



TAUIL | CHEQUER
MAYER | BROWN

Brazil and the International Transfer Pricing Standards: Provisional Measure 1,152/2022

LEGAL UPDATE

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Table of Contents

Brief Background	03
-------------------------	-----------

Provisional Measure 1,152/2022: The New Brazilian Transfer Pricing Rules	09
---	-----------

Overview	09
-----------------	-----------

General Features	11
-------------------------	-----------

Arm's Length Principle	12
------------------------	----

Controlled Transactions	12
-------------------------	----

Related Parties	13
-----------------	----

Comparability Analysis	13
------------------------	----

Transfer Pricing Methods	14
--------------------------	----

Tested Party	15
--------------	----

Comparability Range	15
---------------------	----

Transfer Pricing Adjustments	16
------------------------------	----

Selected Comments Referring to Certain Specific Transactions	17
---	-----------

Commodities	18
-------------	----

Intangibles	20
-------------	----

Interactions with Royalty Deductibility Rules	22
---	----

Intragroup Services	23
---------------------	----

Cost Contribution Agreements	24
------------------------------	----

Business Restructurings	26
-------------------------	----

Financial Transactions	27
------------------------	----

Contact Us	28
-------------------	-----------

Brazil	28
--------	----

United States	29
---------------	----

United kingdom	30
----------------	----



Brief Background

Brief Background

The current Brazilian Transfer Pricing ("TP") rules were first enacted in 1996 with the primary goal of preserving the national tax base against harmful shifts of profits through the manipulation of prices in transactions between Brazilian and foreign related parties.

Although, the explanatory statement of the relevant legislation indicates that the rules were inspired by the international standards, in practice, the **Brazilian TP system was unique and presented distinctive features that departed from the Organization for Economic Cooperation and Development Transfer Pricing Guidelines ("OECD TPG") and the arm's length principle ("ALP")**.

In summary, the current Brazilian TP system grants freedom to taxpayers to elect the method to be applied (i.e., no **"best method approach"**), provided such election is restricted to one of the specific methodologies set forth by the current law (i.e., **no use of "other methods"**). Brazilian methods generally established **fixed pre-determined markups** that apply to all taxpayers in general (i.e., without regard to peculiarities of specific sectors and segments).

Other distinctive features of the Brazilian system include: (i) its personal, material and territorial scopes, (ii) strict "item-per-item approach", (iii) rejection of corresponding adjustments to avoid economic double taxation, (iv) lack of profit attribution rules to permanent establishment, (v) absence of advance pricing agreements; and (vi) very little experience with mutual agreement procedures in transfer pricing.

Historically, Brazil has reaffirmed its TP approach in the international context¹. In 2018 - 2019, however, Brazil drastically changed its position resulting in several developments and policy discussions around the design of new Brazilian TP rules that would align with international standards.

The following aspects influenced such **TP alignment process**:

Brazil and the OECD

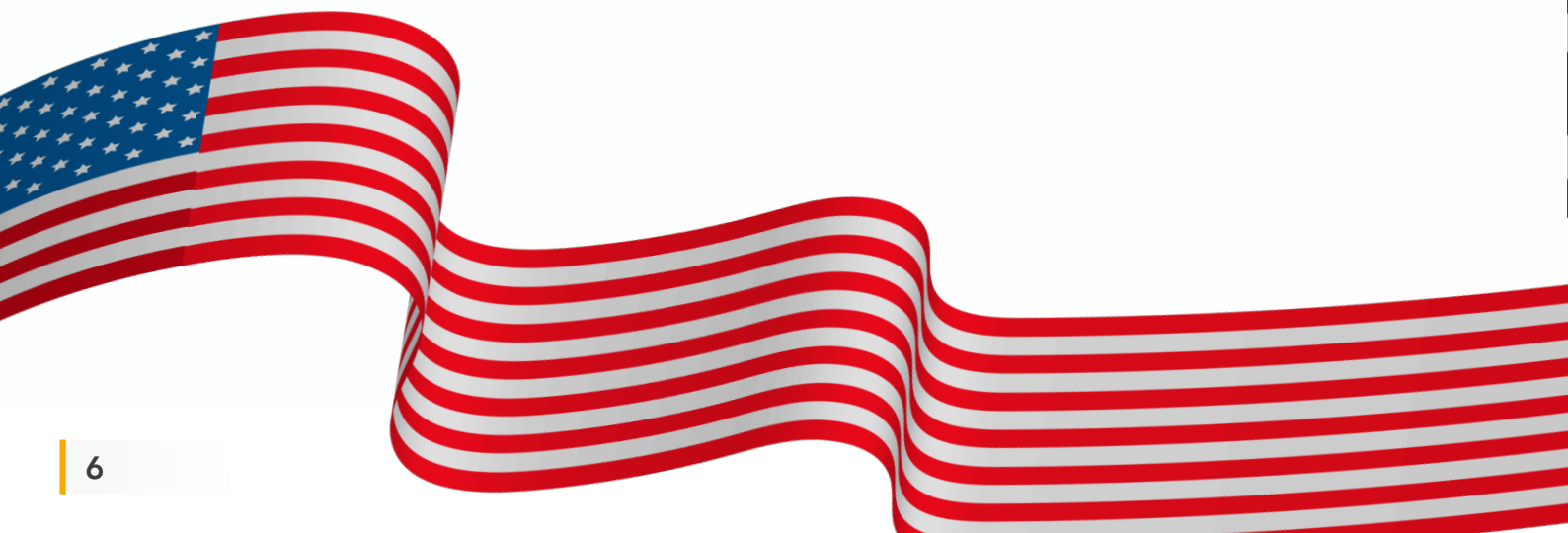
- In the context of Brazil potentially joining the OECD, the current **transfer pricing** rules were identified, among other issues, as **one of the key areas** where alignment with the OECD standards was necessary in order to align with a core aspect of the OECD's international tax policy.
- As a response, the Brazilian Federal Revenue Office ("RFB") and the OECD jointly launched a **TP Project** and released a joint report on December 18, 2019, identifying a large number of gaps and divergences between the Brazilian TP system and the international TP standards, and pointing out convergence options. Later, on April 12, 2022, RFB and OECD held a public joint meeting and presented the main features of the policy decision to achieve a full alignment with the OECD standards.



¹ For instance, although Brazil has endorsed the BEPS package, the explanatory statement of Actions 8-10 Final Report contains a note stating that the country would continue to apply its approach that "makes use of fixed margins derived from industry practices and considers this in line with the arm's length principle."

