



ASSESSMENT OF THE EXISTING TRANSFER PRICING SYSTEM

OECD/RFB
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Brasília, Brazil



Introducing the panellists

- ***Chair: Claudia Pimentel (RFB)***
- Andrea Chaves (RFB)
- Elizabeth Arnold (UK HM Treasury)
- John Hughes (US IRS)
- Antoinette Musilek (Embassy of Spain in Brazil)
- Tomas Balco (OECD)
- Camille Tirand (OECD)



Overview

- **Setting the scene / background of the project**
- **Presentation of findings**
 - Similarities and differences
 - Assessment of effectiveness
- **Discussions**



“TRANSFER PRICING IN BRAZIL” PROJECT: SETTING THE SCENE



Dialogue with Brazil's *Receita Federal* (RFB) on transfer pricing matters

- Project discussed and agreed in **late 2017**
- **February 2018:** official launch of “**Transfer Pricing in Brazil**” project by OECD/RFB, with support from UK Government represented by the Foreign and Commonwealth Office (FCO)
 - Analysis of Brazil’s existing transfer pricing legal and administrative framework and its practical application
 - Assessment of the **strengths** and **weaknesses**
 - Exploration of options for **closer alignment** between the transfer pricing rules applied by Brazil and the international OECD standard
- Official announcement on **launch event** in Brasília, 28 February - 1 March 2018
- Three stages over a period of 15 months to produce **three deliverables/reports**

