

Transfer Pricing in Brazil

Towards Convergence with the OECD Standard

HIGHLIGHTS

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Preface

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 the Federal Revenue of Brazil

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 have 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

Overview of the “Transfer Pricing in Brazil” project

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:



HIGH-LEVEL CONCLUSION

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.

What were the reasons for launching the project?

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

- 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)²;
- 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;

2. 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.

- 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*".

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.



What were the reasons for launching the project?

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.

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.

3. Recommendation of the Council on the Determination of Transfer Pricing between Associated Enterprises, as last amended in 2017, OECD/LEGAL/0279.
4. Recommendation of the Council on Attribution of Profits to Permanent Establishments, as amended in 2009 and 2010, OECD/LEGAL/0368.
5. Recommendation of the Council on Base Erosion and Profit Shifting Measures Related to Transfer Pricing, OECD/LEGAL/0424.
6. OECD (2011), *OECD Guidelines for Multinational Enterprises*, OECD Publishing. <http://dx.doi.org/10.1787/9789264115415-en>.

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,³ the 2008 Council Recommendation on Attribution of Profits to Permanent Establishments,⁴ and the 2016 BEPS Transfer Pricing Recommendation.⁵ 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 did not adhere 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 (OECD 2011)⁶ 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.”

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.

Zooming in on the key findings

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 unrelieved double taxation.

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, 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.



SIMPLICITY BUT AT WHAT COST?

At least three aspects of the Brazilian transfer pricing system simplify compliance and administration – fixed margins, freedom of selection of the method, and safe harbour regimes – but raise concerns because they fail to achieve the dual objective of transfer pricing rules.

The current system may be perceived as practical and predictable, but it comes at the cost of loss of revenue for Brazil and double taxation and tax uncertainty for taxpayers in the cross-border context. It is recognised that Brazil implemented a system that has the benefit of ensuring predictability in some respects, of protecting the Brazilian tax base to a certain extent, and of being practical as demonstrated by areas where ease of tax administration and compliance were observed. However, in some cases, the key features contributing to these benefits may undermine the dual objective of transfer pricing rules, leading to potential double taxation and BEPS risks.

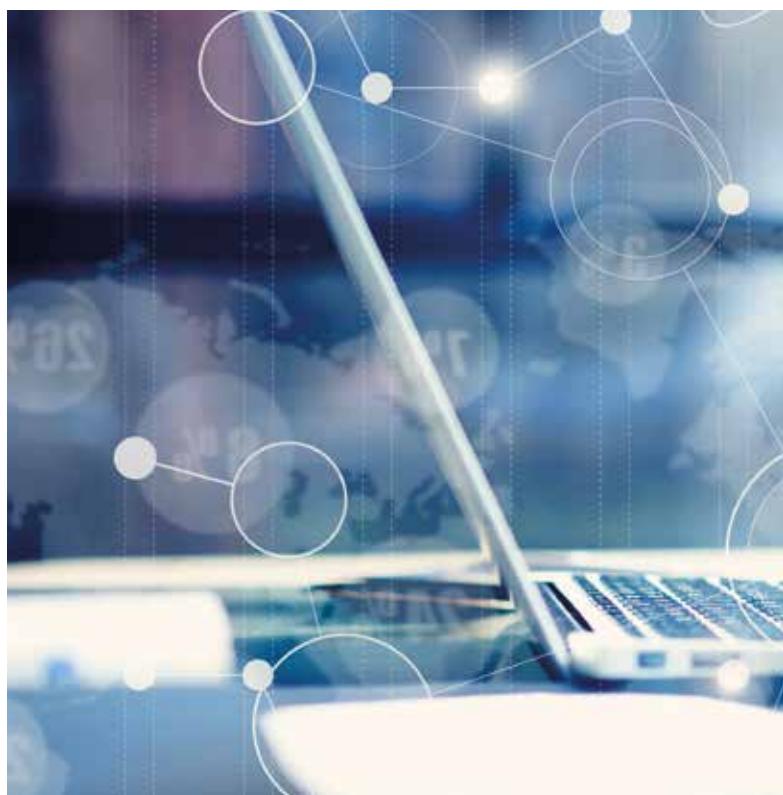
While the use of fixed margins presents a number of advantages in terms of simplicity and practicality, it represents a trade-off between simplicity and appropriateness as well accuracy and may create inappropriate outcomes. The lack of transparency under which the margins have been developed (in terms of the data employed and the criteria used) and the available evidence of its failure to reflect the economic reality in numerous cases indicate that the fixed margins used do not lead to arm's length outcomes.

