D.1. Brazil Country Practices[1]

D.1.1. Introduction: General Explanation

D.1.1.1. Brazil introduced a law on transfer pricing, through Law n. 9430/1996, in 1996.[2] The bill was proposed to deal with tax evasion trough transfer pricing schemes, and according to the proposal, it adopted the arm´s length principle.

D.1.1.2. The methodology introduced by the law listed the traditional transaction methods (Cost Plus Method and Resale Price Method) but denied the use of transactional profit methods (the Profit Split Method and Transactional Net Margin Method) and formulary apportionment. Regarding the CUP Method, for exports or imports, the law introduced a methodology that is similar to OECD practices; and in addition Brazil also adopted the so called Sixth Method (which is the CUP method applied specifically for commodities). However, with regard to the Cost Plus Method and Resale Price Method, instead of making use of comparable transactions, the law established fixed margins for gross profits and mark-up.

D.1.1.3. In 2012 the law was changed by adopting different margins for certain specific sectors as applicable to the Resale Price Method (RSP). The Brazilian perspective is that the conventional use of the Resale Price Method and the Cost Plus Method implies some uncertainty and juridical instability, since they are implemented by the taxpayer without previous consent or summary review by the tax authorities. This affects stability and expectations in economic and fiscal relations.

D.1.1.4. Brazil's Resale Price Method and Cost Plus Method with fixed margins are applicable to both export and import operations. In order to make them easier to understand they are p(e)-16 (y)2.l2 rom

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[2]Law n. 9,430/1996 was modified by Law 9.959/2000, Law n. 10,451/2002, Law n. 11,727/2008, Provisional Measure n. 499/2008, converted into Law n. 11,941/2009, Provisional Measure n. 478/2009, Provisional Measure n. 563/2012, converted into Law n. 12,715/2012, Provisional Measure n. 575/2012, converted into Law n. 12,766/2012 (this last one affecting only interests). These laws are consolidated and explained by administrative regulations issued by the Brazilian Federal Revenue Secretariat: Normative Instruction RFB n. 1,312/2012, available at http://normas.receita.fazenda.gov.br/sijut2consulta/link.action?idAto=39257&visao=anotado (text in Portuguese).

certain obligations in pricing controlled transactions otherwise applicable under the arm's length standard. The Resale Price Method and Cost Plus Method with fixed margins can be applied by the taxpayers as regular methods, not as safe harbours. The fixed margins are subject to modifications authorized by the Minister of Finance, based on the taxpayer´s request or *ex officio*, as discussed below.

D.1.2 Resale Price Method with Fixed Margins

Explanation of the methodology

D.1.2.1. The mechanism of the Resale Price Method using fixed gross profit margins is considered by Brazil to be similar to the conventional Resale Price Method with margins, except that the gross margins are set out in the rules, rather than being based on comparables. See Figure 10.1 below. In order to determine the transfer price (deemed arm´s length price, or parameter price, as it is called in Brazilian transfer pricing laws), the resale price that the reselling company (Associated Enterprise 2) charges to an unrelated customer (Independent Enterprise) is reduced by a fixed gross profit margin. The remainder is the acceptable transfer price between the associated parties (Associated Enterprise 1 and Associated Enterprise 2), which is the parameter price.

D.1.2.2. Reference is made below to two applications of how this method could be

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D.1.2.6. Resale Price (with manufacturing operation)

In this methodology the transfer price would be calculated having regard to the proportional participation of the goods negotiated between associated parties (product A + input) in the goods resold to an independent enterprise (product B). This methodology reduces the weakness of using the Resale Price Method when the reseller adds substantial costs to the product traded between associated parties. The resale price to be considered shall be that price agreed upon by the reselling company with an independent enterprise. More details are given below.

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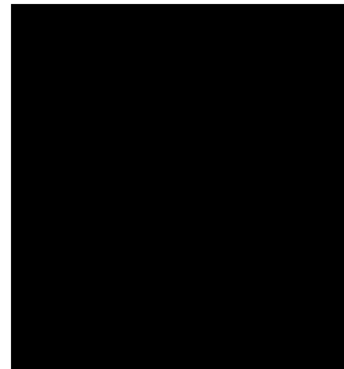

Figure D. 2: Resale Price Method (with manufacturing)

D.1.2.10. In order to avoid distortions between companies operating within Brazil it is necessary to ensure accounting uniformity between taxpayers in the country. If certain expenses are characterized as operating expenses by some companies and costs of goods sold by others the system will not be satisfactorily implemented.

