



Adhesion of Brazil to the OECD: Critical analysis of the new Brazilian transfer pricing rules by the major trading and investment partners

21-22 September 2023

Annual IBA The New Era of Taxation Conference

Rio de Janeiro, Brazil

The Panel

21-22 September 2023, Annual IBA The New Era of Taxation Conference

Rio de Janeiro, Brazil

Adhesion of Brazil to the OECD: Critical analysis of the new Brazilian transfer pricing rules by the major trading and investment partners

CO-CHAIRS



Thais de Barros Meira



Lars Gläeser



RAPPORTEUR



Teresa Novais Corrêa Meyer



SPEAKERS



Alex Cordova



Ivan Garcia Ferreira



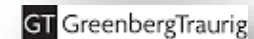
Claudia Pimentel



Victor Polizelli



Pallav Raghuvanshi





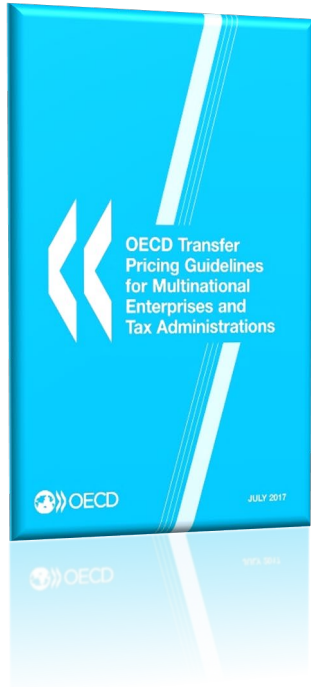
Topic 1: Current Status of Implementation



Current status of implementation

Alignment with OECD standards

❑ 1995, 2009, 2010, 2017: OECD Transfer Pricing Guidelines Development



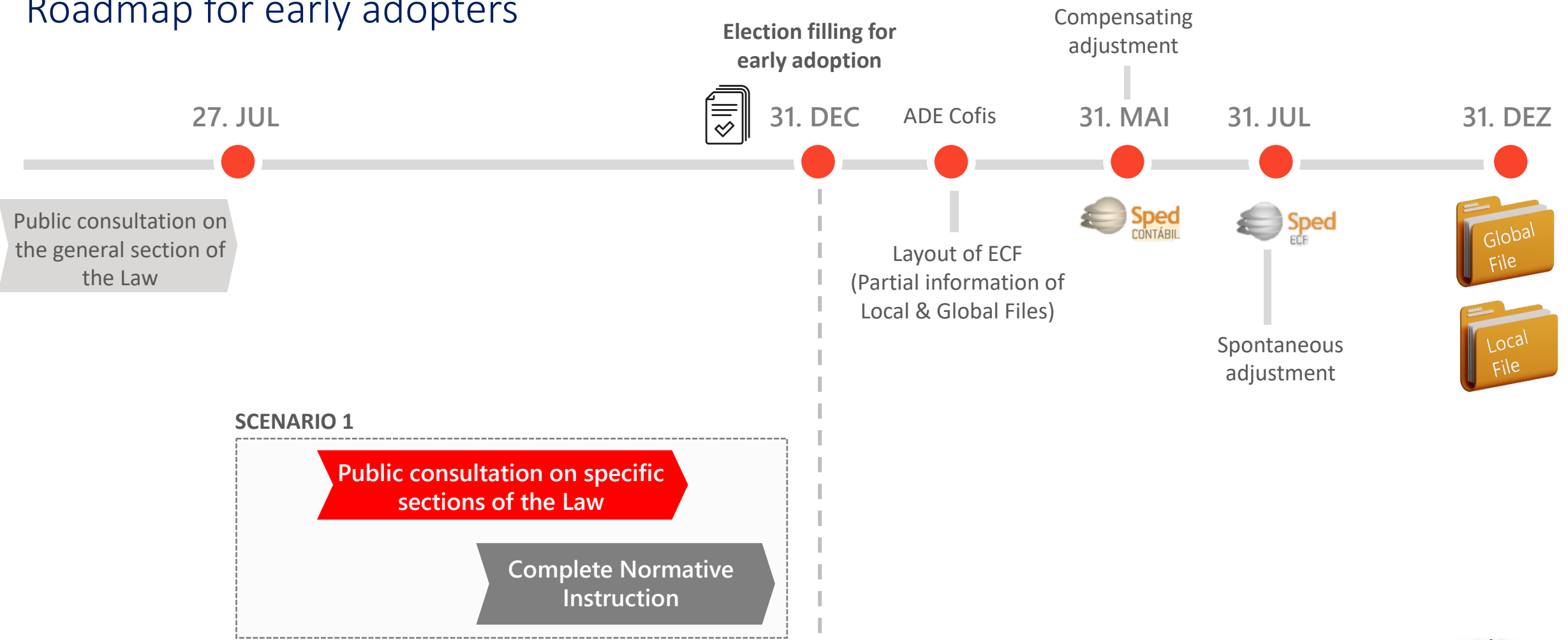
- ❑ 2017: Formal request for accession to the OECD
 - ❑ 2019: Project for alignment of Brazilian TP rules to OECD TPG
 - ❑ 2020: US FTC credit draconian regulations
 - ❑ 2023: Law 14,596 approved
- Complete substitution of Brazilian TP rules for adoption of OECD and UN-style TP rules
 - Inclusion of royalties / intangibles in the scope to TP control
 - New rules are mandatory for 2024 onwards and optional for the year 2023 (with retroactive effects)
 - Ongoing public consultation on the draft regulations.
 - Regulation of main topics expected to be issued by September (next week).