Another issue linked to the fixed margins is their rigidity. The rigid application of fixed margins may require taxpayers to apply excessively high margins in some situations, while also allowing taxpayers to apply excessively low margins in other situations. The mechanism to challenge the fixed margins appears to be designed in a way that does not facilitate its use by taxpayers – to date, the mechanism has never been successfully applied.

The fixed margins approach provides simplicity by not requiring an extensive transfer pricing analysis but produces inappropriate outcomes. The approach relies on prescribed mathematical calculations, which are applicable without considering the circumstances of the transaction at hand. For example, a fixed mark-up of 15% on service fees is imposed under the application of

the CAP method (the equivalent of the cost plus method for exports) regardless of the value of the service provided. This means that a high value-adding service or activity that creates unique and valuable intangibles resulting in profitability in the range of hundreds of percent under an arm's length approach, would be remunerated under the Brazilian system on a cost plus 15% basis, leading to significant under-taxation. Other examples also exist where the law prescribes excessively high profit margins to be applied, which may even exceed the profit margin earned from the transactions in their totality, thus leading to over-taxation and double taxation, which naturally discourage various types of activities and investments. Thus, while the process of arriving at the outcomes is simple, the outcomes are not appropriate for Brazil or for the taxpayer.

The second feature that brings simplicity is the freedom the taxpayer has in the selection of the method. In principle, the taxpayer can choose any method (except for commodity transactions), even if it results in inappropriate outcomes.. Taxpayers are thus more likely to select the method that leads to the most favourable tax outcome, which may in some cases reduce the potential double taxation but in other cases leads to under-taxation and loss of revenue for



Brazil. This means that where a choice of more than one method is feasible, the taxpayer will not consider which of the methods is the most appropriate with a view to achieving arm's length outcomes, but rather which of the available methods leads to the lowest tax liability.

A third aspect of the transfer pricing framework intended to provide simplicity for export transactions is related to the existing safe harbour provisions, which exclude the application of the transfer pricing rules to the relevant transactions under specific conditions that must be met by the taxpayer.

For example, the 90% test safe harbour may produce inappropriate outcomes. It 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 by the taxpayer is deemed acceptable. The issue is that it is based on a comparison between prices on the domestic market in Brazil and the prices of the same goods or products on foreign markets and the profit potential may be significantly different in the foreign market, as in the case where foreign customers have a different purchasing power or where premium pricing would apply in foreign markets due to scarcity or uniqueness of the particular products.

The profitability test safe harbour also presents a concern in terms of its appropriateness. It establishes that 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 revenues. The issue is that 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



What are the gaps and divergences identified?

A large number of gaps (absence of specific concepts or features) and divergences (concepts which differ significantly and lead to divergent outcomes) were identified in the assessment phase of the project. It should be noted that not all of the gaps and divergences identified are critical to achieve alignment with the OECD approach. It may nevertheless be desirable to address these gaps and divergences so as to enhance the efficiency and effectiveness of the system.

The joint OECD-RFB project also considered, based on the assessment conducted, how each issue can be addressed with targeted recommendations when exploring the possible options for alignment. The issues are grouped below according to the ten key areas that are carefully reviewed and considered by the OECD during any accession process.

LIST OF THE ISSUES RESULTING FROM GAPS DIVERGENCES

1. OECD Council Recommendation on the Determination of Transfer Pricing between Associated Enterprises and future BEPS Recommendations

Brazil has yet to adhere to the relevant OECD legal instruments

2. Statement and application of the arm's length principle

- Absence of restatement of the arm's length principle in the domestic law
- Scope of application of transfer pricing rules

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4. Comparability issues

- Absence of notion of accurate delineation of the actual transaction
- Use of fixed margins, which lead to non-arm's length outcomes
- Absence of a complete comparability analysis / process of performing a comparability analysis
- Strict use of comparables
- Strict application of the item-per-item approach and not permitting combining transactions
- Limited comparability adjustments

3. Transfer pricing methods

- Freedom of selection of the transfer pricing method
- Use of "other methods" not permitted
- Absence of transactional net margin method
- Absence of profit split method

