Brazil publishes Normative Instruction with new rules for transfer pricing

October 30, 2023

In brief

Following the public consultation process which ended on August 3, the Brazilian Federal Revenue Service (RFB) on September 29 published Normative Instruction (IN) IN/RFB 2,161/2023. This is the first set of regulations to rule Law 14,596/23, which introduce in Brazil the Arm's-Length Principle (ALP) and the OECD Transfer Pricing Guidelines system (OECD Guidelines).

The IN regulates the new law — including interpretations of the ALP, related parties, controlled transactions, delineation of transactions and methods — and documentation — the procedures related to the filings of the reports, among other measurements and future implementation of Transfer Pricing return. However, it does not regulate important 'specific provisions' from the new law which, the RFB indicates, will be addressed in future public consultations.

The final version of the new regulations maintains an express reference to the OECD Guidelines as a "source of subsidiary interpretation" to Brazilian laws concerning the ALP, as well as related future modifications, except if the OECD Guidelines were at odds or inconsistent with the law provisions, the IN/RFB 2,161/2023, or other normative acts issued by the RFB. The prevalence of the domestic law would require Brazil to legislate again in cases of substantial modifications/changes in the OECD Guidelines, which is consistent with practices from several OECD member countries.

Observation: The new regulations bring Brazil closer to an OECD Guidelines 'dynamic application' methodology. Nevertheless, the express indication of RFB prevalence may result in cases of interpretative disparity that have the potential to move Brazil away from OECD Guidelines application standards.

As defined by law, the application of the new rules is optional for fiscal year 2023 (retroactively for transactions as from January 1, 2023) but will be mandatory for fiscal year 2024 (starting at January 1, 2024). The RFB responded to taxpayer requests to postpone the deadline for exercising this early adoption option, previously established on September 30, and now extended until December 31, 2023 by IN/RFB 2,161/2023.

This Tax Insight addresses some key topics of the regulations and highlights areas or points of consideration, as well as specific action items that taxpayers should undertake in seeking to mitigate potential risks and to achieve greater efficiency in complying with the new rules.

Action item: It is important for taxpayers to decide before December 31 whether to exercise the option for the early application of the new rules in 2023, and also to consider which operational model will be used from 2024. In order to make this decision, it may be necessary to complete an assessment to understand the economic-financial modeling, legal-tax alternatives in short, medium, and long-term. This is an urgent task in this quarter of 2023, but also important as a continued practice from 2024 forward.

In detail

Controlled transactions and controlled parties

The IN replicates the Law 14,596/23 definition of controlled transactions, referring to any commercial or financial relationship between two or more related parties. This rule introduces a broader concept of transaction, seeking to cover situations such as 'series of transactions,' 'arrangements,' and 'significant influence,' to clarify which operations will be subject to the analysis under the transfer pricing methods.

The IN also provides several examples, including transactions with tangible goods (including commodities), transactions involving intangibles, services of any type/kind, loan and leasing, cost-sharing contracts, financial operations (including issuance of debt), intra-group guarantees, centralized treasury management agreements, and insurance contracts.

Observation: The new wording of article 3, item VII, calls for special attention, as it includes in its exemplificative list the transactions that address the transfer or disposition of assets, including shares or other interests, even if they occur upon capital redemption or capital subscription transactions. ***Note:*** This provision was not included in the original public consultation proposal, nor listed in the sections of the law. Furthermore, the interpretation of this article should be made in connection with other provisions (such as articles 22 and 23) from the Law 9,249/95 that authorize corporate restructuring processes to be carried out at book or market value. Therefore, taxpayers should evaluate how to interpret the articles of the law and the new regulations based on the actual delineation of the transaction, in analyzing whether any and every capital contribution or redemption should be considered within the transfer pricing analysis or if such application could represent divergence between the regulations and the Law, or even between RFB interpretation and OECD Guidelines.

