



Overview

Demarest, Taxand Brazil

Our team can offer the best legal advice on transfer pricing “TP” matters, especially regarding:

- ❖ Assessment of the application and respective impacts of TP rules in operations and transactions carried out and intended by the client.
- ❖ Legal consultation in administrative proceedings regarding tax authorities’ audits on the correct application of TP rules.
- ❖ Litigation at the administrative and judicial levels to guarantee the authorities apply TP rules correctly on the client’s operations and transactions.

General: Transfer Pricing Framework

On June 15, 2023, Law No. 14,596/23 was published, amending the Brazilian TP rules for calculating the Corporate Income Tax “IRPJ” and Social Contribution on Net Income “CSLL”.

Law No. 14,596 resulted from the conversion into law of Provisional Measure No. 1,152/2022, enacted in late 2022 and entered into force on January 01, 2024, with some provisions applicable, optionally, as of 2023.

TP rules establish minimum amounts of taxable income and maximum amounts of deductible expenses “Benchmark” to calculate IRPJ/CSLL in transactions between related parties and parties that benefit from a more advantageous tax treatment.

The previous Brazilian TP rules currently in force – Law No. 9,430/1996 – were widely criticized for diverging from international practices adopted by many countries. This legislation even caused several discussions in the United States regarding the recovery of income taxes paid in Brazil.

The new rules amended the previous system by replacing fixed margins with comparability tests that best enforce the arm’s length principle. This principle establishes that the Benchmark calculation must consider the relationships carried out between independent parties in comparable transactions.

The new TP rules still apply to transactions with related parties, parties residing in countries that do not tax income or levy taxes at a maximum rate lower than 17%, or parties that benefit from preferential tax systems. However, the definition of “related parties” was expanded to include all parties whose relationship of influence can, directly or indirectly, impact the transaction prices. The legislation also establishes a list of parties presumed to be related to the Brazilian taxpayer, as in the case of controlled and controlling companies.

Accepted Transfer Pricing Methodologies

In terms of application, the rules still require the establishment of the controlled transaction and its comparison with the Benchmark, in order to identify the need for adjustment in calculating IRPJ/CSLL.

A comparability test will be carried out to compare the terms and conditions of the controlled transaction with those established between unrelated parties. It will consider a series of factors, including the economic characteristics of the transactions and the applicable method and financial indicators. The following methods should be considered:

- ❖ PUC - Comparable Uncontrolled Prices
- ❖ RPM - Resale Price Method
- ❖ CPM – Cost Plus Method
- ❖ TNMM – Transactional Net Margin Method
- ❖ PSM - Profit Split Method
- ❖ Other Methods as established by the tax authorities

Also, Normative Ruling No. 2,161/23 provides for the guidelines of the Organization for Economic Co-operation and Development “OECD” as a subsidiary source of interpretation when “expressly approved by the Tax Authorities” and does not conflict with other rules on this matter.

Transfer Pricing Documentation Requirements

Law No. 14,596/23 only established that the tax authorities should determine how the information and other supporting documents would be provided. The Normative Ruling No. 2,161/23 defined that the taxpayer must submit:

- i) **Country-by-Country Statement**, containing information on the global allocation of revenue and assets, the income tax paid by the multinational group to which it belongs, and indicators concerning the group’s global economic activity. It must be submitted by the Brazilian entity (for tax purposes), which is the final controlling shareholder of a multinational group, including other specific provisions, annually and through the Income Tax Return “ECF”.
- ii) **Master File**, drafted at the group level, with information on the structure and activities of the multinational group, including intangibles and financial operations. It must be submitted by the taxpayers subject to TP rules (except those whose total amount in controlled transactions, before the TP adjustments, in the previous year, is less than BRL 15 million), within three months of the ECF’s deadline for the respective fiscal year through the Tax Authorities’ electronic portal (except for applications carried out in 2023 and 2024, when the deadline is the last business day of the following year).



