



New Brazilian Transfer Pricing Rules

Law No. 14,596/23 (*Lei Federal n.º 14.133/2021*)



Campos Mello Advogados in cooperation with DLA Piper - June 2023



Overview and Effective Date

- **Law No. 14,596/23**, resulting from the conversion by Congress of Provisional Measure No.1,152/2022, published on June 15, 2023, establishes a new Transfer Pricing framework in accordance with the **Arm's Length Principle of OECD guidelines**.
 - **When will the new rules be in effect?**
 - i. mandatory from 2024;
 - ii. optional for 2023 (irrevocable election must be made during September 2023).

Law 9.430/1996

Methods mostly based on fixed margins.

Narrower scope, more suitable for tangible goods.



Law 14.496/2023

Methods in line with the Arm's Length Principle of the OECD guidelines, based on comparable transactions.

Wider scope; methods more suitable for today's economy (re transfers of rights and intangibles and provision of services); comparability analysis.

TP Rules: Before (Fixed Margins) x After (ALP)

	Laws 9,430/96 (Before)	Law 14,596/23 (After)
Covered Transactions	Import and export of goods, rights and services between related parties or with third parties in a country with favored taxation.	Any commercial or financial transaction between related parties or with third parties in low tax jurisdictions, including royalties for all types of IP rights.
Benchmarks	Determined by methods generally based on fixed profit margins.	Based on comparability studies and functional analysis – Arm's Length principle (ALP).
Pros	Practicality, tax certainty.	Contributory capacity, better suited to combat double taxation.
Cons	Lack of alignment with international rules creates double taxation and double non-taxation (BEPS*); US foreign tax credit restrictions.	Complexity, subjectivity, potential increase in tax litigation.
Treatment of Intangibles	Scope does not include passive royalties for certain IP rights (trademarks, patents, know-how and technical assistance) with fixed percentages on net sales under Ordinance MF 436/58. Lack of rules for active royalties.	Royalties (passive and active) are subject to ALP.
Financial Operations	Only loans and advances.	Loans, guarantees, cashpooling, insurance, etc.
Choice of Method	Taxpayer may choose the most beneficial method for them.	Best method rule - “most appropriate method” (the one that conveys the most reliable results for the situation under analysis). Hierarchy of methods: PIC preferred when reliably applicable.

*BEPS = Base Erosion and Profit Shifting

Main Changes

What is the scope of the new rules?

Controlled transaction : any business or financial relationship with one or more foreign **related parties**

It also covers operations with unrelated parties, if domiciled in a country that does not tax income or that taxes at a maximum rate lower than 17%, or that is a beneficiary of a privileged tax regime.

Related parties : broad concept, covering parties that have **influence, direct or indirect**, capable of impacting the terms and conditions of the transaction.

The rule brings a list of related parties (parent company, affiliate, etc.), but it may reach other hypotheses that are included in the above definition.

How is the Arm's Length Principle applied?

- 1 – Delineation of the transaction;
- 2 – Comparability analysis;
- 3 – Selection of **most appropriate method**;
- 4 – Selection of the **tested party**;
- 5 – Adjustments.

Most appropriate method: Of the 6 available methods (see next slide), the most appropriate method is **the one that provides the most reliable determination** of the terms and conditions that would be entered into between unrelated parties in a comparable transaction.

Tested Party: the taxpayer can select either the **Brazilian or the foreign entity**, depending on **which of the parties the selected method can be more appropriately applied to** and for which **more reliable** comparability data are available.

Methods

Comparable Independent Price (PIC or CUP)

Comparison with prices and conditions practiced between independent parties. ***Preferred method for commodities.***

Resale Price Less Profit (PRL or RPM)

Comparison with gross margins applied on subsequent resale to unrelated parties (**no longer based on fixed margins**).

Cost plus Profit (MCL)

Comparison with profit margins on cost in comparable transactions with unrelated parties (**no longer based on fixed margins**).

Net Margin from Transactions (MLT or TNMM)

Comparison with net margins in comparable transactions with unrelated parties, calculated based on an appropriate profitability indicator.