The general formula for the inter-company transfer price would be (for a 30 per cent margin):
TP (parameter price) = PV – GPMV,

Where:

TP (parameter price) = deemed arm´s length transfer price determined under Brazilian law. The maximum price on imports or the minimum price on exports.

PV = participation value of the goods transferred to the associated enterprise in the net resale price = (price of Product A ÷ total cost of Product B) x (net resale price of Product B);

GPM = gross profit margin = the value of gross profit margin ratio, as determined by lag ( )]TJc8

A manufacturing enterprise domiciled in Country X, MCO, sells Product A with no similar product available worldwide to an exclusive distributor domiciled in Brazil, YD, for $16,000 per unit. YD, in its turn, resells the same Product A to customers for $18,750. According to

D.1.2.17. Example 3: Intercompany Software Licenses

SIRFRO, a service provider domiciled in Country A, in Europe, exports licenses of unique software to its affiliated company established in Brazil, named SARPRO. Each software license agreement grants the affiliated company the right to sublicense it within their respective territory. As a result, SIRFRO charges SARPRO a monthly royalty fee of $140,000, while it makes $160,000 out of sublicense agreements per month. According to the transfer pricing rules of Brazil, the parameter price (deemed to be the arm´s length price) in transactions like the one performed by SIRFRO shall be calculated by decreasing a 20 per cent fixed gross margin of the sublicense price resold. Thus the parameter price would be equal to $160,000 minus $160,000 x 20%, which is $128,000. Thus the transfer pricing adjustment would be $12,000 per month ($140,000 – 128,000) to SARPRO´s tax basis, in Brazil

D.1.3.5. Example: Intercompany Distribution

PHARMAX, a pharmaceutical industry with headquarters in Brazil, acquires the active ingredient of a drug produced in its laboratories from an independent enterprise (located in Brazil or abroad). The price paid in the acquisition of the active ingredient is $100 per unit, while PHARMAX exports medicine to companies in the same MNE group for $120 per unit. The Cost Plus Method in Brazil requires the exporter to stipulate prices taking into consideration a 15 per cent gross profit mark up so as to comply with transfer pricing rules. As a result, from Brazil's perspective, PHARMAX should not sell medicine to its affiliates in the other countries for less than $115 per unit ($100 + 15% of $100). Thus there would be no transfer pricing adjustment ($120 > $115).

D.1.3.6. Example: Cost Plus Method as Applied to Imports

PHARMCO is an MNE in the pharmaceutical industry with a distributor in Brazil named BRAZDIST. BRAZDIST imports a medicine produced by PHARMCO in Country B.

D.1.4. Differences Between the Application of the Methods Regarding Import and Export Operations

The RSP and CPM methods with fixed margins are applicable both to export and import operations.[4] Considering the RSP with fixed margins, depicted in Figures D.1 and D.2 of this Chapter, it would be applicable in the country of Enterprise 1 for export operations, and in the country of Enterprise 2 for import operations, hence:

For exports: TP (parameter price) > PV – GPM, which means that (PV – GPM) is the minimum acceptable transfer price for the tax basis calculation.

For imports: TP (parameter price) < PV – GPM, which means that (PV – GPM) is the maximum acceptable transfer price for the tax basis calculation.

[4] The Law and administrative regulations (named Normative Instructions) deal separately with import and export operations, considering particular aspects of each type, and also allowing for specific adjustments.

Considering the CPM with fixed margins, in Figure D.3 of this Section, it would be applicable in the country of Enterprise 1 for export operations, and in the country of Enterprise 2 for import operations, hence:

> For exports: TP (parameter price) > PC (1 + GPM), which means that PC (1 + GPM) is the minimum acceptable transfer price for tax basis calculation.
>
> For imports: TP (parameter price) < PC (1 + GPM), which means that PC (1 + GPM) is the maximum acceptable transfer price for tax basis calculation.

However, due to information accessibility the RSP Method is usually more suitable when the Brazilian company imports and the CPM is usually more suitable when the Brazilian company exports, as explained below.

D.1.5. Imports

D.1.5.1. Considering the case where the product resold is subject to value added costs or manufacturing by the reselling associated enterprise, the RSP Method is normally more useful for imports than for exports. The reason for this is that companies may not disclose their production or manufacturing costs, even to other associated companies located in Brazil. This aspect would jeopardize the method's applicability for exports, because the necessary manufacturing cost data incurred by the associated importing enterprise would be unavailable for the associated Brazilian exporting enterprise and the Brazilian tax administration. Even if the enterprises involved have complete access to each other's books there is still the problem of information availability to the Brazilian tax administration. In addition, the TP Regulations allow the use of a comparable by applying necessary adjustments.