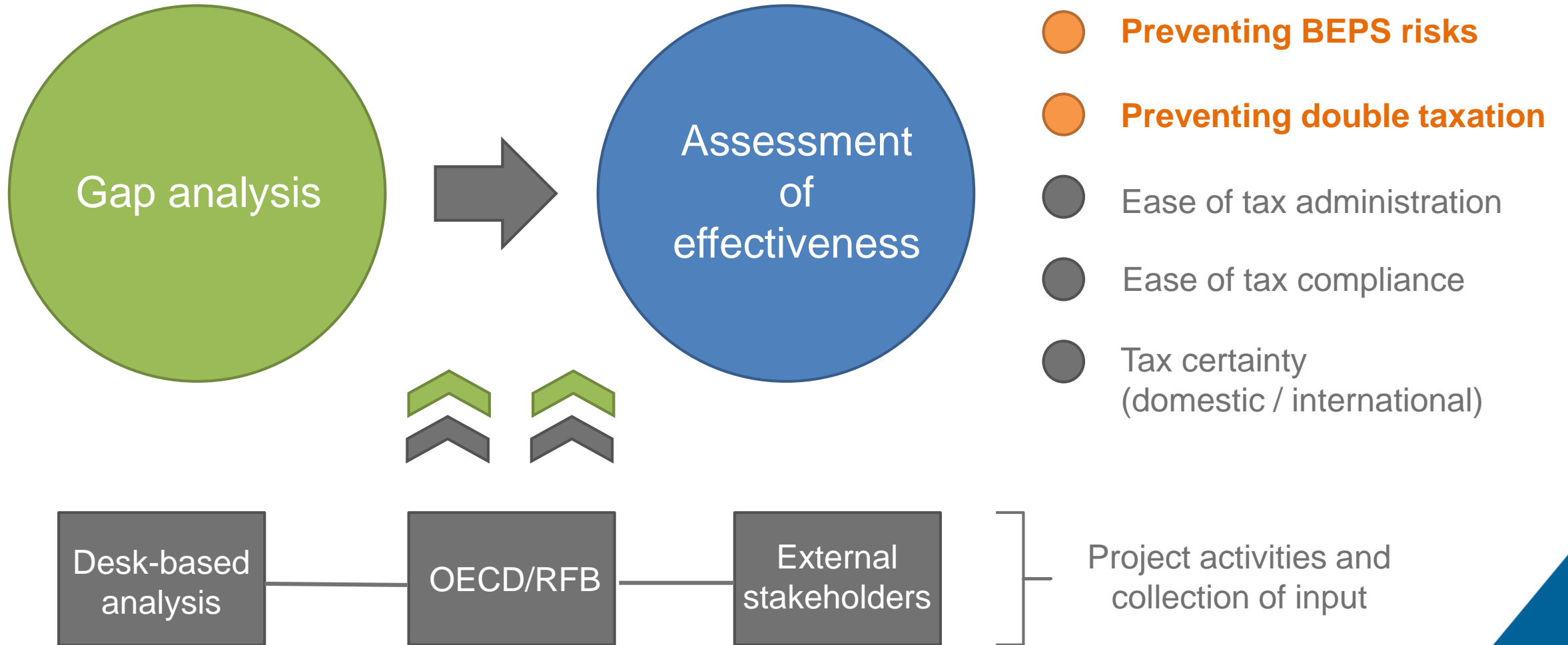


Outputs of the dialogue

- **Stage 1 report** – *Preliminary Analysis of the Legal and Administrative Framework of Transfer Pricing Rules in Brazil*
 - Overview of Brazilian transfer pricing system: origins, interaction with the arm's length principle, Brazil's position on OECD legal instruments and guidance
 - Outline of main differences between the Brazilian and the OECD approaches as well as key policy issues for discussion
- **Stage 2 report** – *Assessment of the Strengths and Weaknesses of Existing Transfer Pricing Rules and Administrative Practices*
 - In-depth analysis of the strengths and weaknesses identifying divergences or issues in the current framework and determining how the concerned rules interact with the policy objectives of transfer pricing rules (namely protection against base erosion and profit shifting risks, prevention of double taxation, ease of tax administration, ease of tax compliance and tax certainty)
 - Collection of input from external stakeholders showing that a number of the identified divergences lead to unrelieved double taxation and result in potential loss of revenue for Brazil, while the effect of the ease of tax administration, ease of tax compliance and tax certainty does not off-set such negative outcomes
- **Stage 3 report** – *Options for Alignment with the OECD Transfer Pricing Standard*
 - Exploring possible ways to align the Brazilian system with the OECD Transfer Pricing Guidelines
 - Two options to achieve full alignment and evaluation of their advantages and disadvantages
 - Comprehensive overview of the various considerations for the implementation of the new system (e.g., drafting legislation, administrative features, and capacity building)



Methodology





ACCESSION TO OECD



Possible accession of Brazil to the OECD

- Relevance/importance of alignment for **potential accession of Brazil to the OECD**
- Brazil will be assessed by different Committees on basis of **core OECD principles**, including the Committee on Fiscal Affairs (CFA):
 - Assessment of adherence of Brazil to the arm's length principle; and
 - Achievement of the primary objectives of transfer pricing rules as reflected in the relevant OECD instruments (i.e. Council Recommendation and the OECD Transfer Pricing Guidelines)
- Basis for the review is an **accession questionnaire** that identifies **ten key areas** (within the chapter dedicated to transfer pricing)



SIMILARITIES AND DIFFERENCES IDENTIFIED BETWEEN EXISTING RULES AND OECD TRANSFER PRICING GUIDELINES

ASSESSMENT OF THEIR EFFECTIVENESS



Gap analysis

- **Objective:** identifying gaps and issues in the Brazilian transfer pricing rules and administrative practices using the **OECD Transfer Pricing Guidelines** as a benchmark
 - **Methodology:** (1) description of OECD guidance, (2) review of Brazilian framework, and (3) identification of gaps and issues, i.e. whether the main concepts, elements and objectives of the guidance are reflected in the Brazilian system
 - Steps that lead to identifying the issues to be assessed as part of “**assessment of effectiveness**”
- Gaps and issues identified in the analysis can be categorised according to **ten key areas on the basis of the accession questionnaire**