5. Special considerations

- Weaknesses in safe harbour rules
- Absence of definition of intangibles for transfer pricing purposes
- Absence of transfer pricing rules or special measures for intangibles, including hard-to-value intangibles
- Treatment of outbound royalty payments (limited deductibility)
- Absence of benefits test in the transfer pricing rules
- Absence of special considerations in order to establish the arm's length price for intra-group services
- Absence of simplified approach for low value-adding services
- Limited guidance on cost contribution arrangements
- Absence of special considerations for the transfer pricing aspects of business restructurings
- Absence of special considerations for the transfer pricing aspects of financial transactions

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6. Transfer pricing compliance and examination practice

- Weaknesses related to transfer pricing compliance practices

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7. Documentation

- Limited documentation requirements and related penalties

8. Tax rulings and advance pricing arrangements

- Absence of advance pricing arrangements / inability to prevent double taxation

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9. Corresponding adjustments and mutual agreement procedures

- Concerns over resolution of transfer pricing disputes
- Absence of secondary adjustments
- Absence of effective dispute resolution mechanism

10. Determination of permanent establishments' profits

- Issues pertaining to the nexus rules
- Absence of guidance on attribution of profits to a permanent establishment

How does the existing framework create double taxation?

AVOIDING DOUBLE TAXATION AS A KEY POLICY OBJECTIVE

Transfer pricing issues typically involve more than one tax jurisdiction. As a result, any adjustment to the transfer price in one jurisdiction implies that, unless this adjustment is mirrored in the other jurisdiction(s), divergent outcomes will arise, as the same profits would be taxed as the income of two different entities belonging to a single MNE group, thereby creating double taxation.

Such outcomes can be prevented either when the respective jurisdictions follow the same standards and approaches to their application and interpretation, or, in cases where divergent outcomes have materialised, the double taxation can be prevented by making a corresponding change in the other jurisdiction. 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, as it will become subject to tax in two different jurisdictions. In order to minimise such risks, an international consensus involving common principles and approaches (namely, the arm's length principle) was established to determine transfer prices on cross-border transactions for tax purposes. In the absence of such adherence to common principles and approaches, the risks of double taxation are amplified.

MAIN SOURCES OF DIVERGENCE RESULTING IN DOUBLE TAXATION

- Absence of adherence to the arm's length principle, which is followed by most countries around the world. This prevents Brazil from applying the same approach as other countries to the determination of the tax base of MNEs located in Brazil, and thus inherently leads to a risk of double taxation, which is not prevented from the outset;
- Absence of transactional profit methods (transactional net margin method and profit split method);

- Important divergences in relation to performing a comparability analysis, including the absence of the notion of accurate delineation of the transaction, the limited comparability analysis (largely disregarding the functional and risk profile), combined with a strict use of comparables, the item-per-item approach and limited comparability adjustments;
- Absence of special considerations for specific types of transactions, including those involving the use or transfer of intangibles, intra-group services, cost contribution arrangements, business restructurings, and financial transactions;
- Deductibility limitation rules applying to certain out-of-scope types of outbound payments;
- Matters related to the mechanisms that would allow prevention and effective resolution of transfer pricing disputes;
- Divergences in the area of attribution of profits to permanent establishments.

EXPLAINING THE REASONS AND ILLUSTRATIONS OF THE DIVERGENCES

Absence of a complete comparability analysis and the role played by fixed margins

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 by using a complete comparability analysis. In other words, the specificities of the application of some of the Brazilian methods, which substitute the need for a comparability analysis with fixed margins may lead to different, non-arm's-length outcomes, and therefore double taxation.

The input provided by external stakeholders (both business and key trading partners) confirms the concerns over double taxation occurrences because the fixed margins may, in some cases, be lower or higher



than they would be if determined in accordance with the arm's length principle. This approach may also result in taxation that is not commensurate with the profitability of the company.

The application of the PRL and CAP methods (broadly equivalent to the OECD-recognised resale price method and cost plus method, respectively) require the application of fixed margins and usually result 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 is too high or too low compared with the results of a complete comparability analysis under the OECD framework, which takes the relevant economic realities into account and is crucial in establishing an arm's length outcome.

Illustrations of divergences based on intra-group services

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 the outbound situation, the rules may force the Brazilian company providing only "low value-adding" services, such as routine administrative support, to an amount fee that exceeds what is the true economic value of the service provided, but in the foreign jurisdiction only the arm's-length amount will be allowed as a deduction. In this example, more than an arm's-length amount of profit is included in the tax base of the Brazilian company.