Current Status

- One of the main challenges for the application of the new rules in Brazil is the fact that such rules use several subjective concepts and terms (such as the OECD guidelines), and the Brazilian tax system is based on the legality principle.
- Some controversial challenges/controversial issues:
 - Lack of Brazilian data basis for the comparable
 - Cost sharing agreements and taxation of import of services;
 - Relevant penalties applied to taxpayers that do not comply with ancillary obligations

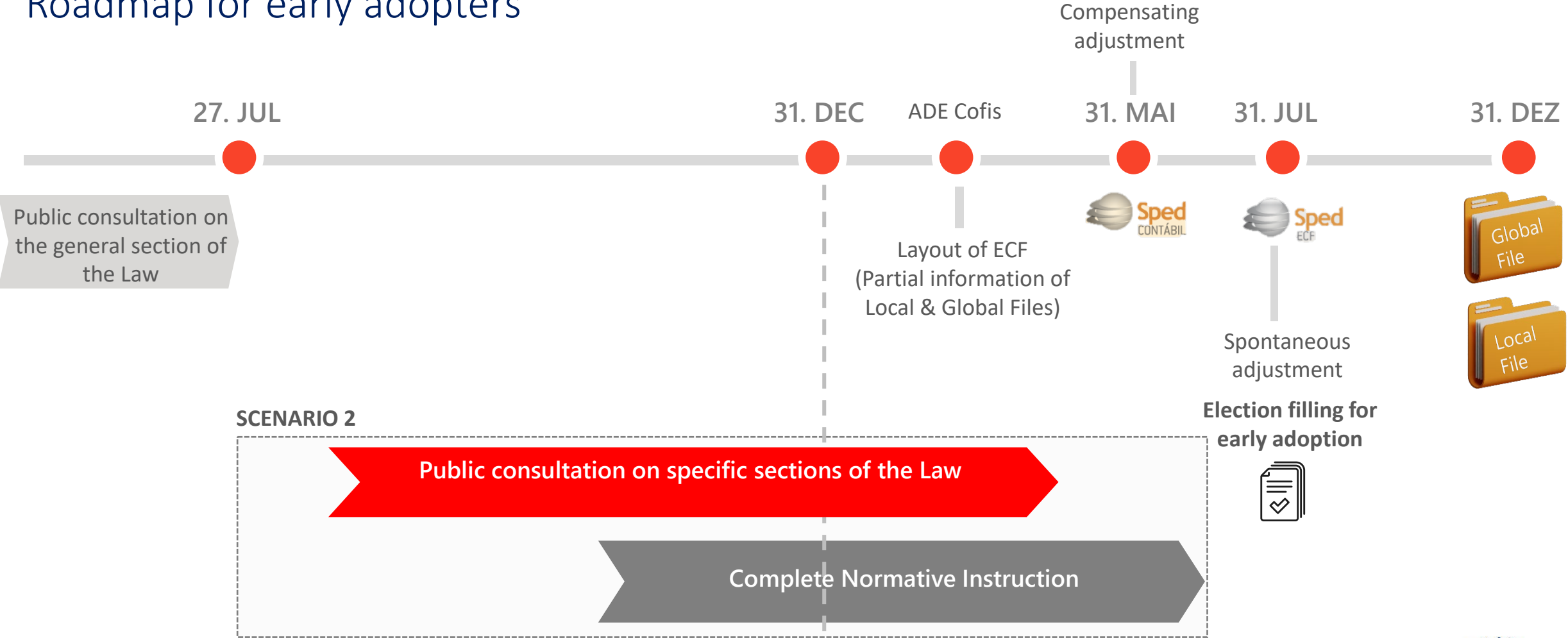
Current status of implementation

Roadmap for early adopters



Current status of implementation

Roadmap for early adopters



US Foreign Tax Credit Regulations Update

- The Treasury Department and the Internal Revenue Service (IRS) issued Proposed and Final Regulations (Nov. 12, 2020 (first Prop. Regs.), Jan 4, 2022 (Final Regs.), July 27, 2022 (corrected Final Regs.), and Nov. 22, 2022 (additional Prop. Regs.).
- One of the most significant changes in the Final Regulations is a new “attribution requirement,” also known as the Jurisdictional nexus requirement.
 - Purpose – Targeting extraterritorial taxes based on factors such as destination, customers and market access. Specifically introduced to target digital services tax introduced by several jurisdiction.
 - General attribution rule - Foreign taxes are creditable only if the foreign law requires a sufficient nexus between the foreign country and the taxpayer’s activities or investments based on one of the three attribution tests (i) activities-based attribution; (ii) source-based attribution; and (iii) property situs attribution. For resident taxpayers – the foreign base should be determined based on arm’s length principles (destination-based standard will not be respected).



US Foreign Tax Credit Regulations Update

- Reach – These regulations will far-reaching impact on creditability of foreign taxes. Thus, a fixed-margin transfer pricing system will not be eligible to get foreign-tax credits in the United States.
- Notice 2023-55
 - Provides temporary relief from the application of the newly introduced US foreign tax credit regulations.
 - The relief generally is available for calendar tax years 2022 and 2023 and for fiscal tax years ending in 2023. For this period taxpayers can rely on slightly modified former regulations.
 - This would be beneficial for Brazilian taxes, specifically for taxpayers who would opt-in to apply the newly introduced TP rules in Brazil.
 - Digital Services Tax would not be able to satisfy the modified regulations despite the relief.
 - The Notice is not a reversal but a temporary and limited relief.



Arm's Length Standard – In General

- A controlled transaction meets the arm's length standard if the results of the transaction are consistent with the results that would have been realized if uncontrolled taxpayers had engaged in the same transaction under the same circumstances (arm's length result).
