

D.1. Brazil Country Practices¹

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 through 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 presented in the following paragraphs disregarding practical distinctions. A more detailed explanation to differentiate the application to imports and to exports and how to deal with that will be discussed separately. This is because the Brazilian transfer pricing law details the application of the two methods (RSP and CPM) for exports and imports in separate sets of rules. There are also specific methods for tradable commodities and interest that are addressed in **part 10.2.3** of this Chapter.

D.1.1.5. Brazil's Resale Price Method and Cost Plus Method with fixed margins are not 'safe harbour' methods. For these purposes, safe harbours mean provisions that apply to a defined category of taxpayers or transactions that relieve eligible taxpayers, at their own option, from

¹By Marcos Aurélio Pereira Valadão. Former Brazilian Member of the UN Committee of Experts on International Cooperation in Tax Matters. Chair 1st Section of the Brazilian Administrative Court of Appeals (CARF) of the Ministry of Finance. Tax Auditor (RFB). Professor of Law at Catholic University of Brasilia (UCB-Brazil). S.J.D. (SMU, USA), L.L.M. (UnB, Brazil) L.L.B. (PUC-GO, Brazil), B.S. (UnB, Brazil).

²Law 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.

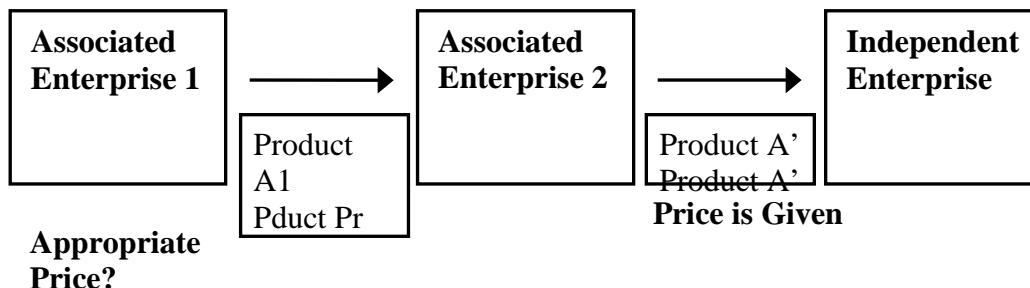
D.1.2.2. Reference is made below to two applications of how this method could be implemented for transfer pricing of products, including cases where the product is subject to manufacturing activities (value added costs) before it is resold.

D.1.2.3. The method is based on the participation of transferred goods in the product that is resold (which is 100 per cent in a simple resale). Then the parameter price will be the resale price participation less a profit margin, fixed by law. Therefore, this methodology is also feasible to apply when other inputs (bought from independent companies) are combined with the inputs traded between associated enterprises and the final goods, manufactured from these different sources of inputs, are resold by a Brazilian enterprise.

D.1.2.4. Resale Price (without manufacturing)

If the product traded between related parties is not subject to any manufacturing modifications the formula adopted will be the same and the participation ratio will be 100 per cent, since the price of product A1 will be equal to the resale cost of product A:

Figure D. 1: Resale Price Method (without manufacturing)



(Net) Resale Price	=	\$ 10,000
<u>Participation Ratio (of Prod. A1 in Prod. A')</u>	=	
100%	<u>Participation Value (of Prod. A1 in Prod. A')</u>	= \$
10,000	<u>Resale price margin (20%)</u>	= €
<u>2,000</u>		
Parameter Price	=	€ 8,000

D.1.2.5. In this case the calculation is simple as the parameter price (deemed arm's length price) is the resale price of the same product (charged between independent parties) reduced by: unconditional discounts granted; taxes and contributions on sales; commissions and brokerage fees paid; and a fixed profit margin of, for example, 20 per cent (according to current Brazilian law).

TP (parameter price) = NRP – GPM x NRP,
Where:

- TP (parameter price) = transfer price determined by Brazilian law. The maximum price on imports or the minimum price on exports;
- NRP = net resale price;
- GPM = gross profit margin = the value of gross profit margin ratio, as determined by law or tax regulations (20 per cent) in this simplified example); and
- TP (parameter price) = NRP – GPM x NRP = NRP – 20% x NRP = 80% NRP.

Hence:

• (Net) Resale Price		\$ 10,000
• – <u>Resale Price Margin (20%)</u>		\$ 2,000
• A1 Transfer Price under Brazilian law	=	\$ 8,000

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.