D.1.5.2. If the RSP Method is applied for import transfer pricing, the manufacturing importer uses its own accounting book costs to calculate the correct transfer price, with no need to request the cost data incurred by the exporting associated enterprise. Furthermore in the case of imports the tax administration has full access to evaluate the uncontrolled operations (with independent enterprises). As a result the Resale Price Method with fixed margins is recommended for import operations.

D.1.6. Exports

D.1.6.1. For the corresponding reasons mentioned above as regards the Resale Price Method, the CPM is more practical for exports than for ie

result the Cost Plus Method with fixed margins is typically applied for Brazilian export operations.

D.1.7. Strengths and Weakness of the Brazilian Methods with Predetermined Profit Margins

D.1.7.1. The strengths of Brazil's predetermined profit margins when using the Resale Price Method and Cost Plus Method, which focus on simplicity**,** include:

It avoids the need for specific comparables;

The use of the conventional Resale Price Method and Cost Plus Method depends on the availability of certain data, databases or reports to empirically determine the gross profit margin and gross profit mark-up. In general these elements are not easy to find;

It frees scarce human resources and can be applied without technical knowledge of specific transfer pricing issues;

It stabilizes the expectations of taxpayers with respect to their Brazilian tax liability associated with inter-company transactions;

It is a low-cost system for companies and the tax administration in that it does away with one aspect of a transfer pricing analysis, the need to empirically determine gross margins;

It has a strong emphasis on practicality;

It does not distort competition among enterprises located where the methodology is applied, since they are subject to the same tax burden, and they are not benefitting from asymmetry of information;

It allows for simple implementation by tax authorities when auditing taxpayers; and

It is simple for taxpayers to apply.

D.1.7.2. The weaknesses of Brazil's predetermined profit margins when using the Resale Price Method and Cost Plus Method include:

The approach may lead to double taxation if there is no access to competent authorities to negotiate relief from double taxation;

The method requires clear classifications and accounting conformity with respect to the allocation of expenses between COGS and operating expenses;

It is unavoidable that some Brazilian enterprises will be taxed at (higher or lower) profit margins not compatible with their profitability. This is because the fixed margin method applies regardless of the cost structures of taxpayers. For example, otherwise economically identical taxpayers with large COGS relative to operating costs weOGos

D.1.8.1. The law and regulations set a precise number of methods for import and export transactions that are, in fact, specific methodologies for CUP, CPM and RSP, as follows:

For import transactions:

Comparable Uncontrolled Price Method (PIC and

approach for commodities is in line with the updated version of the OECD Guidelines after BEPS.[5]

D.1.8.3. Brazilian transfer pricing legislation does not apply to payments of royalties and technical, scientific, administrative assistance or similar activities (on imports), which remain subject to the conditions for deductibility set out in the tax legislation. In this regard the transfer pricing legislation applies, in general, only on export operations, and, in limited way, on intangibles that are imported for resale (see above Example D.1.2.17.)

D.1.8.4. Under Brazilian transfer pricing legislation there are special rules for interest (paid or credited), which are similar to the fixed margin approach if one considers the issue of predictability and clarity. Current legislation states that in the case of a controlled loan transaction (between related parties), or similar transaction, the interest rate to be applied to the transaction is:

i) in the case of transactions in US Dollars with a prefixed rate: market rate of the sovereign bonds of the Federal Republic of Brazil issued in the foreign market in US Dollars;

ii) in the case of transactions in Reais with a prefixed rate: market rate of the sovereign bonds of the Federal Republic of Brazil issued in the foreign market in Reais; and

iii) in all other cases, the LIBOR rate for 6-month deposits;

plus a spread as determined by a tax administrative rule issued by the Minister of Finance. If the actual interest rate of the transaction is different, it is subject to adjustment accordingretaxinrco-10So sul Rc

and this also affects transactions between

D.1.9.6. It is recommended that relevant taxpayers or groups that represent them verify the research, and that the margin found for each sector, line of business, product or service could be applicable to any or the vast majority of transactions in that situation. In short, this method suggests that a margin that is used for a sector, line of business or specific goods and services can be used for similar situations in the same business sector.

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