The IN adopts the definition of 'controlled transactions' of Law 14,596/2023, considering transactions between 'related parties,' even if they do not represent an economic control over transactional terms, or a 'substantial influence' that raises questions on the scope of applicability of the new regulations. In addition to a general definition of 'substantial control or influence,' Brazil's new regulation also brings a list of legal assumptions that could represent a question as to the ALP as well, potentially diverging from international standards. Furthermore, Brazil's regulations continue applying the controlled transaction rules for transactions made between a Brazilian taxpayer and any entity, if such entity is resident or domiciled in countries considered as tax havens as defined under Brazilian rules (i.e., countries that do not tax income or have a maximum tax rate lower than 17%, or if such entity benefits from a 'privileged fiscal regime'). In both cases, the rules appear to deviate from OECD practices and standards. This rule may be challenged by taxpayers in some circumstances.

Controlled transactions delineation

The delineation of the controlled transactions must be made based on both the analysis of the facts and circumstances of the transaction and the evidence of effective conduct of the relevant parties, with the aim of understanding the economic characteristics of these transactions. The delineation analysis seems consistent with OECD Guidelines.

Nevertheless, a new provision was introduced specifying that cases where the taxpayer incurs repeated losses, while the multinational group or related parties are profitable, may indicate the ALP is not being observed. In such situations, Brazilian companies should include additional controls and monitoring of documentation and eventual losses justification.

Finally, within the concept of transaction delineation, the regulations bring several descriptive items to guide all comparability factors that must be observed (e.g., contractual terms, functional analysis, goods and services characteristics, economic circumstances, and business strategies, in addition to other relevant specific characteristics of the transaction, including synergies).

Comparables

With respect to comparables, Brazilian laws also seek alignment with the OECD Guidelines.

The IN suggests a preference for domestic comparables, i.e., comparables identified in the same geographic market where the tested party operates. If the tested party is Brazilian, therefore, the data must be national. Where there is a lack of domestic comparables, the use of comparable transactions from other geographic markets is allowed, as long as "reasonably precise adjustments" can be considered for existing material differences.

Observation: Brazil's competitive regulatory and economic environment must be considered, adding a complexity to the delineation process. When foreign data is used for comparability adjustments, the process tends to be more complex considering Brazil's economic environment and its particular features, which may lead the RFB to revisit or even redefine global standards.

In this context, the IN lists some examples of situations that should be analyzed — adjustments of accounting standards, exchange rate, adjustments for differences in functions, risk assumption, assets, and capital (including working capital), adjustments of contractual terms, including sales conditions (volume, payment deadline/term, and International Commercial Terms- Incoterm, inventory risks, conditions for amortization or early debt settlement).

Observation: With respect to country risk and netback adjustments (as exemplified in annexes II and IV, respectively), in all cases, each and every referred adjustments in the Brazilian regulation are neither prescriptive nor mandatory, and applicability is determined based on the economic and transactional facts and circumstances of each taxpayer.

A new provision was included that determines that the mere existence of a policy will not be sufficient to justify the functions associated with risk control. In other words, concrete evidence, rather than contracts, provides the starting point in the delineation of the transaction, which may increase the risk that the tax authorities may have a different interpretation than the taxpayer.

Observation: The potential lack of reliable Brazilian data for benchmarking also can be a concern. The need for foreign data in several situations may require complex comparability adjustments. Brazil is faced with the challenge of the potential lack of robust information for comparability to be made consistently with tested transactions. This initial shortage will be corrected over time with more data being developed in the Brazilian markets and potentially along with the RFB or other independently validated sources curated from public sources.

Regarding business strategy, specifically in situations that would be plausible to justify the absence or low rate of profitability in certain years, the regulations acknowledge that such situations may occur, but emphasize that this strategy must endure for a limited period and cannot last further than reasonable. The taxpayer must document this situation and be prepared to justify the expectation of adequate return produced by the business strategy in documents and possibly during inspection.