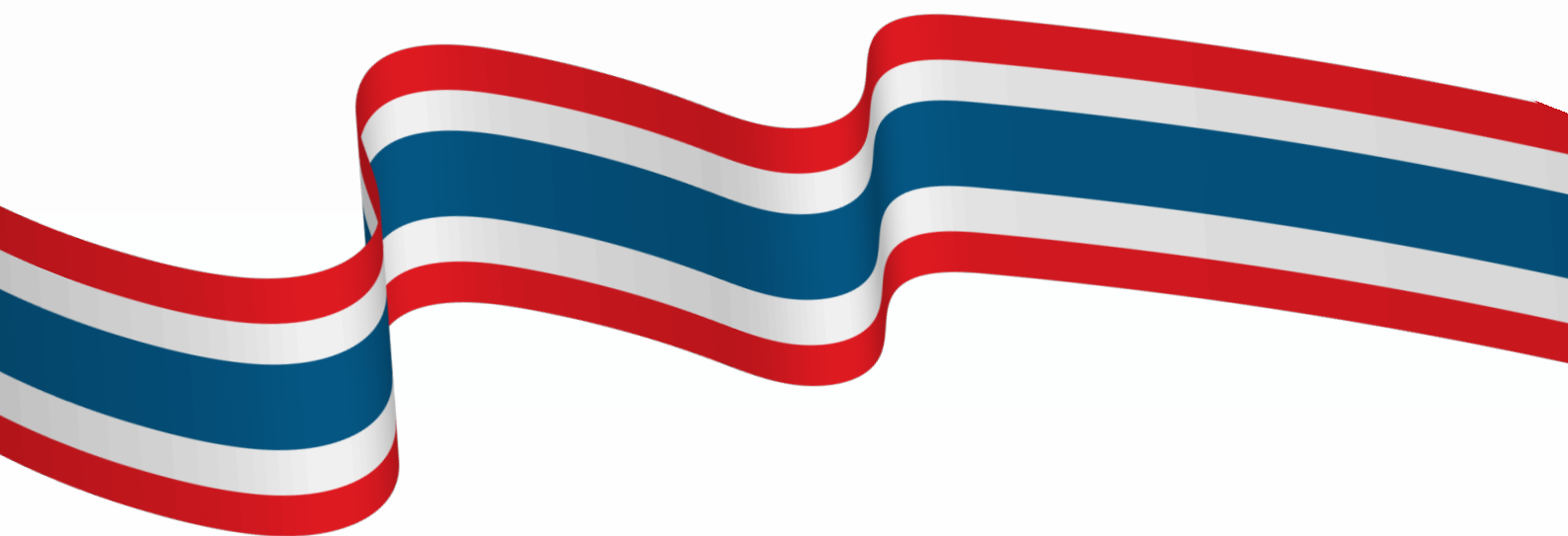
US Regulation on Foreign Tax Credits

- Another aspect that brought a sense of urgency to the TP discussions was the revamped **US foreign tax credit regulations** (TD 9959) (the “US FTC Final Regulations”), which provide that a foreign tax will be creditable in the US only if any allocation of income, gain, deduction or loss between a resident taxpayer and a related or controlled entity under the foreign country’s transfer pricing rules follows the arm’s length principles (the “attribution requirement”), among other requirements.
- In this context, the proposed changes in the Brazilian TP system have also become of great relevance for **companies that have counterparties / or are part of multinational enterprises (“MNE”) with US operations**. In fact, this was one of the aspects mentioned in the explanatory statement of PM 1,152/2022 to justify its relevance and urgency.
- The changes to the Brazilian TP rules may allow US taxpayers to support a position that the Brazilian Corporate Income Tax (“CIT”) meets the “attribution requirement” under the US FTC Final Regulations. However, we understand that the possibility of claiming foreign tax credits for Brazilian taxes in the United States must be evaluated on a case-by-case basis, as the US FTC Final Regulations include other requirements that need to be observed. **Mayer Brown’s Global Tax Teams, from the Brazilian and the US offices, are at your disposal to address any additional questions and provide assistance in relation to these rules.**



UK Participation

- Additionally, it is relevant to mention the **participation of the UK**, including with financial assistance, in the project developed by Brazil and OECD towards alignment of the Brazilian TP rules with the OECD standards.
- Although the UK is one of the main trading partners of Brazil, until very recently, both countries had not yet entered into a tax treaty because, among other reasons, Brazil was not aligned with the ALP standard.
- **On November 29, 2022, Brazil and the UK finally reached an agreement** and signed a tax treaty, which, contrary to the position taken by Brazil under most of its tax treaties, included paragraph 2 of Article 9, allowing for corresponding TP adjustments through Mutual Agreement Procedures ("MAP"). **Mayer Brown's Global Tax Teams, from the Brazilian and the UK offices, are at your disposal to address any additional questions and provide assistance in relation to the Brazil-UK treaty.**



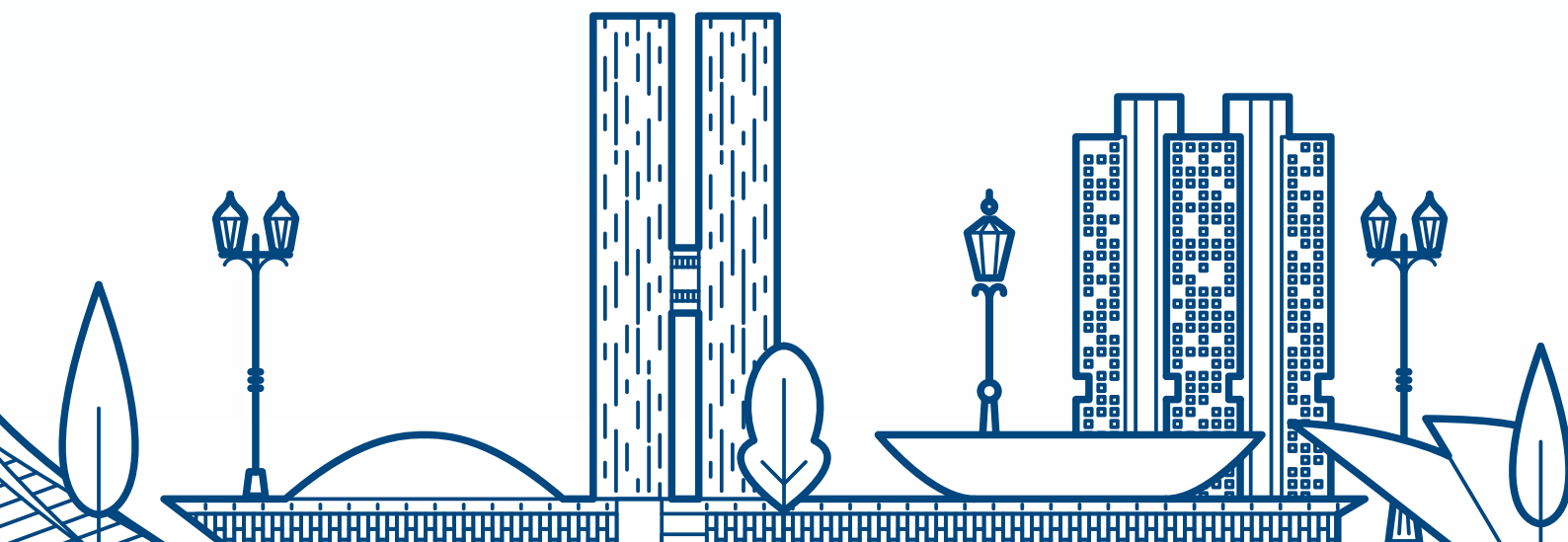
During 2022, the Brazilian Federal Government indicated on several occasions that it intended to change the Brazilian TP system. Finally, the long-awaited new TP rules were introduced on December 29, 2022, in **Provisional Measure ("PM") 1,152/2022**.