 - Generally determined by reference to the results of comparable transactions under comparable circumstances
- Best Method Rule
 - The best method rule assesses controlled transactions “under the method that provides the most reliable measure of an arm's-length result” in the given circumstances.
 - The two primary factors to take into account are the **degree of comparability** between the controlled transaction (or taxpayer) and any uncontrolled comparables, and the **quality of the data and assumptions** used in the analysis.
 - No strict priority of methods.
 - It is not necessary to establish inapplicability of other methods.
 - The regulations provide a number of examples of the applicable of the best method rule.





Topic 2: Main Changes



Main changes to the current scenario

30-year leap into the future

Current practice

- Free selection in benefit of taxpayer
- Fixed ceilings for deductions (from 1% to 5%)
- Current adoption lack regulation
- Divergence in the TP rules applied / amounts determined by other group entities
- Implementation triggers taxes / risks
- Adoption of article 9(2) in cases involving companies in a treaty jurisdiction lack proper regulation

Expected adaptations

- Best method approach
- Hierarchy: traditional vs. transactional methods
- Sanity check / corroborative methods
- DEMPE Analysis
- Compensating adjustments extensively regulated
- Payments/receipts will not trigger other taxes (e.g. on importation of goods or services)
- Secondary adjustments not adopted
- Correlative adjustment clearly provided in the Brazilian TP law with the effect of reduction in the taxable basis

Method Selection

Royalties

Year-end adjustment

Correlative adjustment

Main changes to the current scenario

30-year leap into the future

Current practice

CUP

- Broader concept of similarity
- Marketing functions and presence of intangibles do not affect comparability
- Sample formation: internal imports 5%, other comparables must be of the same year

RPM

- Widespread application on imports
- No attention to functional analysis
- No differences for position in the supply chain, performance of manufacture, business strategies, etc.
- Fixed formula / fixed margins

Expected adaptations

- Stricter concept of (significant) similarity
- Marketing functions and presence of intangibles affect comparability
- Reliable comparables: ordinary course of business & no purpose to set an ALP result
CFR § 1.482-1(d)(4)(iii)(A)

- Greater level of identity of functions required
- Functions performed/risks assumed by Brazilian distributors might differ from the standard LRD
- Packaging and assembly acceptable?
- Use of internal comparables
- Adjustments for accounting consistency

Main changes to the current scenario

30-year leap into the future

Functional analysis and comparability

- Full adoption of the OECD Transfer Pricing Guidelines
- Proposed regulations mentions strengths and weaknesses of certain methods in line with international practice

RPM ➤ Pure resale
(+packaging, labelling, assembly)