International compensation — which was contemplated in the original draft and maintained in the IN — is addressed such that a related party can compensate the benefit provided to another related party in a controlled transaction, through a benefit received from the other related party in various controlled transactions, and net gains or losses must be counted when determining the income tax calculation.

The most appropriate method

The new rule focuses on selecting the most appropriate method, considering the facts and circumstances of the transactions and the availability of reliable information on comparable transactions, among other factors such as (1)

Comparable Independent Price method (PIC); (2) Resale Minus Method (PRL); (3) Cost plus Profit method (MCL); (4) Transaction Net Margin Method (MLT); and (5) Profit Split Method (MDL). The use of 'other methods' (i.e., valuation techniques) is allowed when it is demonstrated that none of the previously described methods would be more adequate in the specific case. A combination of methods is allowed as well.

For commodities, the PIC will be applied when reliable independent price information is available, unless it can be demonstrated that another method would be more appropriate considering the characteristics of the transaction (see PwC's Tax Insight dated July 21, 2023 for more details). In case a taxpayer selects the PIC method, it will be necessary to register details of the transactions and reference to the import/export agreement, including amendments, in a system available in the RFB e-CAC. ***Note:*** In the case of commodities, when applying this method, the new rule is even more specific as it exemplifies which date and time can be notably relevant.

Regarding the specific compliance for commodities, the deadline for recording this information has been extended until the 10th day following the 10-day period in which the transaction occurred (the norm previously stated "up to the 10th day following the conclusion of the contract or amendment"). ***Observation:*** Even with this flexibility, companies that operate with commodities have expressed concern that this requirement will significantly increase the cost of compliance, particularly given that the same information is provided in the ECF (Income Tax Return). The RFB´s position on this additional compliance may represent a distancing from the ALP and the OECD Guidelines.

A welcome aspect of the regulations is the express provision of a combination of transactions and the permission to use nontransactional data from unrelated parties in the comparability examination — especially in the application of the MLT — as long as such data represent reliable comparables for the controlled transaction.

Adjustments to the calculation

The law provides for three types of adjustments:

Type of adjustment	Description
Primary	Made by the tax authority.
'Compensatory' (Corresponding)	Bilateral or corresponding, regulated by the RFB, carried out until the end of the calendar year. Must be registered in the ECD (Digital Accounting Bookkeeping). The adjustment can be upward or downward.
Spontaneous	Unilateral, carried out at first by the taxpayer in the calculation, only to add to the IRPJ and CSLL bases (mitigating the risk of double nontaxation). Only an upward adjustment can be made.

The new regulations clarify that compensatory (corresponding) adjustments can be performed by the time of the ECD filing, after the end of the calendar year, which is welcomed and guarantees adherence to ALP and the OECD Guidelines.

However, the new rule provides additional details regulating the compensatory adjustment, including that the referred adjustment is prohibited from being made in transactions carried out by a legal entity, resident or domiciled in Brazil, with any entity characterized in the cases addressed in the Law 9,430/96, articles 24 and 24-A (entity resident or domiciled in low-tax countries or considered beneficiary of a 'privileged tax regime'). This provision was not included in the original draft.

A welcome aspect of the Brazilian rule is the mandatory use of the entire range (i.e., not just the interquartile range of comparables) when the data is reliable. If the data are not considered reliable and uncertainties remain, the rule calls for the use of the interquartile range, which in the worst case replicates the practice of OECD member countries in this regard, if the RFB does not disregard the comparables.

Documentation, penalties, early option deadline

The new rule calls for significant modifications to transfer pricing documentation. What previously was broadly supported by individual transactional documents (i.e., contracts or invoices), translated into mathematical calculations, and presented in the ECF, will be replaced by the OECD three-tiered approach: Master File, Local File, and country-by-country report (CbCR). The law assigns technical responsibility to the external expert or consultant/advisor on whose economic studies the taxpayer´s analysis and documents are based.