- iii) **Local File**, drafted at the company or country level with detailed information on controlled transactions. Tax authorities waived a significant part of the required information for taxpayers whose total amount in controlled transactions, before the TP adjustments in the previous year, is between BRL 15 million and BRL 500 million. It must be submitted by the taxpayers subject to TP rules (except those whose total amount in controlled transactions, before the TP adjustments, in the previous year, is less than BRL 15 million), with the same deadline as the Master File. It is important to mention that the Local File must include information on the following controlled transactions (the ones with the highest value):
- a) **100%** of controlled transactions for the import and export of commodities;
 - b) **100%** of controlled transactions involving rights, business restructuring, cost contribution arrangements, financial operations, and transactions with intangibles; and
 - c) **80%** of the total amount of controlled transactions involving: (i) the import of goods (except for commodities); (ii) the export of goods (except for commodities); (iii) the import of services; and (iv) the export of services.

Local Jurisdiction Benchmarks

The benchmark calculation must consider comparable transactions between independent parties, allocating assets, risks, and functions between the companies involved. The preferred and recommended method is the Comparable Uncontrolled Price "CUP", which considers comparable prices in transactions between unrelated parties.

The assessment of the controlled import transaction must be based on its facts and circumstances and on the evidence of the parties' effective conduct and intentions to identify the relationships and their economic and financial characteristics.

Law No. 14,596/23 even allows disregarding or replacing the controlled transaction when it is concluded that unrelated parties would not have carried out the controlled transaction as established.

However, considering the new rules are mandatory as of January 2024, no precedents indicate the tax authorities' interpretation/application of such rules yet.

Advance Pricing Agreement "APA"/Bilateral Advance Pricing Agreement "BAPA" Overview

Law No. 14.596/23 introduced the APA into Brazilian legislation and changes to the Mutual Agreement Procedure "MAP", representing a significant step forward compared to the previous scenario in the quest to address the gaps and divergences found by the OECD from the perspectives of legal certainty and business predictability.

Although the Federal Revenue Office still needs to regulate the APA, it could serve as an alternative tool for taxpayers to define the transfer pricing methodology to be used for

future transactions. The method adopted could be discussed, critical assumptions extended, and even renewed, with the possibility of discussing comparables, critical assumptions, and deadline extensions.

The regulation of the Brazilian APA is expected to value mutual trust between the parties and be practical in terms of negotiation, which will allow a genuine exchange of information and negotiation proposals, with concessions on both sides, preventing the APA from becoming a traditional consultation, with the establishment of a unilateral methodology.

Focus on Financial Transactions

Financial transactions between related parties are subject to the Danish arm's length principle under section 2 of the Danish Tax Assessment Act. The Danish Tax Agency's Legal Guidance states that this principle is to be interpreted in accordance with the arm's length principle in the OECD Model Tax Convention and the latest version of the OECD Transfer Pricing Guidelines. The Legal Guidance also contains specific guidance on financial transactions based on Chapter X of the OECD Transfer Pricing Guidelines.

In practice, we generally see significant attention from the Danish Tax Agency in relation to financial transactions, and financial transactions are often a key focus area in Danish transfer pricing audits.

For Danish transfer pricing purposes, controlled financial transactions must be accurately delineated by reference to the economically relevant characteristics of the transaction. These include the contractual terms, the functions performed, assets used and risks assumed by the parties, the characteristics of the financial product or service, the economic circumstances and the parties' business strategies. The Danish Tax Agency's Legal Guidance states that the transfer pricing documentation must address the purpose of the financial transaction, identify the group entities that make the significant decisions in relation to the transaction and analyse which entities exercise control over the economically relevant risks associated with the financial transaction.