Profit Sharing (MDL or PSM)

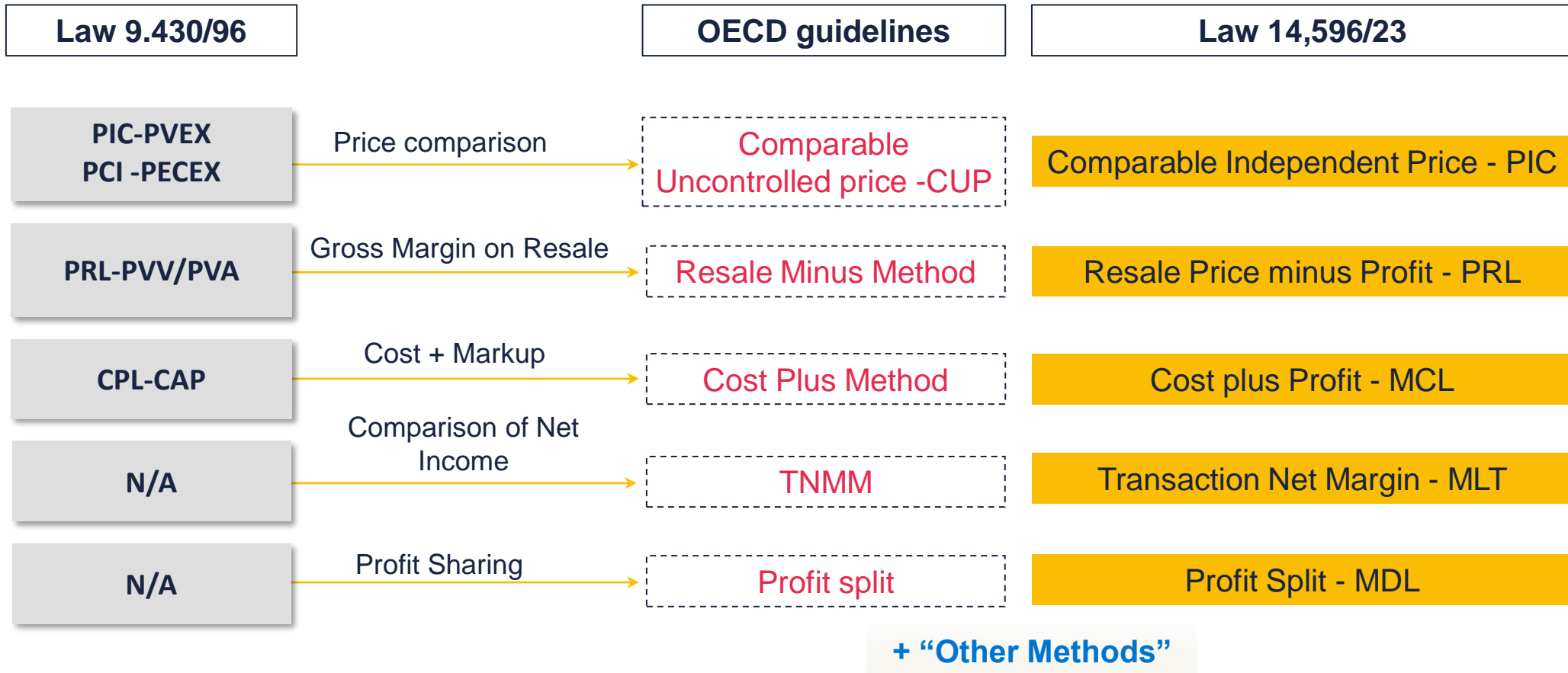
Split of profits or losses, or part thereof, in a controlled transaction in accordance with what would be established between unrelated parties in a comparable transaction, considering the relevant contributions provided in the form of functions performed, assets used and risks assumed by the parties involved in the transaction.

Other methods

Allowed when the adopted alternative methodology produces a result more consistent with that which would be achieved in comparable transactions with unrelated parties than any of the other specified methods.