CPM ➤ Manufacture of semi-finished products
Provision of services

TNMM ➤ Adequacy of PLIs to certain activities

Net margin ➤ Pure resale

Return on cost ➤ Manufacture
Provision of services

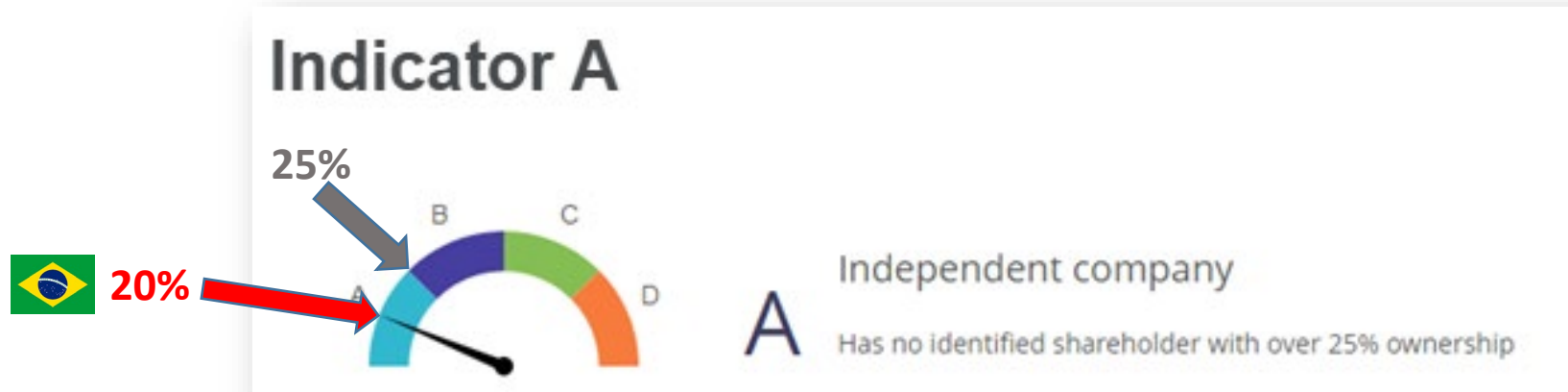
Return on assets ➤ Capital-intensive activities

Main changes to the current scenario

30-year leap into the future

Functional analysis and comparability

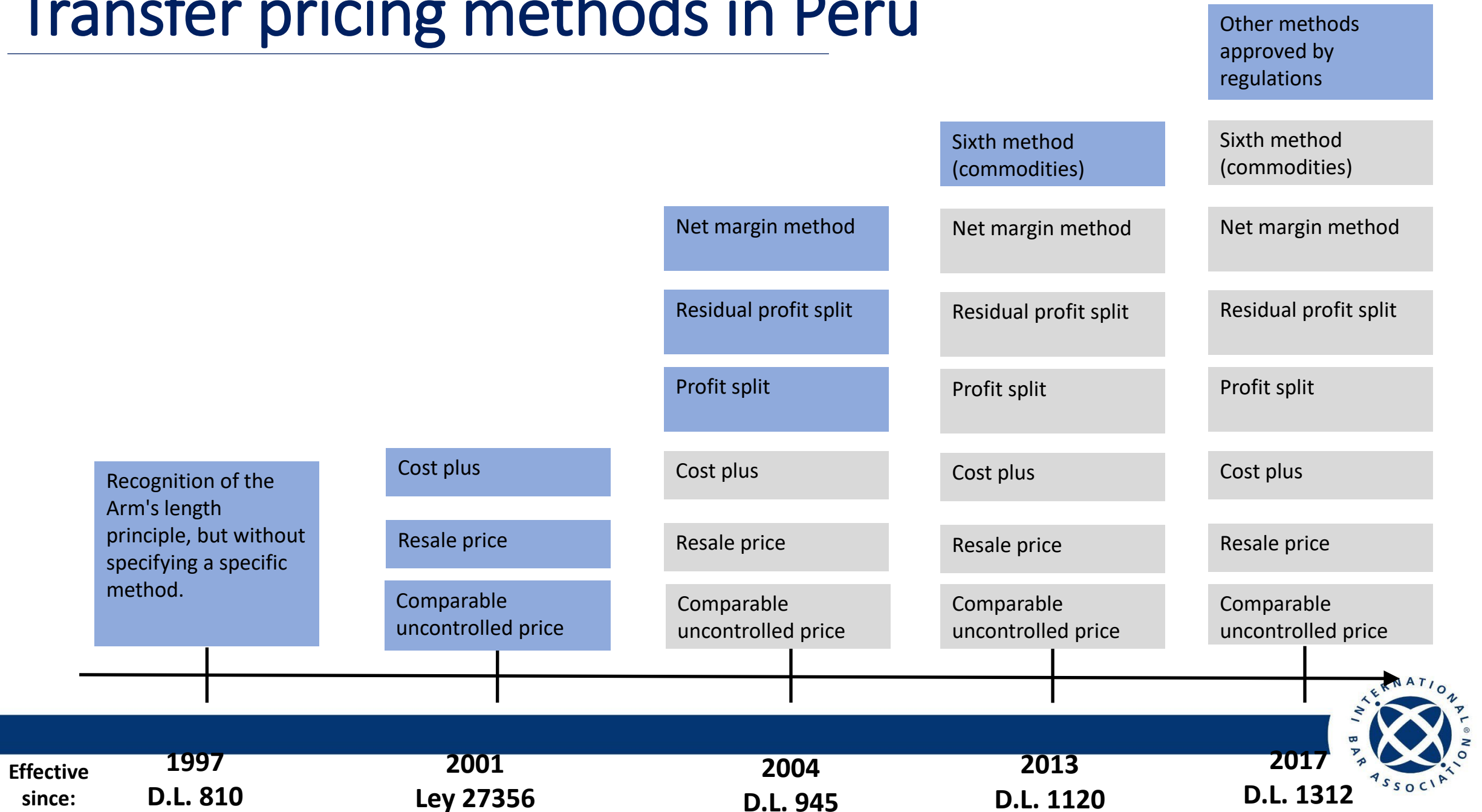
- Group synergies and location savings must be considered
- Local market features and country risk factors
- Search for external comparables must pay attention to local requisites:
 - ✓ Preference to “domestic” comparables
 - ✓ Independence indicator <20%



