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Brazilian TP: Missed Opportunities Ahead

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Since the news of the Brazilian request to accede to the OECD broke out, much has been speculated about the future of the Brazilian TP approach. Brazil is historically one of the major economies to deviate from the OECD Guidelines – and its approach has been severely criticized for that. Thus, it is no surprise that the release of a joint statement developed by the OECD and the Brazilian Tax Authorities (RFB) about the future of the Brazilian TP legislation was received with much anticipation by academic and business circles alike.

None of the stakeholders deny that the current Brazilian TP approach requires much improvement. However, the joint statement and its delivery event of July 11, 2019, went far beyond the expected. Instead of proposing an approximation to the Guidelines where the Brazilian approach requires improvement, the OECD required a full alignment, largely ignoring the positive features developed in Brazil over the years.

In the face of these problems, a group of academics, myself included, produced a public position about the joint statement. Our main objective was to highlight that a broad overhaul of the Brazilian TP approach would represent a missed opportunity of taking advantage of its positive features as building blocks of a more suitable system – to the benefit of Brazil and also other countries.

Below is the text of our public position:

Brazil and OECD: building a future of certainty and equality

Public statement regarding the OECD-Brazil transfer pricing project

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The Brazilian Government officially confirmed its intention to join the Organization for Economic Cooperation and Development (OECD) and created the Council for the preparation and assistance to the accession process by way of the Decree No. 9,920, of July 18, 2019. This is certainly a fundamental step for our country and, in tax matters, it may contribute to enhance the Brazilian legislation at this time of reforms.

Within the accession agenda, among other important issues, it is worth highlighting the debate over "transfer pricing" (TP), a tax-technical rule which seeks to control prices practiced by multinationals in related parties' import or export transactions. Such control aims to protect the tax base of countries whilst seeking to prevent distortions that would amount to unfair competitive advantages as compared to the prices practiced between unrelated parties (*arm's length* principle or ALP). Brazilian methods historically differed from OECD recommendations, hence the need to reconcile such norms. In this regard, we are convinced that a coordinated convergence should be sought, extending to the taxpayer the right to choose between Brazilian or OECD methods, all under the ALP, as a means of ensuring equality and legal certainty in tax relations between companies.

In February 2018, months after Brazil's request to accede to the OECD, the organization's TP team publicly announced it had joined forces with the Brazilian tax administration (RFB) to assess the Brazilian TP approach and identify areas where further alignment is needed. The joint statement of July 11, 2019, gives a flavor of the outcomes of the project.

On July 11, 2019, during an event hosted by the *Confederação Nacional da Indústria*, a joint statement about the outcomes of this project was publicly released.

The news of such joint initiative were no doubt welcomed in the legal and business communities, as the Brazilian TP legislation contains many features that hamper neutrality and, thus, prevent an adequate flow of foreign direct investment into the country.

Broad economic evidence confirms that Brazil remains largely outside of major global value chains, while anecdotal evidence and firm-specific cases seemingly captured in the TP Survey conducted by the OECD correlates this issue with inconsistent TP standards.

We believe the TP Survey conducted by the OECD failed to capture the situation of numerous taxpayers who are in compliance with the current rules and in fact patterns that do not lead to double taxation or to non-taxation.

In fact, introducing the OECD Transfer Pricing Guidelines (OECD Guidelines) into the Brazilian system, whilst keeping the current fixed-margins approach (with necessary enhancements), has

been the proposal that we have defended or endorsed at the launch of the OECD-RFB TP Project in 2018. Through this approach, the current Brazilian rules would be enhanced and effectively converted into OECD-compliant "safe harbor" system.

We felt that the joint statement did not do justice to the many positive features of the Brazilian TP approach. **Much to our surprise, the document does not simply indicate areas for further alignment, but proposes a broad overhaul of the Brazilian TP legislation.** For this reason, we felt it would be valuable to voice the aspects with which we disagree.

First, inasmuch as the OECD Guidelines can indeed be fairly characterized as part of the "internationally accepted transfer pricing standard", it is by no means the only source of application of the arm's length principle. For instance, valuable work has been developed under the umbrella of the United Nations, and many countries do deviate from the OECD TP Guidelines whilst adhering to the ALP – even OECD Members, which can never be legally bound by an OECD Recommendation. In our opinion, the foremost internationally accepted transfer pricing standard is the ALP, and the OECD Guidelines are one (but not the only) useful tool to implement this standard.