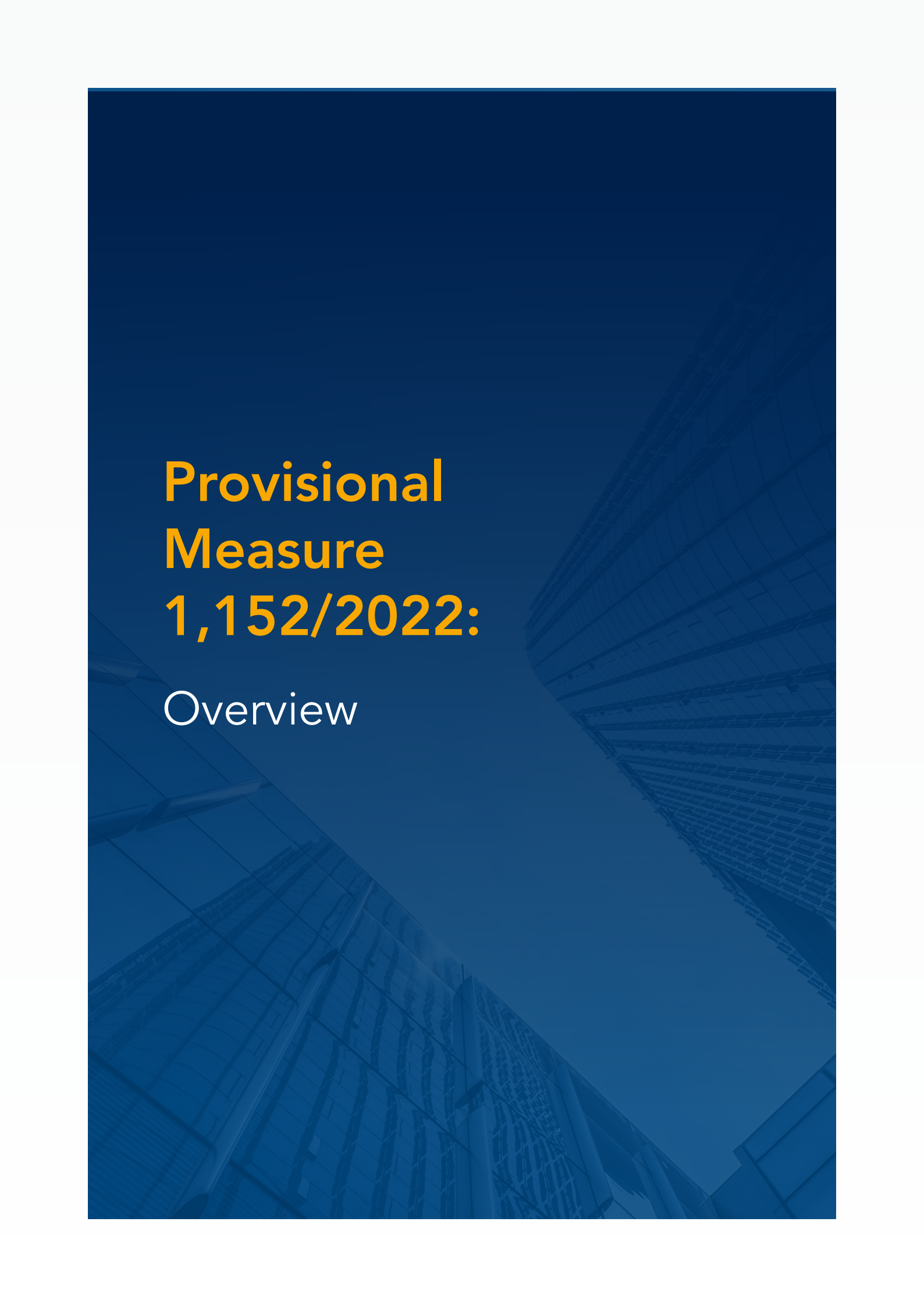
Please note that such rules are not yet fully enforceable. In this regard, PM 1,152/2022 adopted the following rules for its application:

- As a general rule, PM 1,152/2022 shall become effective as of January 1, 2024;
- However, taxpayers may elect to apply the new Brazilian TP rules as of January 1, 2023 by making an irrevocable election to transition early to the new system.

Notwithstanding the above, the application of PM 1,152/2022 **depends on its enactment by the Brazilian National Congress**, which may approve, amend or reject its text (partially or entirely). For its proper application, PM 1,152/2022 must be converted into law within a period of 60 days, from its publication date, (extendable for the same period -i.e., total of 120 days, suspended during Congress recess period), or it will no longer have any legal effects.

We summarize below the main aspects of the "New Brazilian TP Rules", as provided for in the PM 1,152/2022.





Provisional Measure 1,152/2022:

Overview

Provisional Measure 1,152/2022:

Overview

PM 1,152/2022 neither adopts an all-encompassing / extensive model, nor adopts summarized / condensed provisions. Instead, the intended approach is for the legislation to balance a **principle-based** framework with **detailed provisions to expand / reinforce the principles**.