Arm's length standard in Peru

- The arm's length standard was broadly implemented in Peruvian legislation **since 2004**. The implementation was **influenced by the OECD Transfer Pricing Guidelines and Section 482 of the United States Treasury Regulations**.
- Peruvian transfer pricing rules have **few differences compared to the OECD** arm's length standard, such as the fiscal harm rule, application of transfer pricing rules to domestic transactions, the sixth method, and others.
- The OECD Transfer Pricing Guidelines are **legally recognized as a source for interpreting** the Peruvian transfer pricing rules (soft law).

Transfer pricing methods in Peru



Method selection criteria

(Article 113 of the Peruvian Income Tax Regulation)

- The **'most appropriate method'** rule is followed (no method prevails over another). Criteria for method selection:
 - Best alignment of the method with the nature of the business, corporate or commercial structure (e.g., resale price method aligned with distribution operations of goods).
 - Highest quality and quantity of available information.
 - Most suitable degree of comparability.
 - Requires the least amount of comparability adjustments.
- **Criteria for selecting comparables:**
 - Transaction characteristics.
 - Functions, assets, and risks of the parties.
 - Contractual terms.
 - Market conditions.
 - Business strategies, including market penetration, stability, and expansion.
- Criteria **similar to the OECD Transfer Pricing Guidelines 2017 model** (paragraph 2.2). Exception to the 'most appropriate method' rule: Subsidiary application of 'other methods' as regulated (e.g., discounted cash flow, profit multiples method).