**RFB will provide further guidance on the application of methods.*

Method Comparison



Specific Provisions

Intangibles (including hard-to-value intangibles)

- **Application of transfer pricing rules in accordance with the Arm's Length Principle** – the old deductibility limits of 1% to 5% of net revenues are no longer applicable.
- **Registrations with Trademark & Patent Office (INPI) or Central Bank cease to be required for deductibility purposes.**
- Royalties and considerations for technical, scientific, administrative or similar assistance are not deductible if the same amount is treated as a deductible expense by another related party, or if not treated as taxable income by the beneficiary's jurisdiction.

Intragroup Services

- Application of transfer pricing rules in accordance with the Arm's Length Principle **on any activity carried out that results in benefits for one or more parties** – i.e.: when it provides a reasonable expectation of economic or commercial value for the other party of the controlled transaction.
- Shareholder activities, for instance, will be considered as an activity that does not result in benefits (apply test to confirm this qualification).
- When the activity performed for the taxpayer by another related party does not result in a benefit, the Corporate Income Tax ("CIT") calculation basis will be adjusted.

Specific Provisions (cont.)

Cost Contribution Agreements (CCA)

- CCAs allow two or more related parties to share the contributions and risks related to the acquisition, production or joint development of services, intangibles or tangible assets based on the proportion of benefits that each party expects to obtain in the contract.
- **Concept distinct from the cost-sharing agreement and administrative expenses usually seen in Brazil.**

Business Restructuring

- Application of transfer pricing rules in accordance with the Arm's Length Principle on changes in commercial or financial relationships between related parties that result in the transfer of potential profit or benefits or losses to either party and that would be remunerated if they were made between unrelated parties.

Financial Operations

- Application of transfer pricing rules in accordance with the Arm's Length Principle when the controlled transaction involves the provision of financial resources and is formalized as a debt transaction, treasury transactions and insurance contracts. Specific provisions to confirm whether an intragroup guarantee is a member service or activity.

Types of Adjustments

Comparability adjustments

- Corrections over variables (i.e., traded volumes, working capital, etc) to make more accurate comparisons

Adjustments to the CIT calculation base

- **Spontaneous adjustment:** adjustment made by the taxpayer directly in the calculation of the CIT, made on December 31 (or on the date of the “special event”, in the case of M&A).
- **Compensatory adjustment:** adjustment made by the taxpayer on the value of transactions, until the end of the calendar year.
- **Primary adjustment:** adjustment made by the Federal Revenue Service, if they disagree with the price (or margin) declared by the taxpayer.

Next Steps

- The Federal Revenue announced that it will issue regulations by August, providing further guidance on implementation and addressing open questions on:
 - Databases and possibility to use foreign comparables;
 - Net profit indicators;
 - Safe harbors;
 - APAs;
 - Business restructuring;
 - Comparability adjustments;
 - TP documentation obligations (i.e, local files and master files), etc.
- Companies should assess the impacts of the new rules and plan ahead throughout 2023, for the mandatory application regarding FY2024.
- Companies should also assess whether it is worth exercising the early adoption option in September 2023 (re FY 2023).

Comparability Analysis

How to Determine Arm's Length Price

Accurate transaction design (Comparability Analysis)

Contract Terms

- Functions, responsibilities and rights of the parties
- Territory, duration, risk allocation, payment
Obs: Substance over form

Functional analysis

- Activities: who does what?
Assets: What assets are used?
Risks: Which party bears the risk?

Characteristics of Goods and Services

- Quality
- Commodity

Economic Circumstances

- Territory
- Economic growth
Competition
- Coin

Business strategy

- Entry into new markets
- Marketing

Determining the method of transfer pricing

- Principle of the most appropriate method
- Hierarchy of methods

Determination of Arm's Length Price

Select Commercial Database

- Compustat, EdgarStat, TP Catalyst, Osiris, Orbis (business financial data),
- Bloomberg (financial transactions)
- RoyaltyStat, KtMine (intangibles licensing)

Define search criteria

- Exclusion of inappropriate companies (related parties, inactive companies)
- Include companies based on comparability factors
 - Functions Performed
 - Rights transferred
 - Property characteristics

