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Global Transfer Pricing

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## Brazil Issues New Transfer Pricing Regulations

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Following the enactment of Brazil's new transfer pricing rules in September 2012, the Brazilian revenue services, on December 31, 2012, published Normative Ruling 1,312. The purpose of NR 1,312 is to provide instructions to tax inspectors and taxpayers on how to apply the country's new transfer pricing rules set forth by Law 12,715. Although NR 1,312 is generally consistent with Law 12,715, it provides significant details associated with the application of Brazilian transfer pricing rules. Although Law 12,715 applies to fiscal years starting on or after January 1, 2013 (taxpayers may opt to apply the new rules from fiscal year 2012), some of the provisions of NR 1,312 are effective for fiscal year 2012.

The Brazilian government also enacted Law 12,766 on December 28, 2012. Law 12,766 provides new transfer pricing rules for financial transactions. The new rules on financial transactions are not regulated by NR 1,312. We expect the Brazilian revenue service to issue an additional ruling addressing the new transfer pricing rules on financial transactions soon.

### The key points of NR 1,312 include the following:

**Changes to the safe harbor rules on outbound transactions:** Since the enactment of the Brazilian transfer pricing rules in 1996, the Brazilian revenue services have provided some flexibility to taxpayers that enter into eligible outbound intercompany transactions (outbound transactions carried out with parties located in jurisdictions Brazil does not consider tax havens or favorable tax jurisdictions) through safe harbor rules on outbound transactions. Safe harbor rules consist of two independent thresholds allowing taxpayers not to apply a transfer pricing method to analyze the reasonableness of their outbound transactions' pricing. The thresholds are based on profitability and/or representativeness of the relevant intercompany outbound transactions. The table below compares the old safe harbor rules (applicable to all fiscal years before 2012) and the new rules (in principle applicable to any fiscal year starting on or after January 1, 2012). Please note that under NR 1,312 commodity product transactions are not eligible to benefit from the safe harbor criteria.

Thresholds	Applicability	
	All fiscal years before 2012	In principle applicable to fiscal years starting on or after January 1, 2012
<b>Revenue representativeness safe harbor</b>	Transactions are not subject to the Brazilian transfer pricing rules if the net revenue for intercompany outbound transactions is below 5% of the total net revenue for the year under analysis.	Same as before.
<b>Profitability safe harbor</b>	Taxpayers earning pretax margins in intercompany outbound transactions equal or above 5% are not subject to the Brazilian transfer pricing rules, based on the financial data for the three most recent years (current year, plus two preceding years). Exceptions were available for some years allowing the calculation on a single-year basis.	The pretax margin threshold was increased from 5% to 10%. The 10% margin should be determined based on the financial data for the three most recent years (current year plus two preceding years). Additionally, the profitability safe harbor will not apply to taxpayers entering into outbound intercompany transactions whose net revenue from related parties represents more than 20% of the total outbound transaction net revenue.

As shown above, NR 1,312 changes the profitability safe harbor rules significantly, affecting taxpayer's ability to pass muster under the threshold. Theoretically, because safe harbor rules are considered a "privilege," these can be changed by the Brazilian revenue services without further notice. Changing the rules in the last business day of the year and requiring their application for fiscal year 2012 will most likely trigger legal considerations, as this change may result in an immediate increase in the tax burden.

We expect this to become a major topic for discussion within the next months.

Taxpayers that fail to meet one of the existing safe harbor rules are subject to the Brazilian transfer pricing rules on outbound transactions. In other words, taxpayers will need to apply one of the available transfer pricing methods to analyze and assess the reasonableness of their intercompany prices. Given the limitations of the Brazilian transfer pricing rules, most taxpayers would be subjected to the cost plus 15 percent margin (CAP) method on outbound transactions.

**Application of the new transfer pricing methods for commodity transactions:** Law 12,715 introduced two additional transfer pricing methods to the existing Brazilian methods: the commodity exchange import price and the commodity exchange export price for inbound and outbound transactions with commodities, respectively. Under these methods, the basis for comparison is the average commodity exchange price for the relevant items, adjusted for upward or downward spreads. For commodity products not negotiated in commodity exchanges, Law 12,715 also allowed the use of prices obtained

from reputable market institutions.

NR 1,312 provides a nonexhaustive list containing 21 classes of products that the Brazilian tax authorities consider commodity products. These include cotton, meat, soy, orange juice, petroleum, gold, iron, steel. NR 1,312 goes further, indicating that any products negotiated in specific mercantile exchanges (listed in the annex to the ruling) will be deemed commodity products. Finally, the NR lists institutions the Brazilian tax authorities consider reputable and that can be used as source for obtaining commodity products' prices.

**Application of transfer pricing rules to back-to-back transactions:** Less risk-adverse taxpayers and tax practitioners have historically argued the Brazilian transfer pricing rules did not apply to intercompany back-to-back transactions to the extent products did not enter or leave the country, therefore not configuring import and export transactions, regardless the fact that title changed hands in back-to-back transactions. In November 2012, addressing a taxpayer's question on the application of the Brazilian transfer pricing rules to back-to-back transactions, the Brazilian revenue services indicated those should apply. Consistent with the Brazilian tax authorities' position, NR 1,312 specifically indicates that back-to-back transactions are subject to the local transfer pricing rules.

**Margin of difference:** As general rule, the Brazilian transfer pricing legislation calls for the comparison of two prices: the practiced price (generally the actual transaction price) and the parameter price (the price derived from the application of one of the available transfer pricing methods). Whenever the parameter price is lower than the practiced price in an outbound transaction, or if the parameter price is higher than the practiced price in an inbound transaction, the difference represents an adjustment to the Brazilian tax basis. The Brazilian transfer pricing rules have historically provided that whenever the difference between both prices is equal or less than five percent, no adjustment is necessary. NR 1,312 retains the five percent threshold, and applies it to all available transfer pricing methods except those for commodity transactions. Under NR 1,312 the margin of difference criteria applies for commodity transactions, but the difference between practiced and parameter prices is limited to 3 percent.

## Conclusion

NR 1,312 contains 60 articles and three annexes. It is a long and detailed document designed to address the major topics associated with an application of the Brazilian transfer pricing rules. The ruling is generally consistent with the recently amended Brazilian transfer pricing rules, with the exception that it does not address the newest transfer pricing rules on financial transactions. The language in the ruling is unclear at times, which will create some confusion for taxpayers and the tax authorities that will ultimately enforce the rules. An unexpected change brought by the ruling is the increase in the threshold for meeting the profitability safe harbor criteria, and the inclusion of an additional condition for qualifying under the profitability safe harbor criteria. We expect this to become a controversial issue among taxpayers and the tax authorities.

[Back to top](#)