Topic 3: Documentation



Documentation

Innovations in the Master & Local Files practice



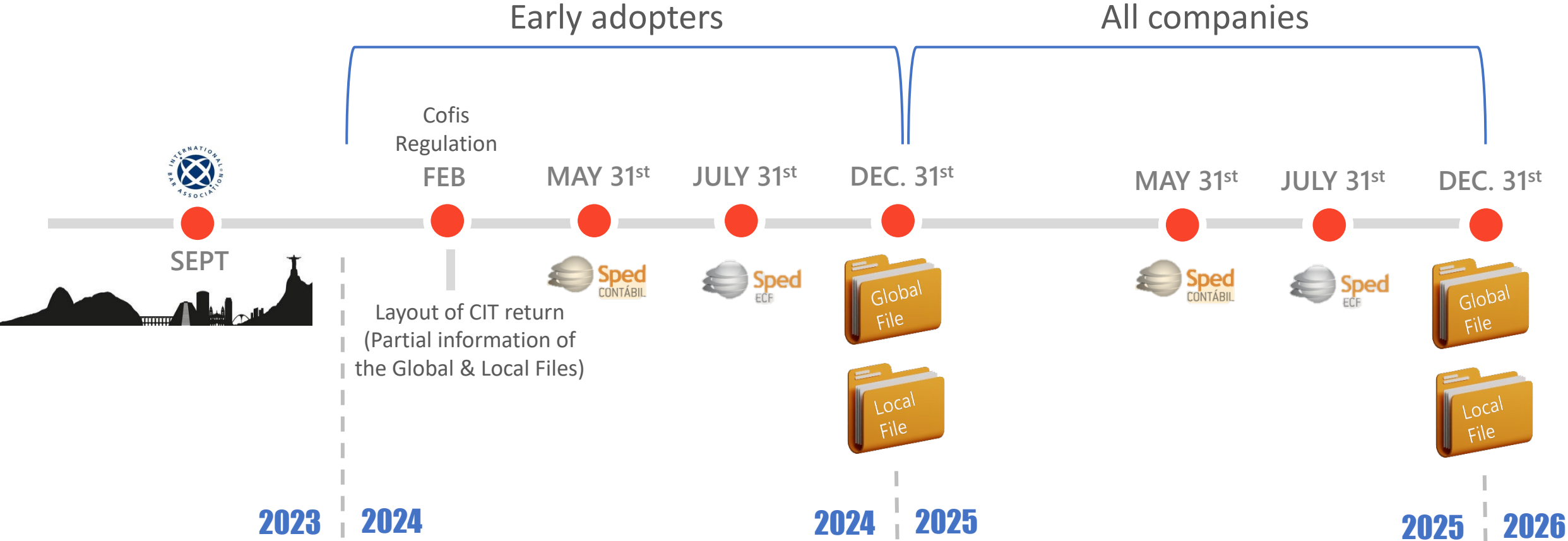
Early adopters

All companies



Documentation

Innovations in the Master & Local Files practice



Documentation

Innovations in the Master & Local Files practice

- Mandatory yearly submission of Master & Local Files
- All information in Portuguese (including supporting documents)
- The files must contain information of a 3-year interval (current year and prior 2 years)



- Each group entity identified with name, TIN, corporate purposes, country, ownership, net results and taxes paid in the prior 3 years.
- Characterization of the business activities, strategies etc. capable of influencing the TP
- Demonstration of the financial and actual flows of the important transactions of the group, with a detailed summary of the amounts transacted.



- Detailed characterizations of each associated enterprise that is a counterparty in a controlled transaction, specifying the relevant corporate or commercial relationship.
- Detailed description of the terms and conditions of the controlled transactions.
- Details on price formation policy, including review factors, multi-year reviews, factors associated with economic cycles etc.



Topic 4: Commodities and Simplification



Commodities and Simplification

Adaptations on the Brazilian “sixth method”

- Preference for the CUP method in cases of transactions involving commodities
- New definition of commodities:
 - Commodity:** the physical product, regardless of its stage of production, and derivative products, for which quotation prices are used as a reference by unrelated parties to establish prices in comparable transactions
- No longer a clear definition of products, scope and commodity exchanges
- Full adoption of the ALP (instead of anti-abuse rule)
- New obligation of registration of transactions

Perú: Commodities and Transfer Pricing

“Sixth Method” - Income Tax Law Art. 32-A° (inc. e)

Relevant Issues

Goods Included

Concept

- Specific transfer pricing method in cross border transaction with *commodities* (or goods whose price is set based on international quotes).

- Only a specific list of assets is included in this regime.

Purpose

- Avoid an abusive quotation period “QP” **choice** in controlled transactions (also with tax heavens) just to have lower taxation.

- In sales operations (export):

- ✓ Copper
- ✓ Gold
- ✓ Silver
- ✓ zinc
- ✓ Fishmeal

Method

- Comparable Uncontrolled Price: “Price vs. Price” based on the international quotation. **Taxpayers can use another method as long as there is an economic justification.**

- In purchase operations (import):

- ✓ Corn
- ✓ Soybeans
- ✓ Wheat

Compliance Control

- Prior communication to authorities: requirement to keep the QP agreed for taxation purposes. If the communication was not made (or carried out incorrectly), the QP will be replaced by the one in force in the date of shipping or unloading.

Perú: Commodities and Transfer Pricing

Oil and Gas

■ There is no specific transfer pricing rule for Oil and Gas transactions:

- The "sixth method" rules are not applicable since these types of goods are not included in the list stipulated by regulation.
- If there is an Oil and Gas transaction between related parties (or with tax havens), the general transfer pricing rules will apply (using the most appropriate method to reflect economic reality).

■ Notwithstanding, there is a specific fair market value rule for certain Oil and Gas transactions (as long as transfer pricing rules are not applicable: non-controlled transaction neither with tax heaven intervention): Income Tax Law Art. 32°

- The background of these specific rule is the **natural gas** exploitation in Peru.
- Applicable in transactions: (i) within Long-Term/Stability Agreements; and (ii) with exportation purposes.
- Tax fair market value rule will be the **same price agreed by parties** as long as is determined with reference to *spot prices* from international markets such as **Henry Hub** or others abroad (not located in tax heavens).