Within this context, PM 1,152/2022 is divided into **6 chapters** which can be grouped into two **main parts**:

- **a general part:** applied to all transactions, establishing principle-based provisions; and,
- **a special part:** containing provisions that address certain specific transactions, such as those involving intangibles, intragroup services, cost-contribution, reorganizations and financial transactions.

Additionally, PM 1,152/2022 expressly delegates to **secondary legislation** (i.e., to RFB normative rulings) the determination of certain relevant issues, such as:

- Safe Harbors (in the context of simplification measures) and Advance Pricing Agreements;
- Additional guidance regarding specific transactions (e.g., intangibles, cost-contribution, business restructurings, etc.) and compensatory adjustments;
- Implementation of results obtained under DTC's Mutual Agreement Procedures.

A more detailed comparison between the "Current Brazilian TP Rules" and the "New Brazilian TP Rules", as provided for in the PM 1,152/2022, follows below:

Provisional Measure 1,152/2022:

General Features

GENERAL FEATURES

ALP PRINCIPLE

CURRENT BRAZILIAN TP RULES (LAW 9,430/96)	NEW BRAZILIAN TP RULES (PM 1,152/2022)
- No express definition.	- Definition expressly established by the new rules, requiring that the taxable income resulting from a controlled transaction is aligned with the terms and conditions that would be established in a transaction between independent parties.

CONTROLLED TRANSACTIONS

CURRENT BRAZILIAN TP RULES (LAW 9,430/96)	NEW BRAZILIAN TP RULES (PM 1,152/2022)
- Current legislation makes reference to loans, exportation and importation of goods and services. - Triggers doubts on the application of the TP rules in relation to several transactions (e.g., share transfer transactions, corporate reorgs). - Additionally, current legislation does not properly reflect functions developed and risks assumed by the parties.	- Controlled transactions are any commercial or financial relationship between related parties, carried out directly or indirectly, including contracts or arrangements in any form and series of transactions. - Besides this principle-based definition, Chapter III establishes special provisions to deal with certain specific transactions (e.g., business restructurings, financing, intragroup guarantees, centralized treasury management, etc.). - Moreover, the new rules significantly focus on the <u>accurate delineation</u> of the controlled transactions, relying not solely on the contractual terms of formal agreements. - The new rules require the analysis of economically significant characteristics of the transactions, including the effective commercial and financial relations in place, how the functions and risks are actually allocated, what are the goods, services and rights involved, etc. - IMPORTANT! Where the controlled transaction is not considered consistent with what would be transacted by unrelated parties in comparable circumstances, the new rules authorize <u>tax authorities to disregard or replace</u> it by an alternative transaction for the purposes of determining the ALP terms and conditions.

GENERAL FEATURES

RELATED PARTIES	
CURRENT BRAZILIAN TP RULES (LAW 9,430/96)	NEW BRAZILIAN TP RULES (PM 1,152/2022)
- Current legislation simply lists the cases where parties should be considered related for TP purposes. - However, from a practical perspective, some situations may not necessarily reflect an effective influence (e.g., exclusive distributors), while others may not be properly encompassed.	- Principle-based definition of related parties under which the parties are considered to be related when 'at least one of them is subject to influence, exercised directly or indirectly, by the other party that may lead to the establishment of terms and conditions that are different from the ones that would have been agreed between independent parties in comparable circumstances.' - The definition above is supplemented by a list of specific cases that encompasses: controlling and controlled entities; businesses unities (including the head office and its branches); entities included in the consolidated financial statements; common control; entities who have a same partner owning an interest of at least 20% of their capital; entities whose partners are members of a family owning at least 20% of their capital; the entity and the individual who is a spouse or a relative, up to the third level, of a board member, director or controlling partner of such entity.

COMPARABILITY ANALYSIS	
CURRENT BRAZILIAN TP RULES (LAW 9,430/96)	NEW BRAZILIAN TP RULES (PM 1,152/2022)
- Current legislation adopts restricted comparability analysis generally based on fixed pre-determined markups and distinguishes import and export transactions.	- Once the controlled transaction is properly delineated, it is then possible to compare its terms and conditions with the ones that would have been adopted by independent parties. - For that purpose, a transaction between unrelated parties will be considered comparable to the controlled transaction when (i) there are no differences that may materially affect the financial indicators examined by the most appropriate TP method; or (ii) adjustments can be made to eliminate the material effects of existing differences. - Within this context, a number of aspects must be taken into consideration, such as: the period in which the transactions occurred; availability of reliable information; the selection of the most appropriate method and the financial indicator; uncertainties in the pricing or valuation that may exist at the moment in which the controlled transaction was implemented and whether such uncertainties were addressed; evaluation of potential group synergies².

² In relation to such aspect, the new rules recognize that identifiable benefits deriving from group synergies - to the extent they result from deliberate actions - shall be allocated between the parties proportionally to their contribution to the creation of the relevant synergy effect, which shall be subject to proper compensation.

13

GENERAL FEATURES

TP METHODS	
CURRENT BRAZILIAN TP RULES (LAW 9,430/96)	NEW BRAZILIAN TP RULES (PM 1,152/2022)
- Brazilian current system grants freedom for taxpayers to elect the method to be applied (except for commodities transactions). - Such election is restricted to one of the specific methodologies set by the law (i.e., no use of "other methods"), which basically reflect, to a limited extent, the general structure of traditional transaction methods - but they deny the use of transactional profit methods and other methods. - Moreover, Brazilian methods generally establish fixed pre-determined markups applied to taxpayers in general (i.e., without regard to peculiarities of specific sectors and segments).	- New rules establish the "best method approach" by requiring the adoption of the most adequate mechanism for providing greater reliability in determining the terms and conditions that would be entered into between unrelated parties in a comparable transaction. - The new rules comprise: ▪ methods that reflect the international traditional transaction methods (PIC, PRL and MCL); ▪ methods that reflect the international transactional profit methods (MLT and MDL); ▪ the so called "six method" for commodities (see specific comments below); and ▪ also allow for the use of "other methods" in certain cases. - Please note that the new rules establish a <u>general preference for the application of PIC</u>, indicating that such method shall be considered the most adequate one where there is reliable information on prices of comparable transactions carried out by unrelated parties, <u>unless it can be established that another method is more appropriately applicable in order to observe the ALP principle</u>. - Moreover, new rules allow the adoption of alternative methodologies that are able to produce results consistent with the ALP. Where the taxpayer selects some "other method" to apply in a hypothesis that is different from the ones to be established by the RFB in relation to specific transactions, the taxpayer is required to evidence, through the required documentation, that the traditional / transactional methods are not applicable or reliable, and that the selected "other method" is the most appropriate one.