Resale Price (with manufacturing operation)

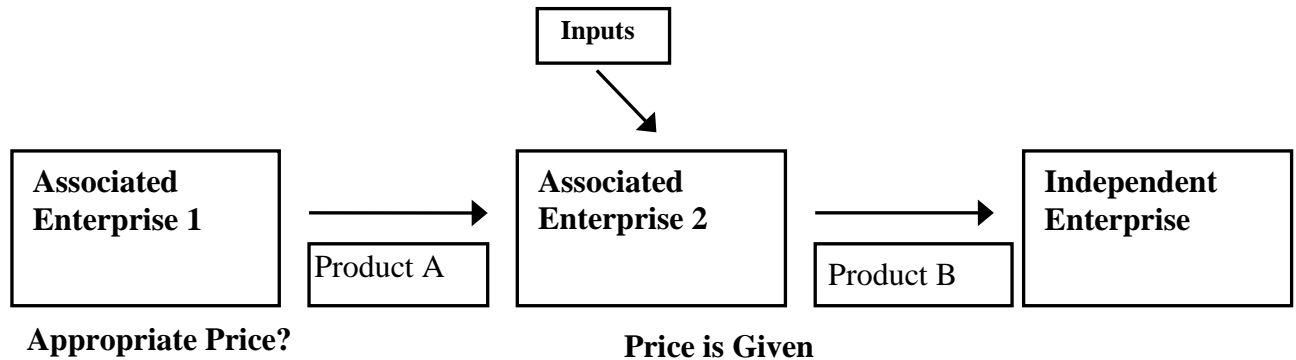
D.1.2.7. In this more elaborate approach the parameter price (deemed to be the arm's length price) would be the difference between the *participation value* of the sale price of goods (Product A) in the net resale price (Product B) less its "*gross profit margin*" participation. For this purpose, the *participation value* of Product A in the net resale price (Product B) would be: the application of the *participation ratio* of the input (Product A) to the total cost of the Product B multiplied by the *net resale price* (of Product B).³

D.1.2.8. The above-mentioned *participation ratio* is determined as follows: the ratio of the price of Product A (input) to the total cost of the goods resold (Product B), calculated according to the company's cost spreadsheet. The *net resale price* is the weighted average price of sales of the goods resold (Product B), less unconditional discounts granted, indirect taxes on sales, and commissions and brokerage fees paid. "Unconditional discounts" are those that do not depend on future events and that are detailed in the invoice.

D.1.2.9. The *gross profit* of Product A (in the resale of Product B) is the application of, for example, a 30 per cent (gross profit margin) on the *participation value* referred to above. As mentioned before, in this approach the gross profit margin will be provided by law. **See Figure D.1.** The 30 per cent margin may vary depending on the economic sector of the activity performed by Associated Enterprise 2.

³It should be noted that the participation ratio has nothing to do with the fixed margin but depends on the cost of imported inputs and the COGS, **see D.1.2.8**

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



(Where Product A is an input for Product B)

(Net) Resale Price	=	\$ 10,000
<u>Participation Ratio (of Prod. A in Prod. B)</u>	=	<u>60%</u>
Participation Value (of Prod. A in Prod. B)	=	\$ 6,000
<u>- Resale price margin (30%)</u>	=	<u>€ 1,800</u>
Parameter Price	=	€ 4,200

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 law or tax regulations (30% in this example).
- GPMV = GPM x PV = GPM x (price of Product A ÷ total cost of Product B) x (net resale price of Product B) = 30% (price of Product A ÷ total cost of Product B) x (net resale price of Product B).
- TP (parameter price) = PV – GPMV = ((price of Product A ÷ total cost of Product B) x (net resale price Product B)) — 30% x ((price of Product A ÷ total cost of Product B) x (net resale price Product B)) = PV (1 – GPM)

Fixed margins for the Resale Price Method

D.1.2.11. Brazilian transfer pricing legislation establishes different margins for specific economic sectors regarding the RSP Method for imports as follows (including simple resale operations and manufacturing operations):

I — **40 per cent**, for the following sectors:

- Pharmaceutical chemicals and pharmaceuticals;
- Tobacco products;
- Equipment and optical instruments, photographic and cinematographic;
- Machinery, apparatus and equipment for use in dental, medical and hospital;
- Petroleum, and natural gas (mining industry), and
- Petroleum products (derived from oil refineries and the like);

II — **30 per cent** for the following sectors:

- Chemicals (other than pharmaceutical chemicals and pharmaceuticals);
- Glass and glass products;
- Pulp, paper and paper products; and
- Metallurgy; and

III — **20 per cent** for the remaining sectors.