The new documentation must reflect Brazil's economic, regulatory, and business environment. ***Note:*** In the case of Brazilian subsidiaries of multinational companies, it will not be possible merely to replicate the current studies from their headquarters and apply them without judgment. The suiting or 'localization' of the information and the independent understanding of the Brazilian functional profile must be properly considered.

Observation: The IN brings several specific rules for delivering the Master File and the Local File in Brazil that may be considered to vary from the practices observed with respect to the OECD Guidelines. These specific rules increase the complexity of information that must be produced for multinationals operating in Brazil.

With respect to transfer pricing documentation, the innovations and particularities in the new rule can result in an additional cost of compliance to Brazilian taxpayers, mainly for Brazilian subsidiaries, that may not necessarily benefit from documentation prepared by its headquarters. Brazilian subsidiaries may need to redo their studies in seeking to avoid being subject to the large penalties imposed by the legislation.

Specific situations were introduced in the law based on the values of the taxpayer´s controlled transactions to enable exemption from presenting documentation, simplified presentation, or complete presentation of supporting documentation. The following table summarizes the parameters, deadline, and other information.

Documentation Table	Transfer Pricing Return	CbCR	Master File	Local File
Exemption	There is no exemption. Respective transfer pricing reports within the Income Tax Return. The return must be presented in the ECF.	In the previous fiscal year, amount of consolidated revenue of the group less than R$ 2,260 million if the final controller is resident in Brazil for tax purposes, or €750 million or the equivalent converted at the exchange rate on January 31, 2015.	If the total value of the taxpayer´s controlled transactions, before transfer pricing adjustments, in the calendar year prior to the calendar year to which the Local File refers is less than R$15,000,000 (fifteen million reais).	
Deadline and types of delivery	July 31 via ECF	July 31 via ECF	For calendar years 2023 and 2024: December 31. From 2025: (three months after the deadline set for filing the ECF for the corresponding calendar year): October 31. Delivery via e-CAC (Tax Authorities Portal). If it is presented in English or Spanish, the Master File requires no translation (unless requested by tax authority during the inspection procedure). Local File must be in Portuguese.	

Other Information	Part of the information from Local File must be registered in the ECF.	Regulated in IN 1681/16	Requirements for providing information in relation to the last two calendar years of certain operations were removed, as well as the tax paid by all entities of the economic group in the last three years.	Possibility of simplified presentation if the total value of the taxpayer´s controlled transactions, before transfer pricing adjustments, is greater than or equal to R$15 million and less than R$500 million, in the calendar year prior to the calendar year to which the Local File refers.

The lack of information or incomplete presentation of the Master File and/or Local File is subject to penalties that will have a minimum value of R$20,000 (twenty thousand reais) and a maximum value of R$5,000,000 (five million reais), depending on the type of infraction (e.g., lack of timely submission, presentation with inaccurate, incomplete, or omitted information, or presentation without meeting the requirements for the presentation of an accessory obligation).

The IN maintained 0.2% on the value of the consolidated revenue of the economic group (limited to R$5 million) in the case of inaccurate, incomplete, or omitted information in the Master File, which will not be applied in the case of duly proven formal errors or immaterial information that does not compromise the reliability of the results of the application of the ALP principle.

Finally, as mentioned, the deadline for expressing the option for the 'early adoption' of the new rules in 2023 was extended to December 31, 2023. The option is irreversible and will be applied from January 1, 2023, including with regard to specific royalties deductibility rules.

Other matters

The safe harbor rule for low value-adding intra-group services, aligned with OECD standards, was maintained, as per the draft of the regulations (i.e., a minimum 5% markup in case of exports of low value-adding services, and a maximum 5% markup in case of imports).