GENERAL FEATURES

TESTED PARTY

CURRENT BRAZILIAN TP RULES (LAW 9,430/96)	NEW BRAZILIAN TP RULES (PM 1,152/2022)
- No provision to precisely address the determination of the tested party. Nonetheless, depending on the method utilized in a specific case, the tested party is pre-established (e.g., when applying the PRL, the tested party is necessarily the Brazilian importer).	- Either the domestic or the foreign party of the controlled transaction may be the tested party for purposes of the TP analysis. - Where the TP analysis requires the selection of a tested party, the one in relation to which the method can be most appropriately applied and for which more reliable data is available must be elected.

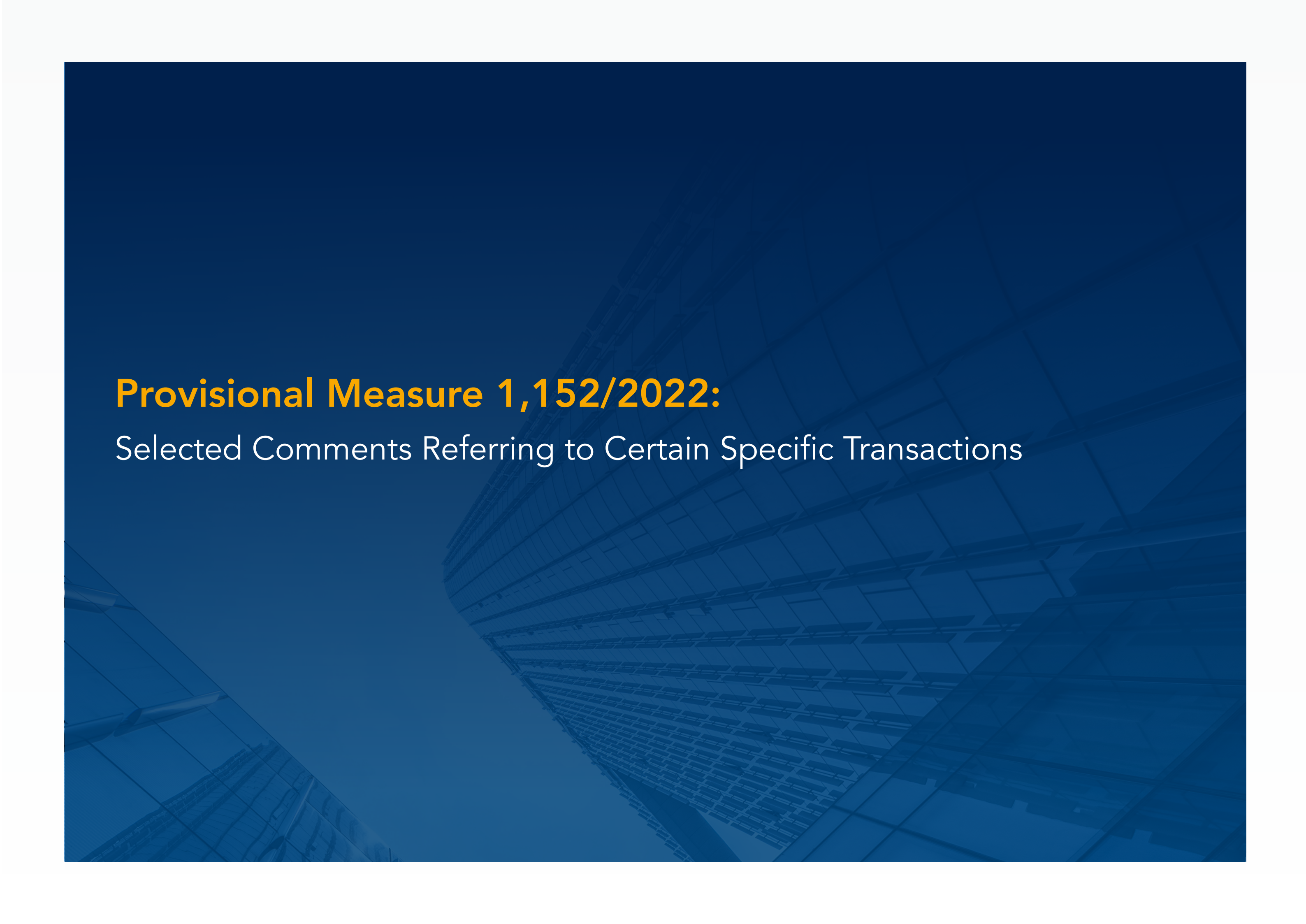
COMPARABILITY RANGE

CURRENT BRAZILIAN TP RULES (LAW 9,430/96)	NEW BRAZILIAN TP RULES (PM 1,152/2022)
- No provision to address the comparability range.	- New rules set some procedures to establish whether the financial indicator utilized in a controlled transaction falls within an "appropriate range" (which shall consider the financial indicators of uncontrolled transactions that present the best comparability degree with the controlled transaction).

GENERAL FEATURES

TP ADJUSTMENTS	
CURRENT BRAZILIAN TP RULES (LAW 9,430/96)	NEW BRAZILIAN TP RULES (PM 1,152/2022)
- Current legislation only contains a few provisions establishing adjustments to the Brazilian CIT taxable base aiming at imposing a deductibility limitation on import transactions or a minimum income recognition on export transactions.	- When the terms and conditions of a controlled transaction differ from those that would be established between independent parties in comparable transactions, three preliminary scenarios can be considered: ▪ <u>Spontaneous Adjustment</u>: the Brazilian taxpayer directly adjusts its CIT taxable base in order to add the income that it would have derived if the terms and conditions of the controlled transaction had been established in accordance with the ALP³; ▪ <u>Compensatory Adjustment</u>: until the year end, the parties to the controlled transaction adjust its value in such a way that the Brazilian taxpayer recognizes the additional income that it would have derived if the terms and conditions had been established in accordance with the ALP; ▪ <u>Primary Adjustment</u>: where no spontaneous or compensatory adjustments are implemented, the Brazilian tax authorities will determine the applicable addition to the taxpayer CIT taxable base. - In case a spontaneous adjustment (by the taxpayer) or a primary adjustment (by the tax authorities) is made to a controlled transaction, an additional adjustment is then imposed by the new rules – the ‘secondary adjustment’. ▪ <u>Secondary Adjustment</u>: intends to address the consequences of profit shifting in terms of financial flows between the parties by adopting a ‘deemed loan approach’. - ‘Deemed loan approach’: the adjusted amount is regarded as a loan bearing an annual 12% interest rate, due as of January 1st of the year subsequent to the one in which the spontaneous adjustment or the primary adjustment applies. - Exception: the above interest rate may be reduced to 0% in case the “deemed loan” amount is repatriated to the Brazilian party within 90 days counted from (i) January 1st of the year subsequent to the assessment period that caused the spontaneous adjustment; or (ii) the acknowledgment of the tax assessment imposing the primary adjustment.