Here we come to our second major disagreement with the joint statement. The document implies that the current Brazilian approach is irreconcilable with the arm's length standard, with which we strongly disagree. The fact that the Brazilian approach relies on fixed margins does not by itself allow the conclusion that the arm's length standard is disrespected. As a matter of principle, we believe that fixed margins can indeed be compatible with the standard, so long the margins fall within an arm's length range, i.e. are better calibrated *vis-à-vis* the respective sector and these margins operate merely as a rebuttable presumption. Admittedly, both these aspects require much improvement in the current state of Brazilian regulations – but that by no means withdraws the significance of the fixed margins approach.

Indeed, the use of rebuttable presumptions or optional safe harbors adds invaluable certainty to the system, while preventing double taxation by allowing the taxpayer to show evidence that its particular situation is different if the fixed margins do not fit taxpayer-specific facts and circumstances.

Based on the debate at *Confederação Nacional da Indústria* on July 11 we understand that the OECD tends to reject this approach because it could lead to double non-taxation. However, we believe that the risk that an enhanced Brazilian system with fixed margins would pose is disproportionally small to the benefit of certainty it would bring along.

Additionally, the joint statement rejects the current Brazilian approach of allowing the taxpayer to select its method of preference. The wisdom of providing this freedom to the taxpayer resides in the acknowledgement that there is no single arm's length price, it is rather a range of prices. Thus, different methods reaching different results can still comply with the arm's length. Moreover, the method deemed to be the most appropriate to a certain situation can also be the most burdensome, which would justify allowing a choice to the taxpayer.

All these elements underscore that the Brazilian approach, developed over years, should not be simply tossed away. Ignoring its many virtues and **moving to a full adoption of the OECD approach would represent at best a missed opportunity to reach a compromise that meets our country's needs and that can be useful to the whole world.**

What is at stake is not simply the interests of certain business groups that do endorse the adoption of the OECD Guidelines, in its complete and original form. Rather, the effort is to ensure that this adoption builds on and respects the legislation that dared to create an alternative to the OECD methods and which is often praised for its relatively simplicity and for ensuring legal certainty. The challenge is to learn from Brazil's experience and benefit from a joint initiative with the OECD, and to co-design a system of acceptable safe harbors.

This is not to say that we reject the Brazilian approximation to the OECD Guidelines. There are numerous areas in which our approach is in need of improvement, which could be reached by the joint effort between the RFB and the OECD. For instance, the Brazilian TP legislation regarding intangibles is insufficient and unable to give adequate answers to the challenges of the modern economy. Further work in this area, keeping in mind the arm's length standard, would be invaluable.

We also believe it would be positive to incorporate new methods and to improve our current ones – so long they are all kept as options to the taxpayer. In particular, the Brazilian legislation and administrative practice still have a long way to go in recognizing and fully implementing comparability adjustments in the transactional methods (i.e. PIC, PVEX, PCI and PECEX). Albeit existent, as of now these adjustments are far too narrow and complex. Also in this area, the OECD's contribution would be invaluable.

Altogether, we firmly believe that **the Brazilian approach is not necessarily incompatible with the arm's length principle** (despite its need of improvements) and that there is space for a compromise that incorporates the virtues of the Brazilian approach in full conformity with the OECD Guidelines and the ALP, to the benefit of Brazil, the OECD, and potentially many other countries.

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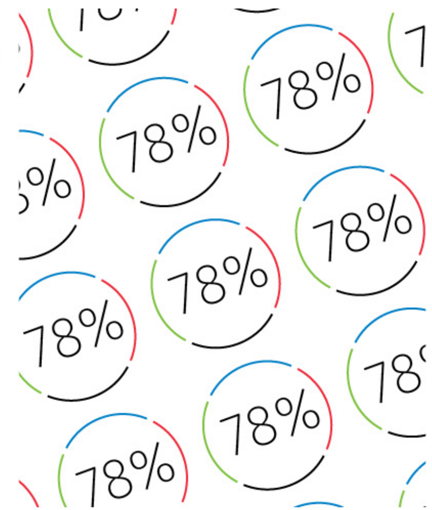

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