D.1.2.12. In order to apply such margins the law also states that in the event that the company engages in activities described in more than one of the categories mentioned above (I, II and III), the margin that should be adopted to apply the RSP Method is the margin corresponding to the activity sector in which the imported goods are intended to be used. In the event of the same imported goods being sold and applied in the production of one or more products, or if the imported goods are subjected to different manufacturing processes in Brazil, the final price parameter is the weighted average of the values found by applying the RSP Method, according to their respective destinations.

D.1.2.13. For exports the applicable margins in the foreign country are: 15 per cent for wholesale and 30 per cent for retail sales.

D.1.2.14. The Minister of Finance, ex officio (that is, by his or her own volition), or by request, is authorized by law to modify these margins. A request for modification presented by a taxpayer must be fully justified, and supplied with the proper documentation as established in the law.

D.1.2.15. Example 1: Resale of Same Product

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 the transfer pricing rules of Brazil, the Resale Price Method provides for a 20 per cent gross profit margin (\$3,750). Therefore, the arm's length transfer price applicable to the transaction between MCO and YD would be \$15,000 on imports of Product A. Thus for YD, the buyer, there will be a transfer pricing adjustment of \$1,000 per unit (\$16,000 – \$15,000).

D.1.2.16. Example 2: Different Products, with manufacturing operation

A controlling enterprise domiciled in Country A, HOLDCO, sells inputs to a subsidiary domiciled in Brazil (a chemical plant other than pharmaceutical) for \$400 per unit. In its turn, the subsidiary manufactures final products that are to be sold to local customers at \$1,200 per unit (net resale price). Along with the inputs acquired from HOLDCO, the subsidiary also uses other inputs, acquired in the host country, in the industrialization process of the final product. The cost of such additional inputs corresponds to 60 per cent of the total cost of the final product, and so the participation ratio of the input sold by HOLDCO is 40 per cent (\$400), thus the total cost is \$1000. The Resale Price Method in Country B imposes a fixed margin of 30 per cent in order to calculate the applicable transfer price. Based on the information above, the calculation is as follows:

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) = \$400/\$1000 x \$1200 = \$480;

GPM = 30% in this example

GPMV = GPM x PV = \$480 x 30% = \$144

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

Important note: This applies only to intangibles that are imported for resale; for other import operations with intangibles [see D.1.8.2.](#)

D.1.3. Cost Plus Method With Fixed Margins

D.1.3.1. Explanation of the methodology:

Similar to the Resale Price Method with fixed margins, the Cost Plus Method may be used with a predetermined gross profit mark-up. The basic functionality of this method is similar to the non-predetermined margin (or traditional) Cost Plus Method except that the gross margins are set out in the rules rather than based on comparables. The method focuses on the related product manufacturing or service providing company determining transfer pricing for transactions with associated enterprises. As explained above, the parameter price (deemed to be the arm's length price) is reached by adding a predetermined cost plus mark-up to the cost of the product or service. This will be a maximum value on imports or a minimum value on exports.

D.1.3.2. Unlike the Resale Price Method, the Cost Plus Method with predetermined fixed gross profit mark-ups does not require the taxpayer to calculate the ratio of certain inputs to the final product. Thus, the gross profit mark-up is applied to the costs as a whole to determine the parameter price. [See Figure D.3 below.](#)

The calculation formula is:

TP (parameter price, which is deemed to be the arm's length price) = PC + GPM x PC = PC x (1 + GPM)

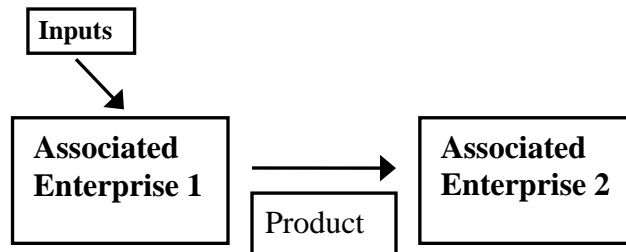
Where

- TP (parameter price) = transfer price determined by Brazilian law. The maximum price on imports or the minimum price on exports.
- PC = product cost.

- GPM = gross profit mark-up, as determined by law or tax regulations (20 per cent in this simplified example, which is the fixed gross profit mark-up for export operations according to Brazilian law).

This method may be also applied in cases where the product is not subject to substantial modification, that is, where Associated Enterprise 1 merely resells the product to Associated Enterprise 2. This method can also be used for services and intangibles, however the existence of cost sharing agreements in the latter case will make it more complex to apply.