In the inbound situation, the rules may force the Brazilian company to limit the deduction to the fixed margin's amount, while the value of the service actually provided by a foreign company may be significantly higher. In the foreign jurisdiction the service provider will be taxed by reference to the full arm's-length value of the valuable service provided and, further, the appropriate service fee income will be included in the tax base of the foreign company, but a corresponding deduction will not be taken into account when determining the tax base of the Brazilian company.

Why is the current framework prone to BEPS risks?

WHAT IS BEPS?

One of the main policy objectives of transfer pricing rules is to secure the appropriate tax base in each jurisdiction. Failing to ensure allocation of the appropriate tax base to the MNE group members, which would reflect the economic activities carried out in the relevant jurisdictions, may not only lead to double taxation as established above, but it may also lead to outcomes where less than the appropriate tax base is allocated and the tax base is thus eroded and also shifted to MNE group members in other jurisdictions (which may levy no or low taxation on such profits). This concerns the risk of inappropriate taxation (including under-taxation) and in particular risks of base erosion and profit shifting (the so-called “BEPS risks”), which are in many cases exploited and lead to unintended double non-taxation.

Aligning domestic transfer pricing rules with the internationally accepted principles set forth in the OECD Transfer Pricing Guidelines also provides a level playing field between countries. This level playing field further reduces BEPS opportunities and cross-border tax arbitrage.

SOURCE OF THE MAIN BEPS RISKS

- Absence of adherence to the arm's length principle, followed by most countries around the world;
- Different criterion for the selection of the method (freedom of choice rather than most appropriate method criterion);
- Absence of transactional profit methods (transactional net margin method and profit split method);
- Specific divergences in relation to performing a comparability analysis, including the absence of the notion of accurate delineation of the transaction, the limited comparability analysis (largely disregarding the functional and risk profile), and the strict use of comparables;
- Weaknesses in the safe harbour rules in place, which may provide further unintended tax benefits by deactivating the existing transfer pricing rules;

- Absence of special considerations for specific types of transactions, including those involving the use or transfer of intangibles, intra-group services, cost contribution arrangements, business restructurings, and financial transactions;
- Issues in relation to the attribution of profits to permanent establishments.

Illustrations of BEPS risks

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

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, of 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 OECD Transfer Pricing Guidelines is also not reflected in the Brazilian transfer pricing framework, 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. 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.

Absence of profit split method

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.

Absence of special considerations for business restructurings and intangibles

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. The divergences and gaps in the

existing system as compared to Chapter I-III of the OECD Transfer Pricing Guidelines 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 significant BEPS concerns and the transfer of profit potential out of Brazil including, importantly, transfers of valuable intangibles that may not always be duly recognised since the definition of intangibles contained in the current Brazilian rules may not be as broad as the one contained in the OECD Transfer Pricing Guidelines. As a consequence, such transfers or use of intangibles will also not be duly reflected in the Brazilian tax base. Brazil is likely to be losing revenue from companies that have such significant profit potential because that profit potential is not currently taken into account neither as part of recurring transactions nor in the cases involving the transfer 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 remaining profit will be recognised by the foreign legal entities located in low- or no tax jurisdictions so that the corresponding profits end up offshore and not in Brazil where the value is created.

Why is the simplicity provided by the existing framework only relative?

SIMPLICITY AS A KEY POLICY OBJECTIVE

Simplicity can be conducive to ease of tax administration and ease of tax compliance. The benefits of simplicity are especially sought after in the area of transfer pricing.

Ease of tax administration, which refers to the reduction of the administrative burden borne by the tax authorities and the associated mobilisation of resources necessary to be employed for the examination of transfer pricing issues. The costs of tax administration must be balanced against the revenue collected. Therefore increasing the effectiveness of tax administration is a desired tax policy objective.

Ease of tax compliance refers to the extent of the compliance burden and costs borne by a taxpayer. Where the tax compliance costs exceed the costs of the tax burden, the general policy objectives may not be necessarily achieved.

Ease of tax administration and ease of tax compliance are very important general tax policy considerations, and also important in the specific context of transfer pricing rules.

SIMPLICITY IS ONLY RELATIVE UNDER THE EXISTING BRAZILIAN FRAMEWORK

- Most aspects of the Brazilian transfer pricing system are generally conducive to ease of tax administration and ease of tax compliance and the system is often characterised by its practicality, predictability and domestic tax certainty;
- However, it emerged from the assessment that perceptions of simplicity are relative and complexity does arise from other existing features, mainly the item-per-item approach, the strict standard of comparability, and documentation burdens in certain situations;
- Most importantly, the key features contributing to simplicity in the existing system may undermine the dual objective of transfer pricing rules, leading to potential double taxation and BEPS risks.

