted as part of Stage 2, which negatively affect the ability of the country to attract trade and investment, 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 allows to overcome challenges related to the lack of information available on comparable uncontrolled transactions and profitability levels and requires only limited administrative and financial resources to be applied, and reduces costs and time involved in litigating transfer pricing cases. Brazil has implemented a system that has the benefit of protecting the Brazilian tax base to a certain extent, ensuring predictability and certainty in some respects, and of being practical as demonstrated by areas where ease of tax administration and compliance was observed. However, in some cases, the key features contributing to simplicity may undermine the primary objectives of transfer pricing rules, leading to potential double taxation and BEPS risks.

Stage 3 Report:
Options for Alignment with the OECD Transfer Pricing Standard

The options for greater alignment with the OECD Transfer Pricing Guidelines were explored and developed in the key final deliverable of the project, namely the "Stage 3 Report". Two separate options – both achieving full alignment – are described in detail in this report, outlining a potential way forward with a view to informing high-level policy discussions on the merits of each alternative, including the strengths and weaknesses as well as the opportunities and threats associated with them.

Two options emerged that both aim to achieve full alignment based on the assumption that, otherwise, significant gaps would remain in the system, which would make it difficult for Brazil to both integrate global value chains and to accede to the OECD. The first option for consideration seeks to immediately align the Brazilian transfer pricing rules with the OECD Guidelines. The second option discusses 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, etc., as changes are progressively implemented. 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 taxpayers into the new system in the short-term, which could for instance be based on a specific threshold and initially concern the largest taxpayers 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).

The options also consider how to maintain a number of elements of simplification, which provide ease of tax administration, ease of tax compliance and tax certainty (i.e. the fixed margins approach – for example, in the form of carefully tailored safe harbours or rebuttable presumptions). An important consideration in the possible implementation process relates to preserving a number of the features of the existing system that provide simplicity and predictability. This perceived simplicity and practicality does not necessarily prevail in all respects, and while simplification elements found in the Brazilian transfer pricing legislation are inspiring in terms of alternative, less complex ways of reaching acceptable outcomes, provided said outcomes conform to the arm's length principle, it cannot be ignored that the existing framework could be subject to improvements. In particular, a number of issues are considered critical given that they provoke situations of double taxation and loss of revenue for Brazil. To resolve the critical issues identified, some of the existing rules will need to be replaced or amended to align them with the OECD internationally accepted transfer pricing standard – embodied in Article 9 of the OECD MTC and the OECD Guidelines. The need to ensure simplicity, tax certainty and effective tax administration can notably be addressed by the potential adoption of safe harbour regimes or rebuttable presumptions.

Next steps

Following this technical analysis, the time is ripe to make political decisions regarding whether to align and how this alignment should occur. The reports resulting from this project will provide the relevant technical analysis and serve as the basis to assist decision-makers in deciding on the way forward, in the light of the findings presented as regards the effectiveness of the current Brazilian transfer pricing rules and the advantages and disadvantages presented by the two different options for alignment.

The specific implementation needs of Brazil will represent an important aspect for the considerations with respect to the way forward. With the objective to aid this process of political decision-making and planning of the possible implementation, a blueprint or implementation roadmap could be developed to outline the key areas to be addressed. Important considerations in this regard include the design of the key features of the new transfer pricing framework, drafting the implementation legislation, capacity building and related investments, changes to the tax administration structure, as well as the development of simplification measures to ensure ease of tax compliance, effective tax administration and tax certainty from both a domestic and international perspective.

Acknowledgments

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) and HM Revenue and Customs (HMRC) and HM Treasury, as well as the jurisdictions that 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* and the National Confederation of Industry of Brazil (CNI).