Assessment of effectiveness

- **Objective:** to determine how divergences, gaps or areas left unaddressed by the Brazilian rules interact with the **policy objectives of transfer pricing rules**
 - **Methodology:** assessment of the effectiveness of the concerned rules according to five objective criteria
 - These criteria are derived from the **primary (dual) objective** of transfer pricing rules: **securing the appropriate tax base in each jurisdiction** and **avoiding double taxation**; and
 - Other important secondary tax policy objectives: **ease of tax administration, ease of tax compliance** and **tax certainty** from a domestic and international perspective
- Contribution of **external stakeholders**
 - Assessment of effectiveness was complemented by the contributions of stakeholders, including academics, practitioners, tax representatives of MNE groups with operations in Brazil, officials of the tax administration of jurisdictions that are trading and investment partners of Brazil
 - More specific information on experience of dealing with Brazilian system was collected through questionnaires tailored to **MNE groups with operations in Brazil** and **key trading partners of Brazil**



OVERVIEW OF INPUT COLLECTED

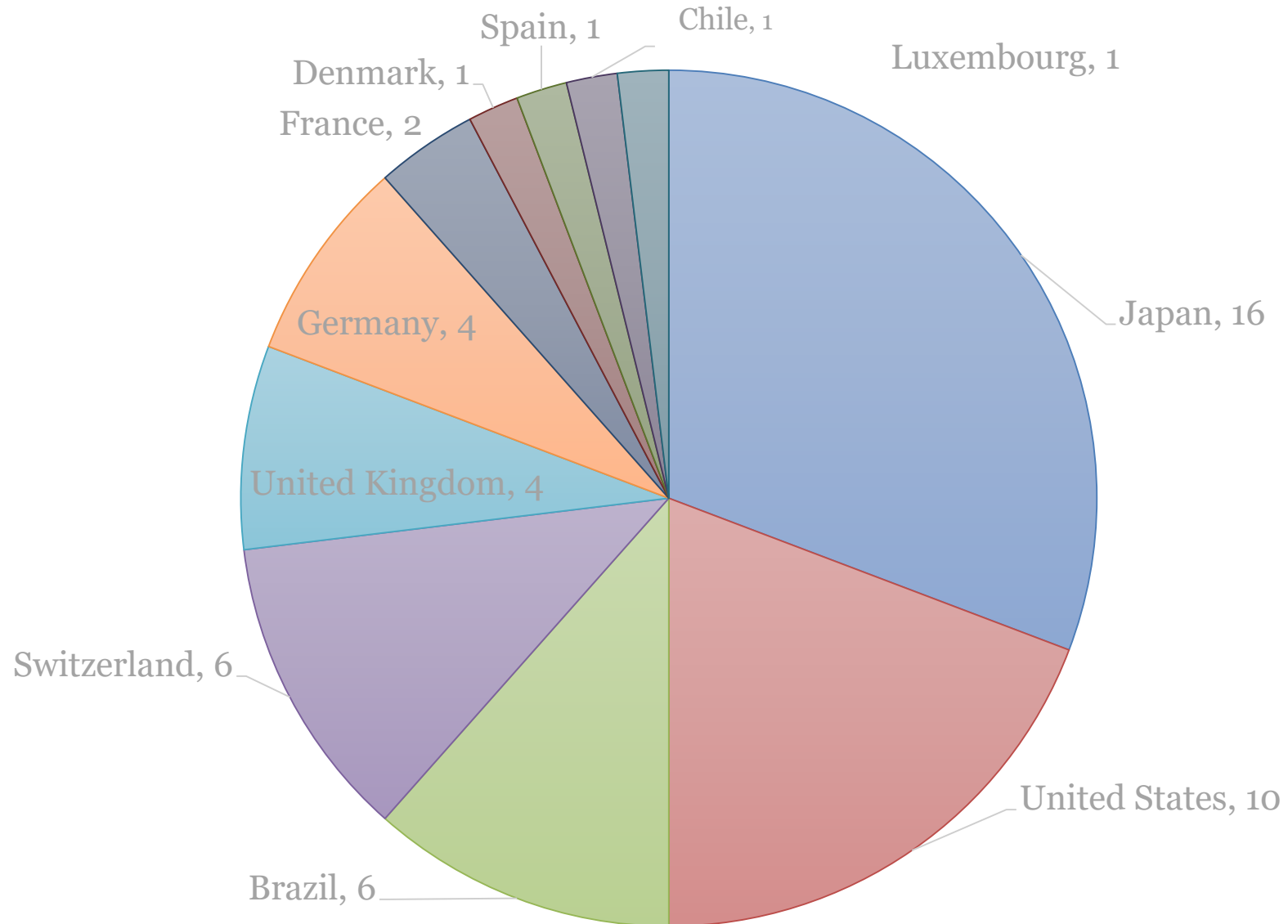


Overview of input collected from MNEs

- Total number of questionnaires received: **52**
- Submissions from MNEs headquartered in **11** different jurisdictions
- Broad industry/sector representation
- **100%** of the MNEs file **Country-by-Country reports**