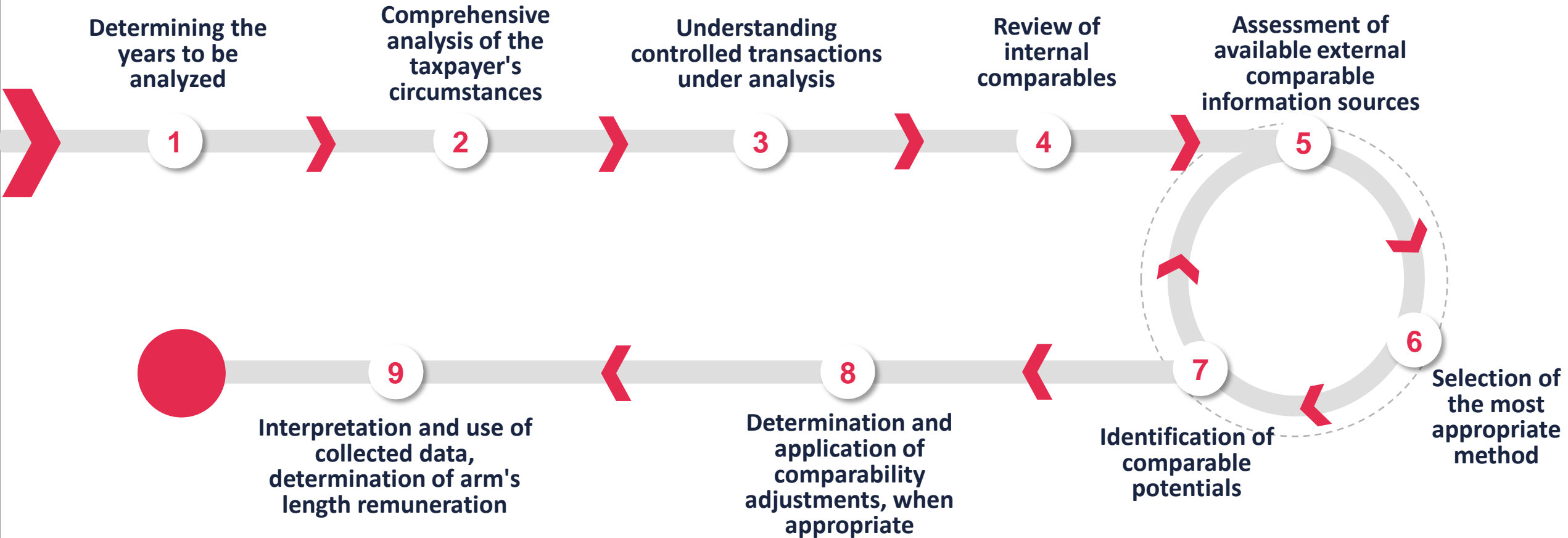
Review of selected comparables (manual)

- Websites
- Annual accounts
- Publications for investors (e.g. SEC)