³ In general, the new rules only allow for the spontaneous or the compensatory adjustments where they result in an increase to the Brazilian CIT taxable base (i.e., no downward adjustment is allowed). Exception is made to results obtained through MAP procedures and certain situations of compensatory adjustments that shall be established under RFB normative rulings.



Provisional Measure 1,152/2022:

Selected Comments Referring to Certain Specific Transactions

SELECTED COMMENTS REFERRING TO CERTAIN SPECIFIC TRANSACTIONS

COMMODITIES

CURRENT BRAZILIAN TP RULES (LAW 9,430/96)	NEW BRAZILIAN TP RULES (PM 1,152/2022)
- Current legislation adopts the so-called "Sixth Method", notably a non-OECD originated method, initially developed by LATAM countries, based on the use of commodity quoted prices. - Specific issues involving commodities transactions were later addressed under the BEPS project and the utilization of quoted prices was endorsed by the OECD TPG as a basis for applying the CUP. - Brazilian current rules comprise the following methods:	- New legislation does not establish a separate/ specific mandatory method for commodities transactions, adopting a slightly different approach. - PIC based on market quotations as default: New rules establish that PIC method shall be considered the "best method" where there is reliable information on comparable independent prices for commodities. This includes quotations and indexes from reputable exchanges, research agencies or governmental agencies from the date / period relevant for the transaction. - In this scenario, the value of the commodity will be determined <u>based on the date or period agreed by the parties to price the transaction</u> when: (i) the taxpayer present timely and reliable documentation, including information on transactions concluded by the related parties with final clients and non-related parties, and proceed with the proper registration, as well as (ii) such date or period is consistent with the actual conduct of the parties, as well with the facts and circumstances of the case. - If such requirements are not complied with, tax authorities may determine the value based on the quotation price referring (i) to the date or period that is consistent with the facts and circumstances of the case and what would be settled between non-related parties in comparable circumstances; or (ii) to the average quoted price on the date of shipment or registration of the import declaration, when it is not possible to apply the provision of item "i". - Moreover, where there are differences between the conditions of the controlled transaction and the ones of transactions with non-related parties or the ones that determine the quotation price and where such differences materially affect the price of the commodity, adjustments shall be made to ensure that the relevant economic characteristics of the transactions are comparable. - Carve-out provision: Exception is made to situations where it can be established, on the basis of the facts and the circumstances of the transaction, that another method is more appropriately applicable in order to observe the ALP principle. > This topic is subject to regulation by the RFB, including with regard to the election of reputable exchanges, research agencies, governmental agencies or other information sources.

- Imports: *PCI* (*Preço sob Cotação na Importação*)
- Exports: *PECEX* (*Preço sob Cotação na Exportação*)
- Such methods generally involve the analysis of the quotation price of the relevant commodity, adjusted by an average market premium, on the date of the transaction.
- Please note that, in general, the value of the commodity is determined on the date of the transaction.
- Different from other transactions, when dealing with commodities, Brazilian taxpayers are not free to elect the method to be applied, being necessarily required to adopt the aforementioned methods.

SELECTED COMMENTS REFERRING TO CERTAIN SPECIFIC TRANSACTIONS

INTANGIBLES

CURRENT BRAZILIAN TP RULES (LAW 9,430/96)

- Brazilian current tax system does not contain a comprehensive set of rules specifically dealing with transactions involving intangibles.
- In fact, due to historic reasons, Brazilian tax legislation is primarily focused on aspects relating to royalties (that may present some relevant intersections, but has a different scope than the broader challenges involved on the taxation of intangibles).
- Currently, outbound royalty payments are outside the scope of transfer pricing rules, being addressed within the helm of specific deductibility limitations.

NEW BRAZILIAN TP RULES (PM 1,152/2022)

- **Intangible Definition:** new rules establish a definition (which reflects the new TPG approach), under which intangibles qualifies as an asset:
 - that is not a physical or a financial asset;
 - which is capable of being owned or controlled for use in commercial activities;
 - whose use or transfer would be compensated had it occurred in a transaction between independent parties in similar circumstances;
 - regardless of being subject to registration, legal protection or accounting recognition.
- **DEMPE Functions:** new rules establish that the relevant functions performed in relation to an intangible encompass the activities relating to its Development, Enhancement, Maintenance, Protection and Exploitation.
- **Accurate Delineation of Transactions involving Intangibles:** besides observing the rules established under the general part, such analysis shall take into consideration particularly:
 - proper identification of the intangibles involved,
 - their legal and economic ownership;
 - determination of the parties that perform the functions, utilize the assets and assume the economically significant risks associated with DEMPE; - with emphasis in determining the parties that effectively exercise control and have financial capacity to support them; and
 - determination of the parties responsible for granting financing or providing other contributions in relation to the intangible, that assume economically significant risks⁴.
- **Allocation in Transactions involving Intangible:** attribution to be established in accordance with the contributions provided by each party and, in particular, based on the performance of DEMPE functions. Additionally:

- mere legal ownership is not sufficient to support any attribution; and
 - mere financing only supports the attribution of an interest-like compensation.
- **Hard to Value Intangibles:** new rules require that uncertainties in the pricing or valuation existing at the moment of the controlled transaction are taken into consideration by the related parties as independent parties would have done in comparable circumstances. Where such uncertainties are not properly taken into consideration, tax authorities may adjust the value of the transaction for CIT purposes.
 - **IMPORTANT!** Unless it is possible to determine an appropriate remuneration at the time of the transaction in the form of a single payment, the adjustments can be conducted by means of contingent annual payments. Additionally, information available in subsequent periods may be used by the tax authorities in order to support the existence of uncertainties at the time of the transaction (particularly sensitive in transactions involving intangibles at early stages).
 - Referred adjustment shall not be imposed: (i) if the taxpayer is able to provide detailed information on the projections used and demonstrate that any significant difference between them and the effective results arise from events that occurred after the determination of prices, which could not have been foreseen; or (ii) referred difference is not greater than 20%.

⁴ With emphasis in determining the parties that effectively exercise control and have financial capacity to support them.