Figure D. 3: Cost Plus Method



Appropriate Price?

Costs for Associated Enterprise 1	=	\$ 5,000
+ <u>Gross Profit Mark-up (20%)</u>	=	<u>\$ 1,000</u>
Parameter price (arm's length)	=	\$ 6,000

Fixed margins for the Cost Plus Method

D.1.3.3. Brazilian transfer pricing law provides two fixed gross profit mark-ups for the Cost Plus Method, depending on whether import or export operations are being addressed. For export operations from Brazil the fixed gross profit mark-up is 15 per cent, and for imports it is 20 per cent (which is the required gross profit mark-up for the export country).

D.1.3.4. The Minister of Finance, ex officio, or by request, is authorized by law to modify these margins. A request presented by a taxpayer must be fully justified, and supplied with the proper documentation as established in the law.

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. PHARMCO acquires the active ingredient of this medicine from an independent enterprise, and incurs other operational costs that correspond to an amount (COGS) of \$100 per unit. The price paid by BRAZDIST when importing such medicine from PHARMCO is \$150 per unit. The Cost Plus Method, in such cases, requires a 20 per cent gross profit mark up so as to comply with transfer pricing rules. As a result, from Brazil's perspective, PHARMCO should not sell medicine to its affiliates in BRAZIL for more than \$120 per unit ($\$100 + 20\%$ of $\$100$). Thus there would be a transfer pricing adjustment of \$30 per unit applicable to BRAZDIST.

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 imports. Companies may not disclose their production or manufacturing costs, even to other associated companies located in Brazil, which jeopardizes the method applicability for imports, because the necessary manufacturing cost data incurred by the associated exporting enterprise may be unavailable for the associated Brazilian importing enterprise. Even if the enterprises involved have complete access to each other's books there is still a problem of information accessibility to the Brazilian tax administration.

D.1.6.2. If the CPM is applied for determining the export transfer price the Brazilian manufacturing exporter uses its own booked costs to calculate the correct transfer price, with no need to request any data from the non-Brazilian affiliate. Furthermore, in the case of exports, all necessary information can be accessed and verified by the Brazilian tax administration. As a

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 will face higher tax burdens than taxpayers with low COGS relative to operating costs.

D.1.8. Other Explanations of the Brazilian Transfer Pricing Methodology

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 PCI used for transactions in commodities) (equivalent to CUP Method)

Resale Price Method (generally 20% gross profit margin (PRL) (equivalent to RSP Method) + other margins for specific sectors (see above section [D. 10.2.2.11](#))

Cost Plus Method (20% mark-up margin) (CPL) (equivalent to Cost Plus Method)

For export transactions:

Comparable Uncontrolled Price Method (PVEx and PECEX used for transactions in commodities) (equivalent to CUP Methods)

Wholesale Price in the Country of Destination Less Profit Method (15% margin) (PVA) (equivalent to RSP Method)

Retail Price in the Country of Destination Less Profit Method (30% margin) (PVV) (equivalent to RSP method)

Cost Plus Method (15% profit margin) (CAP) (equivalent to Cost Plus Method)

D.1.8.2. In the case of the import or export of commodities subject to trading in internationally recognized mercantile and futures exchanges the method that should be used for imports is the Imports with Price under Quotation (PCI) Method, which is a simplified version of the Comparable Uncontrolled Price Method for imports, as defined in the law, and for exports is the Export with Price under Quotation (PECEX) Method, which is a simplified version of the Comparable Uncontrolled Price Method for exports, as defined in the law.

This mandatory methodology for such products considers the average quotation price on the global market as the arm's length price. The law has established that the price to be considered is the average daily price of goods or rights subject to public prices in commodities futures on internationally recognized exchange markets (quoted price). However, the law allows for adjustment of the price for the market premium at the date of the transaction, and other adjustments such as quality of goods traded and terms of payment. If there is no transaction in the organized market on a specific date the price to be taken into consideration is the last price information available in the market. If no price is available at all the taxpayer and tax authority may consider an internationally recognized database as a means of establishing a price. This

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 accordingly. With respect to interest expenses, the spread to be added to the interest rates as mentioned above is 3.5%; with respect to interest credited (received from abroad), the spread to be added to the interest rates as mentioned above is 2.5%.

The interest rate calculated in accordance with these rules is deemed to be the arm's length rate. The rules also apply to transactions between a resident company and a resident in a non-cooperative/low-tax jurisdiction as defined by the law, regardless of whether the resident abroad is a related party.

