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Guidance issued on spread for transfer pricing purposes

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The Brazilian Ministry of Finance (MF) issued a ruling on 2 August 2013 (Ruling 427/2013) that defines and clarifies the “spreads” that should be taken into account for transfer pricing purposes. The spreads apply to interest charged in the context of related party financial transactions.

New transfer pricing rules specifically addressing interest paid on related party financial transactions were published in December 2012 (Law 12,766/2012) and the MF was charged with issuing guidance on the applicable spreads. Before the rules came into effect on 1 January 2013, interest paid on related party financial transactions were outside the scope of the Brazilian transfer pricing rules if the relevant transaction was registered with the Brazilian central bank.

Law 12,766/2012 established the interest rates that should be applied as a “stand-in” to determine the reasonableness of interest expense or income associated with related party financial transactions, and provided that such rates should be applied in conjunction with a spread component to be determined by the MF. Since no guidance was issued until 2 August, taxpayers and tax practitioners have been uncertain as to how to correctly apply the new transfer pricing rules on related party financial transactions. For example, it was unclear whether there would be different spreads for each type of transaction or just one fixed margin, and when and how often the spread(s) would be published.

The basic rule under Law 12,766/2012 is that the interest “limitation” on financial transactions (a maximum for inflows and a minimum for outflows) is a combination of a “rate” plus a “spread.” Different rates apply, depending on the type of transaction, currency used and other factors. The rates are defined as follows:

Currency	Market	Type	Rate limit
USD	Foreign	Fixed rate, predetermined	Market rate of sovereign bonds of Brazil issued in USD in foreign markets
Real	Foreign	Fixed rate, predetermined	Market rate of sovereign bonds of Brazil issued in Reais in foreign

			markets
Any (a)	Any (a)	Any (a)	
Real	Foreign	Variable	May be determined by the Ministry of Finance
(a) The Libor limit considers the adoption of any currency, market and type resulting in different combinations other than those specified for other rate limits. (b) If there is no specific Libor for the currency adopted, the six-month Libor in USD should be used.			

The spread component that must be taken into consideration when applying the above rates has now been determined by the MF. The spread varies depending on the nature of the financial transaction under analysis (i.e. inbound or outbound). For inbound financial transactions, where the Brazilian taxpayer is paying interest to a foreign related party, the annual spread is limited to maximum rate of 3.5%. For outbound financial transactions, where the Brazilian taxpayer is receiving interest from a foreign related party, the annual spread is limited to a minimum rate of 2.5%. The basis on which these rates were assigned by the MF is unclear.

The MOF acknowledges the lack of guidance during the first seven months of 2013, and Ruling 427/2013 establishes that the spread applicable to intercompany outbound financial transactions for the period from 1 January 2013 through 2 August 2013 is 0%. In other words, the 2.5% spread on outbound financial transactions applies for the period from 3 August 2013 to 31 December 2013.

Because transfer pricing in Brazil is assessed on a calendar year basis, the application of a 0% spread for the first seven months of the year should benefit taxpayers entering into intercompany outbound financial transactions (to extent it lowers the minimum interest revenue requirement in Brazil).

Conclusion

Ruling 427/2013 addresses most of the outstanding questions taxpayers and tax practitioners have had about the application of the transfer pricing rules to financial transactions. The ruling fails, however, to address outstanding issues regarding the application of the limit rates in the table in relation to the size, term and other significant economic fact patterns of transactions. Taxpayers should consider the appropriate interest limit at the time a contract is concluded and ensure that the relevant spreads are observed for each calendar year under analysis.