The IN reaffirms that the transfer pricing rules only apply directly to the income tax calculation and cannot imply automatic adjustments to other taxes, such as withholding income tax. Nevertheless, depending on the circumstances tax authorities can reassess other taxes due to the transfer pricing adjustments (e.g., duties) in a separate assessment. Therefore, taxpayers should consider whether the facts and circumstances related to the transfer pricing files are consistent with the position adopted by the taxpayer regarding other taxes, mainly customs taxes as well as the taxes applied to the import of services or intangibles.

The rule clarifies that the nondeductibility of royalties in the income tax calculation is applicable in cases where (1) the value is treated at the same time as the deductible expense for another related party; (2) the amount deducted in Brazil is not treated as taxable income of the beneficiary, according to its local legislation; or (3) the amounts are meant to finance, directly or indirectly, deductible expenses of related parties that result in the previous cases.

The IN includes six annexes, five of which have the goal of bringing examples to specific situations to clarify proposed concepts, and the last annex is related to the form to elect for the early option:

- Annex I: Indirect transactions and series of transactions
- Annex II: Comparability adjustments for country-risk
- Annex III: Multiple year data – MLT (rectified on October, 3, 2023)

- Annex IV: Netback adjustment
- Annex V: Median and interquartile range
- Annex VI: Early Option term.

What remains to be regulated?

According to the RFB, new Normative Instructions will be published, and subject to public consultation, to regulate (1) commodities transactions; (2) intangible, intragroup and cost-sharing transactions; (3) business restructuring; (4) financial operations; and (5) specific transfer pricing consultation process (APA).

The RFB has indicated that the next Normative Instruction likely will deal with commodities, including additional practical examples, and, potentially, a new solution related to the obligation of documentation.

Finally, regarding corporate restructuring, an evolution on this topic should appear in the income taxation reform.

Observations

The new transfer pricing IN is broadly consistent with the draft that was the object of public consultation and does not present major surprises. In fact, the IN incorporates and addresses several taxpayer requests, including the extension of the deadline for early adoption, postponed to December 31, and the possibility of making downward adjustments via compensatory (corresponding) adjustment in the following calendar year, as long as it is reflected in the ECD.

As expected, not all the requests have been addressed, and the Brazilian transfer pricing environment continues to be particularly complex. The content of the IN highlights that Brazil seeks alignment with international standards. At the same time, the IN continues to differ or innovate in several aspects that may result in potential risk of double taxation. Furthermore, it continues to impose an administrative compliance burden higher than that observed in the OECD environment.

Brazilian documentation remains ‘contemporary’ with annual updating and delivery of studies digitally. The content of the files is more detailed and broader, as compared with what is commonly practiced by OECD member countries. Brazil’s large, closed, and highly regulated economy, alongside the multinationals that operate in Brazil, sometimes adapts to the environment through activities performance or the assumption of risks, which differ from the operational pattern seen in other countries. This offers challenges for functional and comparability analyses, in which the economic studies underlying compliance with the standard may be more complex and possibly less uniform than expected by some multinational companies operating in the country.

The complex new regulation raises questions on its application in Brazil and abroad. In Brazil there are complexities that can represent greater legal uncertainty than in OECD member countries, especially when considering the absence of efficient mechanisms for collaborative dispute resolution through transaction without imposition of penalties, as well as the limited network of Brazilian double tax treaties that have substantial gaps with relevant trading partners (e.g., the United States and Germany, and the pending ratification of the treaty with the United Kingdom). In administrative litigation, the complexity of the issue may escape the efficient resolution of specific cases in which double taxation might occur.

The Brazilian rule makes direct reference to the OECD Guidelines, as standards for interpreting national law – even if in a subsidiary manner. Considering that many topics that were not covered in the first IN are quite complex, particularly where there may be deviations or differences in interpretation between Brazil and other countries, this reference may encourage or enable the early adoption of the new rules in 2023, as where the IN is silent (i.e., intangibles), it should be possible to use the OECD Guidelines.

Let's talk

For a deeper discussion of how Brazil's new transfer pricing rules might affect your business, please contact:

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