THE OBJECTIVE OF ACHIEVING SIMPLICITY CAN BE DETRIMENTAL IN THE CURRENT FRAMEWORK

The relative simplicity of the existing system is mainly attributed to a potential reduction of the tax compliance burden (e.g., because of the use of fixed margins, which eliminate the need for a comprehensive comparability analysis), a potential reduction of tax administration efforts (i.e. these efforts are limited to the enforcement of rules that are generally more prescriptive and objective) 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 achieved in practice. Complexity is not completely avoided, as evidenced by the item-per-item approach required under the existing rules, which do not allow the grouping of transactions and considering them as a part of coherent set of commercial activities, which need to be evaluated in their entirety rather than being analysed in isolation. Other features of the current system, such as the associated documentation burden, which is linked to the item-per-item approach, and a strict standard of comparability (when present) may create significant complications, which in some cases outweigh the intended simplification objective. Other difficulties relate to the practical application of inadequate rules, e.g., to transactions involving intangibles and intra-group services, which may create additional complexities that have to be resolved through a very time consuming and burdensome process.

At the same time, the key features of the current system that contribute to simplicity undermine the dual objective of transfer pricing rules, because they may produce double taxation and BEPS outcomes. The implications of double taxation include the negative impact on trade and investment flows (which are currently mostly limited to market- and resource-seeking investments) and on the integration of Brazil in global value chains (which would represent the efficiency-seeking investments). 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 rigid fixed margins, etc.).

MORE EFFECTIVE MEANS TO SIMPLIFY THE APPLICATION OF TRANSFER PRICING RULES

The objective of simplifying the administration of transfer pricing rules and reducing the compliance burden associated with these rules can be achieved through other means that would not undermine the achievement of the dual objective of securing the appropriate tax base, thereby providing also protection against BEPS risks, and prevention of double taxation. The OECD approach does appreciate the need for simplicity in addressing some of the practical challenges of enforcing and applying transfer pricing rules, but recognises the importance of developing such measures in ways that would not have detrimental effects on the very purpose of transfer pricing rules.

CAREFULLY DESIGNED SAFE HARBOUR REGIMES CAN BE A SOLUTION

Some of the difficulties that arise in applying the arm's length principle in practice may be avoided or reduced by carefully designed guidance under which eligible

taxpayers may follow a simplified set of prescribed transfer pricing rules in connection with clearly and carefully defined transactions. Such simplified guidance can include the recommended approach on the application of the most appropriate method as well as the appropriate profit relevant to the given category of transactions, while taking into account the functional and risk profile of the taxpayer to ensure outcomes that are in line with the arm's length principle. Such guidance can also be accompanied by simplified transfer pricing documentation requirements, which would help establish and document that the taxpayer meets the eligibility criteria to apply the specific simplification regime.

The outcomes (prices) established under such rules would then be accepted by the tax administrations (subject to verification of the eligibility criteria). These elective provisions are often referred to as "safe harbours".⁷

The objective of simplification could thus be achieved through the use of carefully designed and regularly reviewed and updated safe harbour rules that would lead to arm's-length outcomes.

7. Section E of Chapter IV of the OECD Transfer Pricing Guidelines

Why does cross-border tax uncertainty prevail?

THE IMPLICATIONS OF TAX UNCERTAINTY ON BUSINESS AND INVESTMENT

Increasing evidence suggests that various forms of tax uncertainty adversely affect investment and trade. A main source of tax uncertainty in the context of the OECD Transfer Pricing Guidelines relates to misalignment of domestic transfer pricing rules with the internationally accepted principles set forth therein.

The main causes of tax uncertainty for business and tax administrations are 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);

8. See OECD/IMF Report on Tax Certainty – 2018 Update,
<http://www.oecd.org/tax/g20-report-on-tax-certainty.htm>.

- 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).

DOMESTIC TAX CERTAINTY IS RECOGNISED BUT THE SIGNIFICANT RISK OF CROSS-BORDER TAX UNCERTAINTY ALSO EXISTS

- Tax certainty is generally provided by the Brazilian transfer pricing framework **from a domestic perspective**;
- Taxpayers also have certainty that their **tax planning and tax avoidance arrangements will not be challenged if they comply with the available methods**;
- However, **significant tax uncertainty** is observed from a **cross-border / international perspective**;
- This is a consequence of the **misalignment** of the rules with the OECD transfer pricing standard.