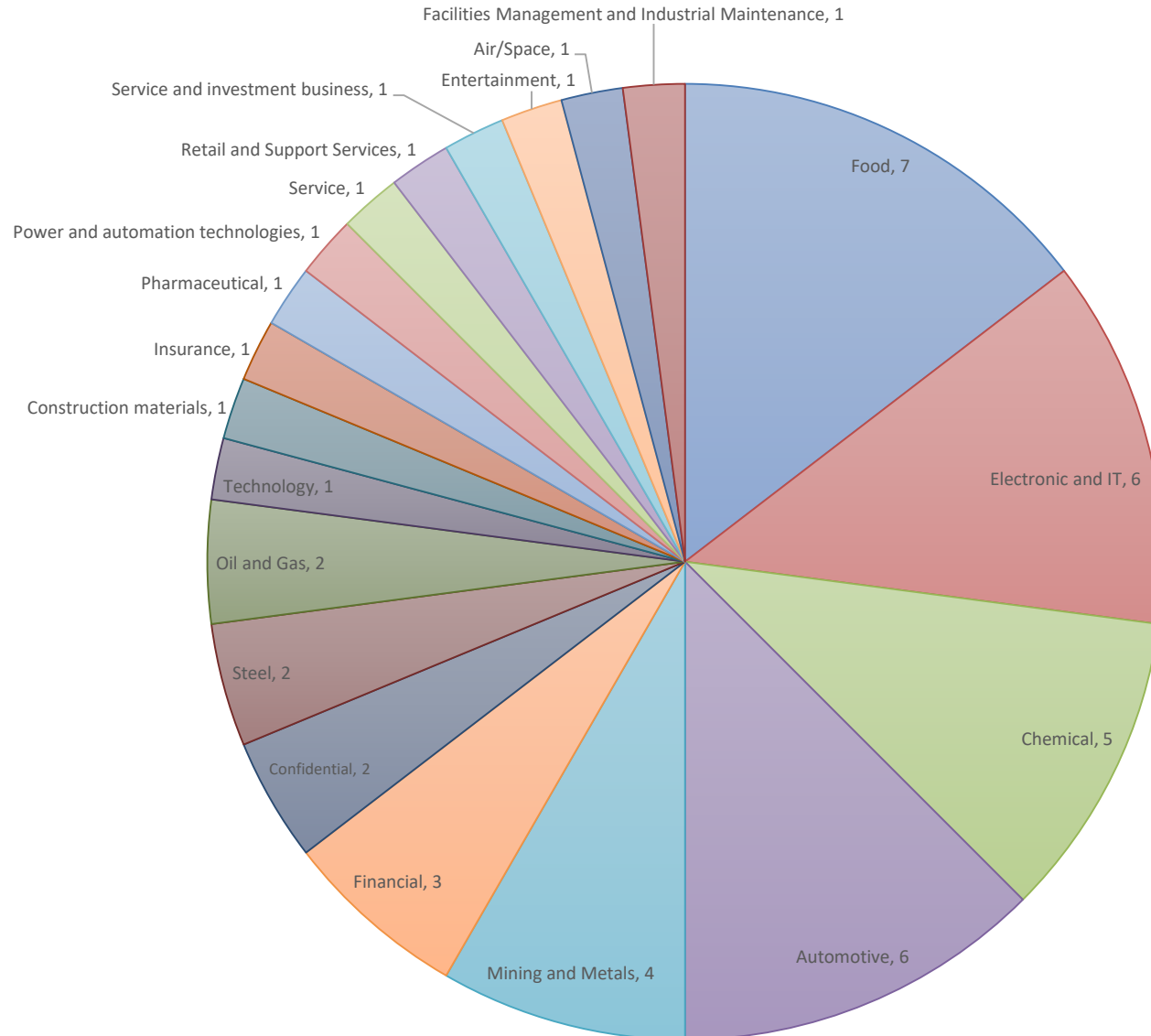


MNE headquarters representation





Industry/sector representation *



* Some companies operate in more than one sector; only the main sector was considered for the purposes of this chart

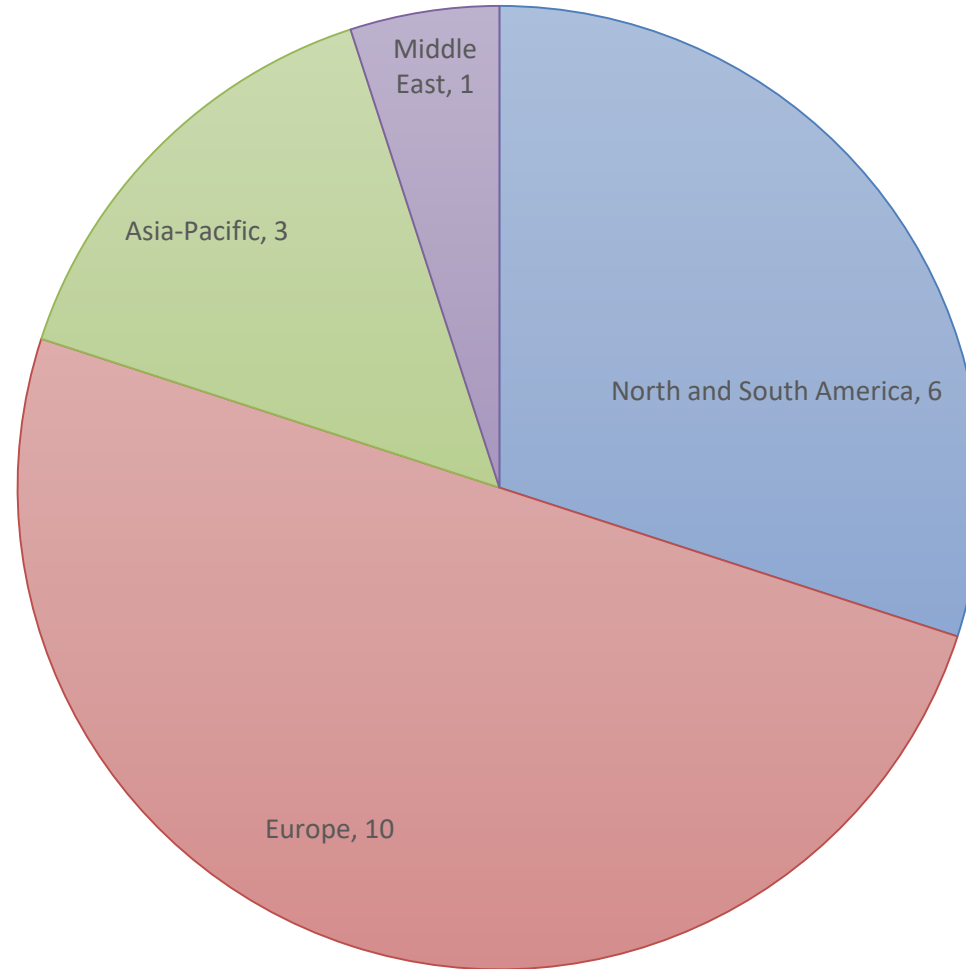


Overview of input collected from key trading partners

- Total number of questionnaires received: **20**
- **15** OECD member countries and **5** non-OECD members
 - 10 have concluded a tax treaty (that is currently in force) with Brazil
- Jurisdictions considered major trading and investment partners based on:
 - Inbound/outbound volume of transactions
 - Foreign direct investment (in-and-out-) flows
 - Volume of imports and exports



