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German Tax and Legal News

Brazilian milestones towards convergence with the OECD Transfer Pricing standard

On 25 January 2022, the Council of the Organization for Economic Cooperation and Development ("OECD") has officially initiated the process of Brazil's accession as a member.[1] Since the country's application for membership in 2017, the harmonization of the Brazilian local tax rules with the OECD Transfer Pricing Guidelines has been outlined as one of the main commitments the country would have to assume.

Although the current Brazilian transfer pricing ("TP") system is often characterized by its practicality, predictability and tax certainty – e.g., by the adoption of fixed margins, freedom of selection of the TP method, and safe harbor regimes – it is considered to do so only at the domestic level and not in line with the "arm´s length" principle.

From an international perspective, due to the existing divergences between the Brazilian TP system and OECD compliant TP systems around the world, taxpayers face risks and uncertainties related to double taxation, as well as to disputes and challenges that can potentially be raised by tax administrations from other jurisdictions.

In light of this, a series of changes are expected in the current Brazilian TP rules towards convergence with the OECD standard. Indeed, since OECD's official invitation for Brazil to become a member, there has been great speculation as to what can be expected during the accession process regarding the topic of TP. However, the main challenge will certainly be to ally what is expected from the Brazilian government by the international community, with the country's fundamental policy goals of preserving simplicity and efficiency in the tax administration as well as ensuring practicability in the application of transfer pricing rules.

Background
Since Brazil's application for membership in 2017, the country's economic team has been organizing a series of meetings between the Brazilian Federal Revenue Service ("RFB") and OECD officials to discuss and address the main issues where there are disagreements regarding the topic of taxation.

Particularly what concerns the topic of TP, OECD and RFB officials launched in February 2018 a joint project to assess the TP framework currently in place in Brazil as compared to the international consensus on transfer pricing, represented by the 2017 OECD Guidelines.[2] As a result of an in-depth analysis of similarities and differences, an extensive report entitled "Transfer Pricing in Brazil: Towards Convergence with the OECD Standard" was published on 18th December 2019[3] (hereinafter referred to as "2019 OECD-Brazil joint report").

A follow-up meeting scheduled for 10 March 2020 was cancelled due to the restrictions caused by the COVID-19 pandemic. Nonetheless, it is known the OECD representatives are in regular contact with RFB remotely, and the work on the new TP system is in progress. In addition, as part of the implementation phase of the joint project, in 2020 the OECD Secretariat and RFB have launched a public survey, where taxpayers with business interests in Brazil and businesses interested in investing in Brazil as well as other stakeholders were invited to contribute to the OECD/RFB joint project by providing their specific experience or comments on elements relevant to the development of safe-harbor regimes and other measures contributing to tax certainty in Brazil.[4]

Identified gaps and divergences
According to the 2019 OECD-Brazil joint report, a number of gaps (absence of specific concepts or features) and divergences (concepts which differ significantly from the OECD standard and lead to divergent outcomes) were identified in the current Brazilian TP rules, of which the following are highlighted[5]:

- absence of adherence to the arm's length principle, which is followed by most countries around the world. This prevents Brazil from applying the same approach as other countries to the determination of the tax base of multinational enterprises

("MNEs") located in Brazil, and thus inherently leads to a risk of double taxation, which is not prevented from the outset;
- in a similar approach, the fixed margins and waivers of proof for exports may result in transactions of no-taxation, confliction with the purpose of OECD transfer pricing guidelines;
- absence of transactional profit methods (transactional net margin method and profit split method);
- important divergences in relation to performing a comparability analysis, including the absence of the notion of accurate delineation of the transaction, the limited comparability analysis (largely disregarding the functional and risk profile), combined with a strict use of comparables, the item-per-item approach and limited comparability adjustments;
- absence of special considerations for specific types of transactions, including those involving the use or transfer of intangibles, intra-group services, cost contribution arrangements, business restructurings, and financial transactions;
- deductibility limitation rules applying to certain out of-scope types of outbound payments;
- matters related to the mechanisms that would allow prevention and effective resolution of transfer pricing disputes;
- divergences in the area of attribution of profits to permanent establishments.

Expectations/ Way going forward
Despite Brazil's resistance in giving up the existing TP system altogether, by emphasizing its strengths (mainly its objectivity and practicality) and proposing instead a partial alignment to the OECD standard (e.g., only to specific types of transactions) or a dual system at the taxpayer choice, the OECD has taken a firm stand requiring full compliance with the OECD Guidelines, either immediately or gradually:[6]

- Immediately: new rules consistent with the OECD standard and the arm's-length principle would be applicable to all taxpayers as from a given date; or
- Gradually: new rules would progressively apply to different groups of taxpayers.

Thus, for Brazil to successfully and swiftly become an OECD member, the government needs to undertake several initiatives to make the process of convergence with the OECD transfer pricing standard a reality. Indeed, since the beginning of his presidential campaign, President Jair Bolsonaro made it clear that one of the goals of his administration would be Brazil's accession to OECD. However, in October 2022, the country will go through new presidential and congressional elections, which would make the continuing changes of transfer pricing rules in the country somewhat more uncertain.

For the time being, as a testament of the current Brazilian commitment to become an OECD member, on 15 March 2022, the government published a new decree which gradually reduces the Financial Transaction Tax ("IOF") levied on certain foreign exchange transactions[7], including cross-border loans.

Webcast
In this context, Deloitte Germany is organizing in collaboration with Deloitte Brazil a webcast to address the main considerations for German multinationals operating in Brazil going forward. Our webcast will address what can be expected during Brazil's accession process as an OECD member, focusing especially on the expected changes in the Brazilian TP rules towards convergence with the OECD standard.

Furthermore, our regional leaders will touch upon the current recommended measures for German multinationals operating in Brazil, by exploring the following topics:

- Developments in Brazilian legislation (tax reform proposal and OECD membership);
- Practical deductibility scenarios;
- TP documentation and adjustments for local purposes.

If you are interested in the webcast, we would be delighted to welcome you on April 28th, 2022 at 15-16:00 CET (11:00 -12:00 BRT). To register, please click here.

Footnotes
[1] OECD, OECD takes first step in accession discussions with Argentina, Brazil, Bulgaria, Croatia, Peru and Romania - OECD

[2] OECD Transfer Pricing Guidelines for Multinational Enterprise and Tax Administrations.

[3] 2019 OECD-RFB Report "Transfer Pricing in Brazil: Towards Convergence with the OECD

Standard". Available at: https://www.oecd.org/ctp/transfer-pricing/transfer-pricing-in-brazil-towards-convergence-with-the-oecd-standard.htm .

[4] OECD and Brazil's federal revenue authority invite taxpayer input on transfer pricing issues relating to the design of safe-harbour provisions and other comparability considerations - OECD

[5] 2019 OECD-RFB Report "Transfer Pricing in Brazil: Towards Convergence with the OECD Standard". Available at: https://www.oecd.org/ctp/transfer-pricing/transfer-pricing-in-brazil-towards-convergence-with-the-oecd-standard.htm .

[6] Carlos Ayub, Brazil: Advancing towards global transfer pricing convergence | International Tax Review, 23 July 2020.

[7] https://www.taxathand.com/article/22974/Brazil/2022/Government-publishes-new-decree-decreasing-IOF-rates

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