SELECTED ILLUSTRATIONS OF TAX UNCERTAINTY OUTCOMES

Fixed margins

From a domestic perspective, the use of fixed margins seems to provide certainty to taxpayers by generating objectively reliable expectations and the guarantee that the margins will not be challenged by the tax administration. From an international perspective, however, the impact of fixed margins (diverging from the economic reality) is an approach that differs from the interpretation of international tax standards by a majority of jurisdictions and leads to increased tax uncertainty.

Absence of the Transactional Net Margin Method

The absence of the transactional net margin method (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 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 on a net profit basis (e.g., due to the actual economic circumstances). This may not be known to the taxpayer in advance of the fiscal year and tax uncertainty may originate from the fact that the taxpayer may not foresee the final economic results and thus also 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. Similarly, the fixed margins may exceed the actual economic profit generated in the relevant economic transactions within the MNE group, which may pose a key barrier to some investments in Brazil.

The absence of this internationally accepted method, which also provides a degree of simplification 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 increases the risks of uncertainty from an international perspective.

Financial transactions

From an international perspective, most countries currently apply 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 transactions produced by the OECD's Inclusive Framework on BEPS, which will provide further clarification on the application of arm's length principle to various financial transactions. The rules in Brazil, however, require the application of certain limited methods, including the fixed margins for some of them, which may not always necessarily lead to the same and/or a reasonable outcome, which means that there is potential for uncertainty from an international perspective under the current system.



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.

Illustration of issues raised by a partial alignment

A partial alignment could mean that new rules fully in line with the OECD guidance will be introduced to address only some transactions (e.g. 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 goods and services would



be disregarded and only the 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.

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).

What are the benefits of alignment with the OECD Transfer Pricing Guidelines?

MOTIVATIONS TO ALIGN

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 issues/gaps outlined above 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 are:

- **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.



Tax challenges arising from digitalisation

How does this project relate to the broader discussions on reforming the international tax system in the context of the digitalisation of the economy?

The solution currently being contemplated to address the tax challenges of digitalisation largely retains the current transfer pricing rules based on the arm's length principle, but complements them with formula-based solutions in areas where tensions in the current system are the highest. There is therefore nothing inconsistent with Brazil moving ahead to align its rules with the OECD transfer pricing standard and the ongoing work to address the tax challenges of digitalisation.

In fact, it would be very difficult for Brazil to implement the solution along the lines of what is being discussed within the Inclusive Framework on BEPS in the absence of alignment. Brazil is fully engaged in this work as a member of the Inclusive Framework on BEPS and can adapt its rules as necessary once an agreement is reached on the solution.

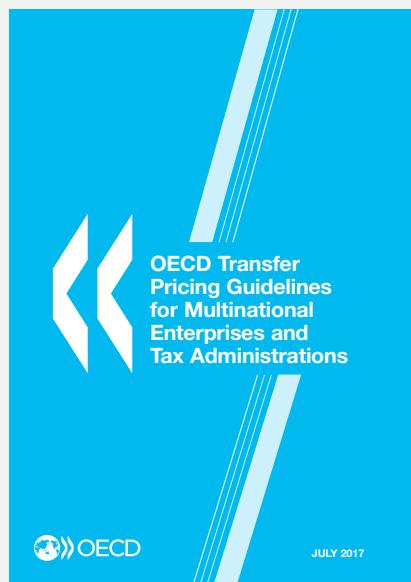


Transfer pricing in Brazil



TRANSFER PRICING IN BRAZIL: TOWARDS CONVERGENCE WITH THE OECD STANDARD A Joint Assessment of the Similarities and Differences Between the Brazilian and Oecd Frameworks

This report is an outcome of the joint project on transfer pricing between OECD and Receita Federal do Brasil (RFB). It 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.



OECD TRANSFER PRICING GUIDELINES FOR MULTINATIONAL ENTERPRISE AND TAX ADMINISTRATIONS

The *OECD Transfer Pricing Guidelines for Multinational Enterprise and Tax Administrations* provide guidance on the application of the “arm’s length principle”, which is the international consensus on transfer pricing, i.e. on the valuation for tax purposes of cross-border transactions between associated enterprises.



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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.