Geographical representation





1. STATEMENT AND APPLICATION OF THE ARM'S LENGTH PRINCIPLE



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

- First element:
 - Domestic rules which implement the **arm's length principle**
 - Domestic rules that **deviate from the OECD Guidelines**
- Second element:
 - Definition of “**related parties (associated enterprises)**”
 - **Scope of “transactions covered”**



Results of the analysis

- First element:
 - Brazil's domestic legislation **does not restate the arm's length principle for cross-border transactions**
 - Number of existing deviations, including **use of fixed margins approach**
- Second element:
 - Personal scope is **broad** – includes parties in low-tax jurisdictions and beneficiaries of preferential tax regimes, exclusive agents and members of a consortium
 - Material scope is **narrow** – excludes outbound royalty payments and specific types of intra-group services in relation to technical, scientific, administrative or similar assistance
 - Territorial scope is **narrow** – limited to cross-border transactions



2. OECD COUNCIL RECOMMENDATION ON THE DETERMINATION OF TRANSFER PRICING



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

- Under the OECD Council Recommendation, OECD members are expected to follow the new guidance related to the **BEPS transfer pricing outcomes**
 - Chapter I, Section D: accurate delineation of transactions, framework for analysis of risk, non-recognition of transactions and guidance on location savings and other local market features, assembled workforce, and MNE group synergies
 - Chapter II: commodity transactions
 - Chapter VI: intangibles, including hard-to-value intangibles
 - Chapter VII: low value-adding intra-group services
 - Chapter VIII: cost contribution arrangements
 - Conforming changes to Chapter IX: business restructurings
- Under the Recommendation, being a member of the **Inclusive Framework on BEPS** is also crucial to support and monitor the implementation of the **BEPS package**



Results of the analysis

- Brazil is a **member of the Inclusive Framework on BEPS**
- Brazil **has not implemented** the key concepts and guidance resulting from the work mandated by BEPS Actions 8-10 given their current transfer pricing rules due to specificities of the current system
- Guidance on transfer pricing documentation (BEPS Action 13): Brazil has adopted **Country-by-Country Reporting (CbCR)**



3. TRANSFER PRICING METHODS



3. Transfer pricing methods

- First element:
 - Transfer pricing methods available: **five OECD-recognised methods** and “**other methods**”
 - Three “**traditional transaction methods**”, namely the comparable uncontrolled price (CUP) method, the resale price method, and the cost plus method and two “**transactional profit methods**”, namely the transactional net margin method (TNMM) and the transactional profit split method
- Second element:
 - Criteria to determine the selection of a transfer pricing method: **most appropriate method criterion** based on strengths and weaknesses of the available methods



Results of the analysis

- First element:
 - Brazil adopted methods **inspired** by the three traditional transaction methods used for the determination of an arm's length consideration
 - Classified between those that apply to import transactions and those that apply to export transactions
 - **Absence of transactional profit methods** and **use of “other methods” is not permitted**
- Second element:
 - **Freedom to select any transfer pricing method** provided in the legislation, regardless of whether it is the most appropriate method in a particular case



4. COMPARABILITY ISSUES



4. Comparability issues

- Definition of “**comparable**” and the **mechanisms** provided for on the use of comparables
- **Guidance on application of the arm’s length principle**, including on the aggregation of transactions, the use of multiple year data, arm’s length range, effect of government interventions (such as price controls in certain industry sectors), use of statistical tools and databases, etc.
- **Comparability adjustments**



Results of the analysis (1/2)