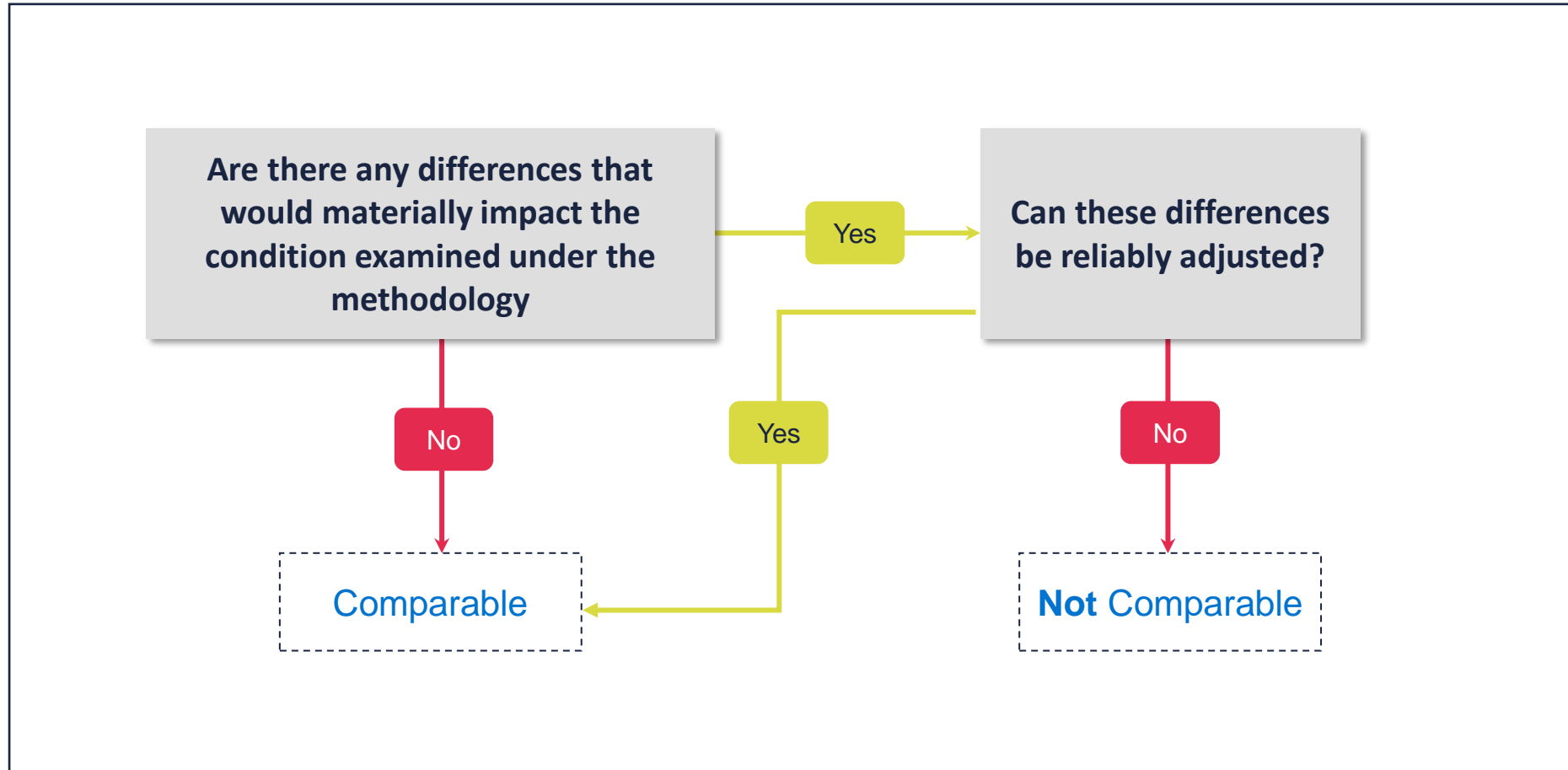
Statistical analysis

- interquartile range
- median

Typical OECD Process to Determine the Arm's Length Comparable Price



Definition of Comparability



Comparability Analysis

The new rules include comparability analysis based on functions performed, assets used and risks assumed, taking into account:

- 1** The economically relevant characteristics of the transactions;
- 2** The date on which the transactions took place;
- 3** The availability of information about transactions between unrelated parties;
- 4** The existence of uncertainties in the setting of prices or in the valuation at the time of carrying out the controlled transaction; and
- 5** The existence and relevance of group synergy effects.

Q&A

Q&A

1. What are the potential benefits of early adoption in 2023 of the new TP rules for taxpayers in Brazil?
2. Will the new TP rules maintain the possibility of applying fixed profit margins in certain cases?
3. What types of transactions that were previously outside the scope of the TP rules will be subject to transfer pricing controls under the new rules in Brazil?
4. What measures are available to simplify compliance and ensure legal certainty under the new TP rules in Brazil?

Q&A

1. What are the potential benefits of early adoption in 2023 of the new TP rules for taxpayers in Brazil?

The early adoption of the new TP rules in Brazil has the potential to be advantageous for taxpayers in several ways.