A particular Danish feature is the interaction between the transfer pricing rules and the Danish rules on debt and interest deductibility. According to the Danish Tax Agency's Legal Guidance, based on a *lex specialis* principle, section 2 of the Danish Tax Assessment Act does not apply to the balance between debt and equity where that matter is governed by the thin capitalisation rules in section 11 of the Danish Corporation Tax Act. In addition, Denmark applies an asset-based interest limitation rule under section 11B and an EBITDA-based interest limitation rule under section 11C. These interest limitation rules may restrict the deductibility of financing expenses independently of the determination of an arm's length interest rate and other arm's length terms under section 2 of the Danish Tax Assessment Act.



For intra-group loans, the arm's length analysis should consider the perspectives and realistically available alternatives of both the borrower and the lender. Relevant factors include the purpose and amount of the financing, maturity, currency, security and seniority, the borrower's creditworthiness and the effect of group membership, as well as the functions performed, risks controlled and financial capacity to assume those risks by the lender. Cash pooling arrangements and financial guarantees are also subject to the arm's length principle. For cash pooling arrangements, the appropriate remuneration depends on the functions performed, assets used and risks assumed, while for financial guarantees it must also be considered whether the explicit guarantee provides a benefit beyond that resulting from implicit support or group membership.

Transfer Pricing Audits

Brazil's tax audits generally aim to verify taxpayers' conformity and compliance with tax legislation. This verification takes place by requesting documents and information sufficient to understand the calculation and payment of taxes. Regarding TP matters, the tax audits are, as a rule, related to tax audits of the calculation of IPRJ and CSLL, with no specific procedure concerning TP rules.

However, the provisions of Law No. 14,596/23 and IN No. 2,161/23 allow the conclusion that the Federal Revenue Service will adopt specific procedures to verify compliance of controlled operations with the new TP rules.

Transfer Pricing Penalties

Law No. 14,596/23 provides for different fines applicable according to the infraction, as indicated below:

- ❖ **Late filing:** 0.2%, per month or fraction, on the gross revenue for the period to which the obligation refers.
- ❖ **Data omission:** 5% on the transaction value or 0.2% on the consolidated revenue of the multinational group for the year prior to which the information refers.
- ❖ **Lack of compliance with filing rules:** 3% on the gross revenue for the period to which the obligation refers.
- ❖ **Refusal to provide information:** 5% on the transaction value.

The penalties above will be applied at a minimum of BRL 20,000 and a maximum of BRL 5 million.

Local Hot Topics and Recent Updates

The new TP rules still contain a few controversial aspects, such as:

- ❖ **Limits and uncertainties** involving the application of the OECD TP Guidelines and how the Tax Authorities should approve them, and significant compliance costs to draft the Master and Local files following the criteria established by the regulations;
- ❖ **Non-deduction of expenses** incurred with interest, "other expenses" outlined as shareholder activity, and royalties "when the deduction of the amounts results in double non-taxation";
- ❖ **Treatment of corporate reorganizations** (i.e., mergers, spin-offs, capital contributions, capital reductions, etc.) and application of Brazilian tax neutrality rules;
- ❖ **Legal nature of the Brazilian APA;** and
- ❖ **Deadlines** for compensating adjustments.

Besides, there are still some topics to be regulated by the Tax Authorities:

- ❖ Transactions with intangibles, intercompany services, cost contribution arrangements, business restructuring, and financial operations; and
- ❖ Further details on the APA request.



Documentation threshold

Master file	Over BRL 15 million
Local file	Between BRL 15 million and BRL 500 million
CbCR	N/A

Submission deadline

Master file	Within three months of the ECF's deadline for the respective fiscal year through the Tax Authorities' electronic portal (except for applications carried out in 2023 and 2024, when the deadline is the last business day of the following year)
Local file	Same as the Master file
CbCR	Annually and by means of the ECF

Penalty Provisions

Documentation – late filing provision	0.2%, per month or fraction, on the gross revenue for the period to which the obligation refers
Tax return disclosure – late/incomplete/no filing	5% on the transaction value or 0.2% on the consolidated revenue of the multinational group for the year prior to which the information refers
CbCR – late/incomplete/no filing	Fines applicable according to the type of infraction regarding the ECF



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