SELECTED COMMENTS REFERRING TO CERTAIN SPECIFIC TRANSACTIONS

INTERACTIONS WITH ROYALTY DEDUCTIBILITY RULES	
CURRENT BRAZILIAN TP RULES (LAW 9,430/96)	NEW BRAZILIAN TP RULES (PM 1,152/2022)
- As indicated above, Brazilian current system contain specific non-deductibility provisions, intricate requirements and limitations caps provisions in regards to outbound royalty payments.	- New rules eliminate: the 5% royalty deductibility cap; the need to register the relevant contracts before the INPI for tax deductibility purposes; and the existing specific non-deductibility provisions. - However, new non-deductibility rules were introduced by PM 1,152/2022. Under such rules, a Brazilian taxpayer shall not deduct amounts paid, credited, delivered, employed or remitted as royalties and technical, scientific, administrative or similar assistance to: ▪ entities that are resident or domiciled in tax haven jurisdictions or beneficiaries of privileged tax regimes; ▪ related parties when the deduction of amounts results in double non-taxation in any of the following hypotheses: a. the same amount is treated as a deductible expense for another related party; b. the amount deducted in Brazil is not treated as taxable income for the foreign beneficiary; or c. the amounts are intended to finance, directly or indirectly, deductible expenses of related parties, which entail the hypotheses referred to in items "a" or "b", above.

SELECTED COMMENTS REFERRING TO CERTAIN SPECIFIC TRANSACTIONS

INTRAGROUP SERVICES	
CURRENT BRAZILIAN TP RULES (LAW 9,430/96)	NEW BRAZILIAN TP RULES (PM 1,152/2022)
- Brazilian current rules are much more focused in addressing transfer pricing on import and export of goods, rather than on immaterial items (such as intangibles and services). - Within this context, there is no specific guidance for the treatment of intragroup services and several methods become practically inapplicable. Usually, either CPL or CAP methods are utilized, and the 20% / 15% mark-ups applies regardless of whether the transaction involves a routine or a high-value service. - Additionally, current rules do not contain a 'benefits test' and the relevant analyses are typically based on legal elements (e.g., agreements, accounting and tax record).	- Service Definition: service is considered to be an activity performed by a party, including the use or the making available of tangibles, intangibles or other resources, that <u>result in benefits</u> to one or more party. - Benefit Test: reflecting the TPG approach, the activity performed will result in benefits when it provides a respective group member with <u>economic or commercial value to enhance or maintain its business position</u>. This can be determined by considering whether an independent enterprise in comparable circumstances would have been willing to pay for the activity if performed for it by an independent enterprise or would have performed the activity in-house for itself. - For illustrative purposes, the following activities are considered not to result in benefits: ▪ duplicated activities in general; ▪ shareholders activities (which would include the ones associated with: the corporate structure of the group, such as participation in shareholders or council meetings, issuing of shares, listing in stock exchange; preparation of financial reports, consolidated statements, auditing reports; raising of funds for the acquisition, by the shareholder, of interest; tax compliance obligations of the shareholder). - Activities that derive incidental benefits do not qualify as "services" and do not entail compensation⁵. - Specific provisions for the application of the MCL or the MTL based on the service cost: new rules generally favor the application of the direct-charge method over the indirect-charge method. The latter may be applicable in certain circumstances - notably, where services are rendered to several parties, and it is not possible to reasonably individualize the costs in relation to each one of them. - The new rules recognize that no mark-up shall apply where one party merely passes along amounts referring to activities or acquisitions performed by others (related or non-related), in relation to which such party does not develop any significant function.

⁵ As anticipated above, Art. 10 of PM 1.152/2022 recognizes that benefits arising from group synergies shall be compensated, to the extent they result from deliberate actions (i.e., not incidentally).

SELECTED COMMENTS REFERRING TO CERTAIN SPECIFIC TRANSACTIONS

COST CONTRIBUTION AGREEMENTS	
CURRENT BRAZILIAN TP RULES (LAW 9,430/96)	NEW BRAZILIAN TP RULES (PM 1,152/2022)
- Brazilian current tax system does not contain a comprehensive set of rules specifically dealing with cost contribution agreements (CCAs). - Hence, there is much debate around several aspects of such arrangements. - There are administrative precedents on this matter, but they provide limited guidance and lack consistency. - The most relevant of such precedents is Private Ruling COSIT 08/2012, in which the tax administration made particular reference to the 2009 TPG and indicated a definition for a CCA. Such definition, however, is not in line with the current guidelines.	- CCA Definition: arrangements under which two or more related parties agree to share the contributions and risks relating to the joint acquisition, production or development of services, intangibles or tangible assets, based on the proportion of the benefits that each party expects to obtain. - CCA's Participants: parties that effectively exercise control over the economically significant risks, having the financial capacity to assume them, and who have a reasonable expectation of obtaining the benefits. - Observation: according to the TPG, a CCA does not necessarily require participants to combine their operations in order, for example, to exploit any resulting intangibles jointly or to share the revenues or profits. Rather, CCA participants may exploit their interest in the outcomes of a CCA through their individual businesses. The TP issues focus on the commercial or financial relations between the participants and the contributions made by the participants that create the opportunities to achieve those outcomes. - CCA's Contributions: comprise any kind of contribution provided by the participant that has value – including, for instance, the provision of services; performance of activities relating to the development of intangibles or tangible assets; and making existing intangibles or tangible assets available. - Allocation Provisions: following the ALP, the contribution of each participant shall be proportional to their shares in the total expected benefit, being assessed based on estimates of revenue increase, cost reduction, or any other benefit expected to be obtained from the arrangement. - Where a participant's contribution is not proportional to its share of the total expected benefit, adequate compensation shall be made between the parties, in order to restore their balance.

- Administrative precedents on cross-border transactions generally involve “services CCAs” in the context back-office activities (rather than development CCAs), in which competent authorities tend to impose the recognition of a taxable compensation, based on the existing fixed mark-ups, and deny the possibility of non-taxable reimbursements.

SELECTED COMMENTS REFERRING TO CERTAIN SPECIFIC TRANSACTIONS

BUSINESS RESTRUCTURINGS	
CURRENT BRAZILIAN TP RULES (LAW 9,430/96)	NEW BRAZILIAN TP RULES (PM 1,152/2022)
- Brazilian current tax system does not contain specific rules or guidance on the application of TP rules to business restructurings. - In principle, TP rules could eventually apply if a certain transaction comprising a restructuring falls within their scope (e.g., if it entails an import or export of a good, service or right). However, even in this situation, the particular transaction would be analyzed separately as such, and not as a part of a business restructuring based on the overall functions, risks and assets at play⁶.	- According to the new rules, any modification in commercial or financial relationships between related parties that results in the transfer of potential profits, benefits or losses. - In summary, the issue to be analyzed is whether there is a transfer of something of value (e.g., asset / ongoing concern) including a termination or substantial renegotiation of existing arrangements that would have been compensated between independent parties in comparable circumstances.