For example, taxpayers who are currently incurring significant TP adjustments or are subject to international double taxation due to the asymmetries between the fixed profit margins under the current Brazilian TP methodology and the remuneration determined by the counterparty in accordance with the arm's Length principle may benefit from early adoption (i.e., companies that act as limited risk distributors - LRDs, which currently use the resale price method with a predetermined gross margin of 40%, may benefit from early adoption, if market comparables corroborate the arm's Length character of a lower margin).

In addition, taxpayers interested in increasing the deductibility of passive royalties, without prior registration with the INPI, or in requesting an Advance Pricing Agreement (APA) with the Federal Revenue Service of Brazil may find the new rules advantageous.

Finally, taxpayers interested in implementing a TP policy in Brazil that is consistent with the policy adopted by other group entities with similar functions, risks and assets may benefit from early adoption if there is already a benchmarking study.

Q&A

2. Will the new TP rules maintain the possibility of applying fixed profit margins in certain cases?

The new rules are based on the arm's length principle of the OECD Transfer Pricing Guidelines, which require a case-by-case analysis and comparison of related party transactions with unrelated party transactions. However, the Brazilian federal tax authorities (“RFB”) has announced that it may adopt safe harbors based on pre-determined “well calibrated” profit margins, likely based on industry statistics for less complex function/asset/risk (FAR) profiles (e.g.; distribution with limited risk, or “LRD”). More details on this subject should be provided in a normative instruction to be published by the RFB in the coming months.

3. What types of transactions that were previously out of the scope of TP rules will be subject to transfer pricing control under the new rules in Brazil?

According to the new rules, all controlled commercial and financial transactions will be subject to TP's control. For example, operations involving royalties and remuneration for technical, scientific, administrative or similar assistance that were previously outside the scope of transfer pricing rules will now be subject to the new TP rules, i.e., the comparability analysis. Also, previously, the only financial transactions subject to TP control were loans and advances, however, under the new rules, all other types of financial transactions (e.g.; intra-group guarantees, insurance, cash pooling, etc.) were included within the scope of the TP.

4. What measures are available to simplify compliance and ensure legal certainty under the new PT rules in Brazil?

Law 14,596/23 provides that a “specific consultation processes regarding transfer pricing” (a kind of advance pricing agreement – APA) will be allowed. In addition, it gives indications that safe harbors will be created, as measures to guarantee legal certainty and simplify compliance with the new transfer pricing rules in Brazil.

However, Law 14,596/23 does not provide specific details or guidance on these measures. It is expected that normative instructions, to be published within the next couple of months, will address the details and guidance necessary for taxpayers to take advantage of these measures.

Transfer Pricing Team

Brazil

Alex Jorge

Partner

Alex Jorge is a partner in Campos Mello Advogados in cooperation with DLA Piper of the and co-head of the Tax Practice based in New York and Sao Paulo.

He advises clients in tax planning and consulting for direct and indirect taxes, audit defense, M&A, transfer pricing, customs, private wealth and international taxation.

Alex advises clients in several sectors, in particular, consumer goods, direct selling, agribusiness life sciences, oil & gas, technology, insurance and financial services, capital venture, real estate and educational enterprises doing businesses in Brazil or investing abroad.

His experience includes the design and implementation of tax efficient business structures and general tax advice on taxation of foreign profits, transfer pricing, thin-capitalization, cross-border transactions, investment in regulated vehicles (i.e., FIP, FII), utilization of special customs regimes, financing and licensing arrangements.

Alex joined Campos Mello in the beginning of 2013 and brings to the firm more than 15 years of experience as in-house counsel for U.S multinationals, including Avon Products and Philip Morris.

Alex is frequently sought by specialized tax publications to provide comments on controversial issues in Brazil. He is praised by clients as being very responsive, clear in how he presents issues and solutions but yet technical.