Note: If it is possible to apply the CUP (as most appropriate TP method), the SPOT prices from indicators such as Henry Hub (Gas) will be an important reference to determine market value (provided that the comparability test allows it).



Topic 5: Intangibles



Intangibles

Full adoption of the TPG

- **Removal of fixed ceilings for deductions** (from 1% to 5%)
- **Removal of bureaucratic requisites** (PTO and Central Bank registrations)
- **DEMPE analysis**
 - Poses interesting problems of potential retroactive effects (e.g. with respect to sales of IP rights implemented under the old Brazilian rules)
- **Super-royalty rule:** Contingent annual payments for the cases of transfers of hard-to-value intangibles
 - Poses intriguing issues on statutory limitations period for analysis of future effects of a transaction and the extent of application of the TP GAAR (TAAR)

Intangibles – US Aspects

- General Definition: Asset with substantial value independent of services of any individual; derives its value not from its physical attributes but from its intellectual content or other intangible properties.
 - Includes:
 - Patents, inventions, formulae, processes, designs, patterns, or know-how
 - Copyrights and literary, musical, or artistic compositions
 - Trademarks, trade names, or brand names
 - Franchises, licenses, or contracts
 - Methods, programs, systems, procedures, campaigns, surveys, studies, forecasts, estimates, customer lists, or technical data
 - Other Similar Items
- After 2017, the definition also includes goodwill, going concern value, workforce-in-place and other items that are neither services of individuals or tangible property.



Intangibles – US Aspects

- Subject to the “best method” principle, the methods of determining taxable income from a transfer of intangible property between related persons are (1) the comparable uncontrolled transactions method (CUT), (2) the comparable profits method (CPM), (3) the profit split method, and (4) other unspecified methods.
 - Although the CPM and the profit split method can be applied to analyze transfers of intangibles, the regulations note that the CUT method if applicable, generally will provide the most direct and reliable measure of an arm’s-length charge.
- Importantly, these methods are further subject to annual adjustment under the “commensurate with income” standard (generally known as the “super royalty” provision).
- The regulations also provide for qualified cost-sharing agreements (allows direct ownership of intangibles instead of any license or transfer of intangibles).

Intangibles – US Aspects

Special Issues:

- Transfer of Intangibles in Tax-Free Transactions (Section 367(d)): Transfers of intangible property by U.S. persons to foreign corporations that would generally be tax-free exchanges (e.g., capital contribution) are generally treated as taxable transfers of such rights for annual payments based on the “commensurate with the income” standard.
- Definitional Issue: Under the expansive definition could differences in management efficiency or business experience be attributed to “know-how,” “systems,” “methods” or “procedures,” which are not legally protected? If yes, it may warrant transfer pricing adjustment.
- Ownership of Intangibles:
 - Legally Protected Intangible – the owner is the party possessing legal title to the intangible under the relevant IP law, but cannot be “inconsistent with the economic substance of the underlying transactions.”
 - Not Legally Protected Intangible – taxpayer who has effective control of intangible



Intangibles – US Aspects

Special Issues:

- Unspecified Methods:
 - Under the principles of the best method rule, a taxpayer is permitted to use of an unspecified method to determine an arm's-length result for a controlled transfer of an intangible if such a method provides the most reliable measure of an arm's-length result.
 - E.g., an unspecified method of valuation can be used where transferred intangibles require additional development by the transferee before they can be exploited (*See CCA 201111013*).
 - Is an unspecified method generally adopted in practice?



Intangibles – US Aspects

Special Issues:

- Commensurate with Income Standard:
 - *Rule:* In the case of controlled party transfers or licenses of intangibles covering more than one year, “the consideration charged in each taxable year may be adjusted to ensure that it is commensurate with the income attributable to the intangible.”
 - Thus, an arm’s length consideration in the first year, may not be arm’s length in a subsequent year.
 - *Policy:* To ensure that U.S. licensors do not shift profits to controlled foreign parties through multiple-year licenses by reflecting arm’s-length royalty at the time of the license, but not taking into account the full actual and projected value of the licensed intangibles throughout the license period.
 - *Criticism:* This standard would require a reappraisal of controlled party licenses post the original transfer, whereas comparable royalty rates under unrelated party licenses are set when license agreements are entered into. This could also result in an increased double taxation.



Intangibles – US Aspects

Special Issues:

- Commensurate with Income Standard:
 - *Exceptions:* (i) If the IP is also transferred “under substantially the same circumstances” to uncontrolled parties, or (ii) the actual profits attributable to the transferred IP are between 80% and 120% of projected profits after each of the first five years following the transfer.
- Cost-Sharing Arrangement:
 - Participants share the costs and risks of developing intangibles in proportion to their reasonably anticipated benefits from their individual exploitation of the interests in the intangibles assigned to them under the arrangement.
 - Each party is considered to own an interest in the developed intangible and no specific consideration is required to be paid to a related party.
 - Limited Scope: Available only if each participant’s intangible development costs share equals its reasonably anticipated profits.