- Apart from the equivalents of the CUP method (PVEx and PIC methods), the **standard of comparability is limited** to a **calculation of the average sales price** of comparable goods, rights or services (or of the **costs incurred**) to which a **specific fixed margin** is applied
 - Strict use of **“item-per-item”** approach (absence of grouping of transactions)
 - Strict use of comparables based on **“similar” and “identical”** standard
- Guidance on comparability analysis is **limited** or simply **does not exist**
 - Arm’s length range, effect of government interventions such as price controls in certain industry sectors, use of statistical tools and databases are not addressed



Results of the analysis (2/2)

- Comparability adjustments are **limited in different ways**
 - Both in terms of **how they can be performed** and in terms of **when they can be performed**
 - Allowed comparability adjustments are explicitly listed in the relevant provisions
 - Limited comparability adjustments are allowed for the Brazilian versions of the CUP method, including the methods for commodity transactions (PIC/PVEx and PCI/PECEX methods) and the methods broadly equivalent to the resale price methods for exports (PVA/PVV methods)
 - No comparability adjustments are allowed for the methods broadly corresponding to the resale price for imports (PRL method) and cost plus methods (CPL and CAP methods)



5. SPECIAL CONSIDERATIONS



5. Special considerations

- Intangible property
- Intra-group services
- Safe harbour rules and simplification measures
- Cost contribution arrangements
- Financial transactions, including interest rates, guarantee fees, or other
- Thin capitalisation rules and/or other rules on expenses relating to debt instruments
- Commodities



General observations

- Application of the arm's length principle to **specific transactions** may require **special considerations** given their complexity
- However, these special considerations are based on the **key principles set out in the OECD Guidelines**
- **Transfer pricing outcomes of the BEPS Project** resulted in updated guidance for the application of the arm's length principle generally as well as for specific types of transactions



Results of the analysis (intangibles)

- **No special TP rules** are provided in this area and intangibles are defined based on accounting rules and company law
- **Special measures** (limiting deductibility for specific types of payments)
 - narrowing scope of TP rules
- Transfer pricing issues relating to controlled transactions involving the **use or transfer of intangibles, including hard-to-value intangibles**, is a key area where the Brazilian **system is not adequate**



Results of the analysis (intra-group services and CCAs)

- **Services**

- **No specific guidance** to address the issues of provision of **intra-group services**
- Special measures (limiting deductibility for specific types of services) – narrowing scope of TP rules
- No specific considerations for high-value added services and also other simplification measures under the Brazilian transfer pricing system
 - The **simplified approach for low value-adding services** has not been adopted

- **Cost contribution arrangements**

- **No legislative guidance** and **only limited administrative guidance** is provided for **cost contribution arrangements**



Results of the analysis (safe harbour rules)

- Safe harbour rules apply **only for export** transactions
 - *De minimis* export amount
 - Where taxpayers derive 5% or less of total revenue from exports, they do not have to adopt transfer pricing rules
 - **Does not distinguish between different sizes** of taxpayers
 - Determination of the 5% threshold can **be affected by mispricing** because it would already be the actual transfer value that would be considered for the purposes of considering whether the threshold was met
 - 90% test
 - Transaction-by-transaction test under which, if the export price represents at least 90% of the domestic market price, the export price adopted is deemed acceptable.
 - Comparison of prices on the domestic market in Brazil and the **prices of the same goods or products on foreign markets – regardless of profit potential**
 - Profitability test
 - Where exports to related parties generate a minimum 10% net profit margin, the transactional conditions are deemed to be acceptable
 - Requires that net revenue from related parties represents more than 20% of the total outbound transaction net revenue
 - Implying **that 80% of the export volume should be in relation to unrelated parties** = would it be basis to apply CUP method?
 - Application could lead to **under-taxation**, as all the taxpayer is required to do is justify the minimum 10% net profit margin



Results of the analysis (financial transactions)