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Education

Fordham University, School of Law, LL.M. in Banking, Corporations and Finance Law (February 2012)

New York University, School of Law, Survey on International U.S Taxation (Summer 2004)

Harvard University, School of Law, Introduction to U.S Legal System (Summer 2002)

Getulio Vargas School of Business (FGV), Sao Paulo, Brazil, Post-graduation in Economic and Corporate Laws, with emphasis in Accounting and Economics (2001)

LL.M in Taxation, Catholic University, School of Law (PUC), Sao Paulo, Brazil (1998)

Juris Doctor, Catholic University, School of Law (PUC), Sao Paulo, Brazil, (1996)

Admissions

São Paulo

Rio de Janeiro

Humberto Marini

Partner

Humberto is a partner in Campos Mello Advogados in cooperation with DLA Piper of the Tax practice, based in Rio de Janeiro.

He has an extensive practice in tax consulting and tax litigation, experienced in the Judicial and Administrative Courts. His work includes responsibility for many substantial cases in state and federal courts, including the Higher Courts in Brazil: Brazilian Taxpayers Council, Superior Tribunal of Justice and Federal Supreme Court.

Humberto also has significant experience in VAT/indirect and direct tax matters, as well as in state and municipal taxes, social security, M&A, customs duties and excise taxes. Represented major companies in tax lawsuits, administrative procedures and consultations at the government tax departments in Brazil.

Among his clients are Brazilian and international companies in industry sectors, such as consumer goods, energy, infrastructure, financial and banking services, mining, hospitality and leisure, retail, industrial goods and services, life sciences and real estate.

He has been assisting Oil & Gas clients for more than 15 years in the tax litigation, representing companies in tax assessments and lawsuits regarding issues related to the industry.

Humberto began his career in 1998, as a member of the Tax department of Trench, Rossi and Watanabe. In 2005, he joined the Tax team of Veirano Advogados, which he left in 2010 to join Campos Mello Advogados to coordinate the Tax Litigation team.



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Juliana Costa

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Juliana Andrade Costa is a partner at Campos Mello Advogados in cooperation with DLA Piper of the tax area, based in Rio de Janeiro.

Juliana has over 15 years' experience in the tax practice. Her practice emphasis is in tax planning and consulting to Brazilian and foreign clients across a variety of industries, including energy, technology, oil & gas, financial market, venture capital, telecommunication, infrastructure, among others.

Besides, she has extensive experience advising clients on the tax implications arising from corporate reorganizations, M&A, debt restructurings, cross-border transactions, domestic taxation, including imports/exports and routine tax issues.

Additionally, she has expertise in tax judicial and administrative litigation at federal, state and municipal levels.



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Education

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Brazilian Tax Institute (IBET), Tax Law Specialist Degree (postgraduate – lato sensu), 2012.

Universidade do Estado do Rio de Janeiro (UERJ), School of Law, B.A., 2008.

Admissions

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Cristiane Drumond

Senior Associate

Cristiane Drumond is a senior associate in Campos Mello Advogados in cooperation with DLA Piper of the Tax Practice, based in Sao Paulo.

Cristiane is a tax lawyer specialized in cross-border transactions, with 17 years of experience with transfer pricing under the OECD Guidelines and 6 years under the Brazilian regulations. Because of her dual-qualification, Cristiane is able to look at both (or more) ends of the intercompany transactions, helping clients optimize their tax planning.



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Education

Federal University of Minas Gerais (UFMG), LL.M candidate in Taxation (expected conclusion in 2023)

University of Florida, LL.M (2010), with honors.

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Admissions

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Laura Kurth

Senior Associate

Laura Kurth is a senior associate in Campos Mello Advogados in cooperation with DLA Piper of the Tax Practice, based in Rio de Janeiro.

Laura provides clients with tax planning assistance and advises on direct and indirect taxation, corporate restructuring, customs regimes, and international tax matters, including the application of international tax treaties.

Laura joined Campos Mello in 2016 after working for another large Brazilian law firm for 9 years, where she gained extensive experience providing tax consulting to the infrastructure, energy, oil and gas, technology, services, and consumer goods sectors.



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Master in International Tax, University of Melbourne, Australia (2020)

Pontifícia Universidade Católica do Rio de Janeiro PUC/RJ – MBA in Strategic Tax Planning (2018)

Catholic University, School of Law (PUC - RJ), Rio de Janeiro, Brazil – Law Degree (LL.B.) (2012)

Admissions

Rio de Janeiro