⁶ As it has been already recognized by the RFB: “the Brazilian transfer pricing rules are inefficient in terms of apprehending transactions comprising a business restructuring. The current methodology in the Brazilian transfer pricing legislation does not take into consideration this kind of operation since potential changes of the functional profile of the company do not affect the transfer pricing analysis in Brazil, i.e. the profit margins will not change if the risk or functional profile of the company is modified. Further, the transfer of valuable assets (especially intangibles) is unlikely to be subject to application of transfer pricing rules unless there is a clear formalization of such transactions. However, even in such cases, the existing rules are unlikely to appropriately remunerate the resident entity, which has transferred its profit potential through the transfer of functions, assets and risks.”

SELECTED COMMENTS REFERRING TO CERTAIN SPECIFIC TRANSACTIONS

FINANCIAL TRANSACTIONS	
CURRENT BRAZILIAN TP RULES (LAW 9,430/96)	NEW BRAZILIAN TP RULES (PM 1,152/2022)
Brazilian current tax system contains some specific prescriptive TP rules applicable to some financial transactions – notably, to determine interest rates for loans between related parties. It is important to note that such prescriptive rules apply irrespective of the characteristics of the transaction (e.g., the term, the amounts involved, the creditworthiness of the debtor). Additionally, the existing rules do not provide for any exception that could allow taxpayers to apply a different interest rate.	- Debt Transactions Qualification: transactions involving the provision of financial resources between related parties must be tested for its qualification as a debt transaction based on the relevant economic characteristics, the perspective of the parties and the options realistically available. - The provisions brought by the PM 1,152/2022 do not contain much guidance on which elements shall be considered in that regard - they simply mention that the credit risk of the debtor is one of the relevant economic characteristics⁷. - Please note that not all transactions involving the provision of financial resources will be qualified as debt transactions, being relevant to differentiate such qualification from the so-called equity transactions, as the new rules expressly determine that interest and expenses relating to equity transactions are non-deductible for purposes of the Brazilian corporate income tax base. - Debt Transaction Compensation: In a controlled debt transaction: ▪ Where the creditor does not have financial capacity or does not exercise control over the economically relevant risks: compensation may not exceed an amount determined based on a risk-free rate of return; ▪ Where the creditor has financial capacity and exercise control over the economically relevant risks: compensation may not exceed an amount determined based on a risk-adjusted rate of return⁸; and ▪ Where the creditor exercises mere intermediation, in such a way that the resources of the debt transaction are effectively provided by another party: compensation shall be determined based on the ALP, considering the functions performed, the risks assumed and the assets used.

⁷ As a reference, the TPG provide for some useful indicators such as: the presence or absence of a fixed repayment date; the obligation to pay interest; the right to enforce payment of principal and interest; the status of the funder in comparison to regular corporate creditors; the existence of financial covenants and security; the source of interest payments; the ability of the recipient of the funds to obtain loans from unrelated lending institutions; the extent to which the advance is used to acquire capital assets; and the failure of the purported debtor to repay on the due date or to seek a postponement. Additionally, the TPG explains that, when considering the options realistically available, the perspective of each of the parties to the transaction must be considered. For instance, in the case of an entity that advances funds, other investment opportunities may be contemplated, taking account of the specific business objectives of the lender and the context in which the transaction takes place. From the borrower's perspective, the options realistically available will include broader considerations than the entity's ability to service its debt, for example, the funds it actually needs to meet its operational requirements. In some instances, although an entity may have the capacity to borrow and service an additional amount of debt, it may choose not to do so to avoid placing negative pressure on its credit rating and increasing its cost of capital, and jeopardizing its access to capital markets and its market reputation.

⁸ A Risk-free rate of return represents the return that would be expected from an investment with a lower risk of loss, in particular the investments in public securities, issued by governments in the same functional currency of the creditor of the transaction and that present the lowest rates. A risk-adjusted rate of return: determined from the risk-free rate of return, adjusted by a premium that reflects the risk assumed by the creditor.



**GUIDO
VINCI**

Partner

gvinci@mayerbrown.com

T +55 21 2127 4230



**FLÁVIA
CAVALCANTI**

Partner

fcavalcanti@mayerbrown.com

T +55 21 2127 4246



**KAROLINA
ROSEN**

Associate

krosen@mayerbrown.com

T +55 21 2127 4282



**MICHAEL
LEBOVITZ**

Partner

mlebovitz@mayerbrown.com

T +1 213 229 5149



**LUCAS
GIARDELLI**

Partner

lgiardelli@mayerbrown.com

T +1 212 506 2238



**JASON
OSBORN**

Partner

josborn@mayerbrown.com

T +1 202 263 3386



**ELENA
KHRIPOUNOVA**

Director of Transfer Pricing and Valuation

ekhripounova@mayerbrown.com

T+1 202 263 3085



**JUAN F.
LOPEZ VALEK**

Associate

jlopezvalek@mayerbrown.com

T +1 212 506 2471

CONTACT US | UNITED KINGDOM



**JAMES
HILL**

Partner

james.hill@mayerbrown.com

T +44 20 3130 3227



**MATTHEW
MORTIMER**

Partner

mmortimer@mayerbrown.com

T +44 20 3130 3384



**KITTY
SWANSON**

Partner

kswanson@mayerbrown.com

T +44 20 3130 3431

Brasília

SCS Quadra 9, Bloco A, Torre B,
Ed. Parque Cidade Corporate,
Salas 503/504
Brasília - DF
70308-200

T + 55 61 3221 4310
F + 55 61 3221 4311



Rio de Janeiro

Av. Oscar Niemeyer, 2.000
Aqwa Corporate, 15º andar
Rio de Janeiro - RJ
20220-297

T +55 21 2127 4210
F + 55 21 2127 4211



São Paulo

Av. Presidente Juscelino
Kubitschek, 1.455
6º andar
São Paulo - SP
04543-011

T +55 11 2504 4210
F +55 11 2504 4211



Vitória

Av. Nossa Senhora dos
Navegantes, 451
17º andar, Conj 1703
Vitória - ES
29050-335

T +55 27 2123 0777
F + 55 27 2123 0780



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