- Specific prescriptive rules are applicable to the **determination of interest rates for loans**
 - General rules for deductibility of expenses require the expenses to be **necessary, usual and normal** in the taxpayer's activities
 - **Thin capitalisation rules**
 - **Interest rate cap**
- The application of the arm's length principle to a number of financial transactions is not addressed – **application of general rules to other types of financial transactions**



Results of the analysis (commodities)

- Listed commodities are subject to the **mandatory** application of special methods
 - “Price under quotation on import” (PCI) and the “price under quotation on export” (PECEX) methods must be applied
 - Adjustments are **limited** and **specified** by the legislation
 - **Functional analysis not foreseen**
 - **3% margin of tolerance**
 - creates effectively a range and also may address the fact that the adjustments are limited



6. TRANSFER PRICING COMPLIANCE AND EXAMINATION PRACTICE



6. Transfer pricing compliance and examination practice / results of the analysis

- Procedural aspects of transfer pricing examinations, even though they vary from one jurisdiction to the other, share **three main objectives**:
 - a) to reduce opportunities for non-compliance;
 - b) to provide positive assistance for compliance; and
 - c) to provide disincentives for non-compliance



Results of the analysis

- Differences identified between the transfer pricing compliance practices of Brazil and OECD member countries result from the **specificities of the Brazilian transfer pricing system**, notably the **absence of a complete comparability analysis**
 - Compliance and examination practices generally focus on **enforcement of prescriptive rules**
 - Limited space for **administrative consideration** and **flexibility**



7. DOCUMENTATION



7. Documentation

- **Three-tiered approach** to transfer pricing documentation consist of
 - (i) a master file containing standardised information relevant for all MNE group members
 - (ii) a local file referring specifically to material transactions of the local taxpayer; and
 - (iii) a Country-by-Country Report containing certain information relating to the global allocation of the MNE's income
- Requirement for resident entities that are the ultimate parent of an MNE group to file a **Country-by-Country report** in accordance with the **BEPS Action 13 minimum standard**



Results of the analysis

- Brazil has implemented CbCR
 - Brazil participated in the two stages of peer review of its implementation and operation
- Brazil has not implemented the master file and local file (not part of minimum standard)
 1. Not relevant for the current system
 2. Some form of TP documentation will be needed if system is aligned



8. TAX RULINGS AND ADVANCE PRICING ARRANGEMENTS



8. Tax rulings and APAs

- Unilateral and bi-/multilateral mechanisms:
 - Whether **unilateral tax rulings** or **unilateral APAs** are available
 - Whether **bilateral or multilateral APAs** are allowed



Results of the analysis

- Brazil does not provide tax rulings and does not have an APA programme in place



9. CORRESPONDING ADJUSTMENTS AND MUTUAL AGREEMENT PROCEDURE



9. Corresponding adjustments and mutual agreement procedures

- Whether **corresponding adjustments** are allowed in order to eliminate double taxation in transfer pricing cases as well as practices or views on:
 - Possibility to make a corresponding adjustment in the absence of a **paragraph 2 of Article 9-type clause**



Result of the analysis

- Brazil has **limited experience and guidance** on corresponding adjustments
- Brazil committed to provide access to MAP in line with the BEPS Action 14 minimum standard when treaties contain Article 9(1)
 - **Corresponding adjustments** in the absence of Article 9(2) can be agreed based on MAP on basis of Article 25 in the applicable tax treaties



10. DETERMINATION OF PERMANENT ESTABLISHMENTS' PROFITS



10. Determination of permanent establishments' profits

- Position regarding **Article 7 of the OECD MTC** and its **Commentary** (i.e. the 2010 version of the “authorised OECD approach” or “AOA”)
- Approach on how to determine the profits of a permanent establishment (PE)



Preliminary results of the analysis

- Brazilian transfer pricing rules **provide only limited guidance on the attribution of profits to a PE** under the principles contained in the relevant provisions of its bilateral tax treaties
- In the absence of such guidance, it is **not clear what approach will be applied** by the tax administration in determining the profits of PEs in the cases covered by the bilateral tax treaties



COMMENTS / QUESTIONS