D.1.8.5. The Brazilian transfer pricing regulations establish that if the taxpayer finds a deviation of 5 per cent, or less, between the actual transfer price and parameter price calculated in accordance with the Brazilian transfer pricing legislation, the taxpayer is not requested to make any adjustment. Thus, in practice there is a range for each price. This allowance rate is only 3 per cent when the method is the CUP for commodities (the so-called 6th method, which corresponds to PCI, for imports, and PECEX, for imports, in Brazilian nomenclature).

D.1.8.6. Brazilian transfer pricing legislation also establishes a broad definition of related parties, which is intended to counter tax planning schemes (as a specific anti-avoidance rule),

⁵ The BEPS Report on Actions 8-10 added paragraphs to Chapter II of the Transfer Pricing Guidelines, immediately following paragraph 2.16 on this issue. For additional details see Marcos Aurelio Pereira Valadao, "Transfer Pricing in Brazil and Actions 8, 9, 10 and 13 of the OECD Base Erosion and Profit Shifting Initiative". *Bulletin for International Taxation*, 296-308, May 2016.

and this also affects transactions between individuals and companies and some specific transactions (back to back transactions, interposed persons). The transfer pricing legislation also applies to all transactions with Brazilian residents and residents in low tax jurisdictions, as defined in the law, regardless of whether the persons and companies performing the transaction are related. Brazil adopts a list of jurisdictions as prescribed by law and detailed through administrative regulations that encompass low tax jurisdictions, non-cooperative jurisdictions and also privileged tax regimes.

D.1.9. Comments for Countries Considering the Adoption of Fixed Margins

D.1.9.1. Countries may establish different profit margins per economic sector, line of business or even more specifically according to the kind of goods or services dealt with, to calculate the parameter price (deemed arm's length price). The more accurately these are computed and the more margins are established, the more likely it is that the use of the margins will neither distort the system nor the decisions of the players involved.

D.1.9.2. It may not be possible to justify establishing many different margins, depending on the actual amount and types of goods and services exported and imported by a country. This is because it is possible that the country does not export or import a sufficiently large amount or many types of those goods and services and the determination of such margins, or even their applicability, could lead to some difficulties.

D.1.9.3. If a country opts for the application of different margins these may be established at different levels of specificity. In other words such margins could be determined by economic sector (e.g. the primary sector, i.e. the extraction or production of raw materials; secondary sectors such as manufacturing; and tertiary sectors such as services). A country may differentiate further, so that the margins could be determined by line of business at different levels of specificity according to the necessity and ability of a country to determine them. For example, the country could use a margin for the chemical industry as a whole, or different margins for different types of products of the chemical industry (agrochemical, petrochemical, explosives, cosmetics etc). The possibilities are nearly limitless. The differentiation per industry into types of products is adopted by Brazil, where, for the Resale Price Method for imports, the margin for the chemicals sector in general is 30 per cent, while the margin for pharmaceutical chemicals and pharmaceuticals is 40 per cent. See **Paragraph D.1.1.3.** above.

D.1.9.4. Each country should determine, according to its specific circumstances, the amounts involved and types of goods and services, how specific the margins should be and whether more margins are merited. Also a country may combine different levels of margin specifications if it seems appropriate; it may set forth some general margins for a line of business in addition to more specific margins for some goods.

D.1.9.5. In order to determine such fixed margins the tax authorities will need to do pricing research or purchase such information from existing (public) databases, in order to find appropriate prices that could be used as a comparable. Then, if it seems necessary to specify more profit margins, the tax authorities will need to determine a range of profit margins, that is, a maximum and a minimum profit margin that statistically corresponds to relevant data from uncontrolled transactions. The maximum and minimum profit margins simply represent an acceptable margin of divergence.

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.

D.1.9.7. It is important to emphasize that what will be applied, in practical terms, are not “margins” but “ranges”. As a result, what will be identified for a specific sector is an average. Thus, some companies may understand that they will fall below the average number, while others will fall above that number. For example, it is assumed that based on market research in a specific country the average market gross profit for resale transactions in the pharmaceutical sector is 30 per cent. It may well be established that some companies have a 25 per cent margin and others a 38 per cent margin. Thus it would be advisable to have a range — in this case say 28 to 35 per cent — that is regarded as acceptable. The exact calculation of the range will depend on the distribution of the margins; in any case, the fixed margin should be inside the range. The details depend on the market, and if the range is very wide that in itself indicates the need for further specification to a line of products, or even to a specific product.