Limited-Risk Distributors – US Aspects

- Most common PLI is Operating Margin (Operating profit/Net sales) evaluating the operating performance of a related party distributor as the tested party.
- Return on Operating Capital Employed (ROCE) (Operating Income/Operating Assets), finds application in cases where the business heavily invests capital, and the role of labor productivity is less significant in generating income.
 - The age of assets used be comparables should be similar and significantly depreciated.
 - Cautious analysis should be done on the types of assets employed and whether such assets are leased or owned.
- Berry Ratio (gross profit/operating expenses) is generally used when distributors employ no intangible assets and sells produced on a limited risk basis. Berry ratio may not be a reliable factor if the taxpayer undertakes other significant functions, e.g., manufacturing, design, warehousing/inventory management, assembling, etc.

Intangibles – Peruvian Aspects

The arm's length principle only serves to value transactions, not to recharacterize them

OECD

Article 9° OECD Model

1. Where a) an Enterprise (...) or b) the same person (...), and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, **then any profits** which would, but for those conditions, **have accrued to one of the enterprises**, but, by reason of those conditions, have not so accrued, **may be included in the profits of that enterprise and taxed accordingly.**

USA

Sec. 482 Allocation of income and deductions among taxpayers

In any case of two or more organizations (...) owned or controlled directly or indirectly by the same interests, the Secretary **may distribute, apportion, or allocate gross income** (...), if he determines such distribution (...) is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations (...).

Peru

Article 32°, no. 4, LIR

Market value is considered:

4. For transactions between related parties (...), **the prices** (...) that would have been agreed upon with or among independent parties.

Intangibles – Peruvian Aspects

But ... Peruvian GAAR can be used to recharacterize the operation (not to value it):

Tax advantage



Appropriateness
test



Economic
relevance test



When the occurrence of the taxable event is wholly or partially avoided, or when the taxable base or tax liability is reduced, or when balances or credits in favor, tax losses, or tax credits are obtained through actions that concurrently meet the following circumstances supported by SUNAT:

- a) The individually or collectively formal transactions are **artificial or inappropriate** for achieving the real obtained result.
- b) The formal transaction **results in legal or economic effects**, distinct from tax savings or benefits, **identical or similar** to those that would have been achieved through customary or appropriate actions.

Intangibles – Peruvian Aspects

Hypothetical case

Before: Company A owns trademarks.

After:



Company A

transfers
trademarks
→
←
licensing



Switzerland

Question:

Is the discrepancy regarding the market value of the trademark transfer or the general anti-avoidance rule to reject the expense deduction?

1. Company A transfers trademarks to a related entity resident in a country with a Double Taxation Agreement (DTA) (e.g., Switzerland), with a royalty withholding rate of 15%. The use of the trademarks is licensed. Company A deducts expenses (at a 29.5% rate). The DTA country has a low tax burden.



Topic 6:
**Services, Financial
and M&A
Transactions**



Services and Financial Transactions

Services

- Aligned with OECD standards
 - Benefits test
 - Shareholders activities
 - Duplication
 - Incidental benefits
- External costs may be passed thru without a profit margin.
- Cost contribution arrangements
- Simplification measure for low value-adding services (cost + 5%).

Financial Transactions

- Aligned with OECD standards
 - Accurate delineation of loan as loan or equity
 - Treasury function
 - Financial Guarantees
 - Captive insurance
- Expected simplification measure and clear guidance on potential “retrospective” effects for pre-existing loans

M&A Transactions – OECD Guidelines

1. **Identify** (i) the commercial or financial (ii) the conditions and economically relevant circumstances
 - Broad-based understanding of the industry sector (e.g. mining, pharmaceutical, luxury goods) and of the factors affecting the performance of any business operating in that sector
 - Analysis of the activities carried out by each company and identification of its commercial or financial relations with associated enterprises as expressed in transactions between them. (para. 1.35)
2. Confirm that the transaction is a transaction that **could be carried out by independent parties**
3. **Compare** the T&Cs of the controlled transaction and the T&Cs of the comparables

M&A Transactions – Brazilian Issues



Brazilian transfer pricing rules also apply to non-related parties resident in a low tax jurisdiction.

- Does every transaction fall into the scope of the new transfer pricing rules?
 - Merger, demerger, capital increase, capital reduction, reverse merger, contribution in kind, among others



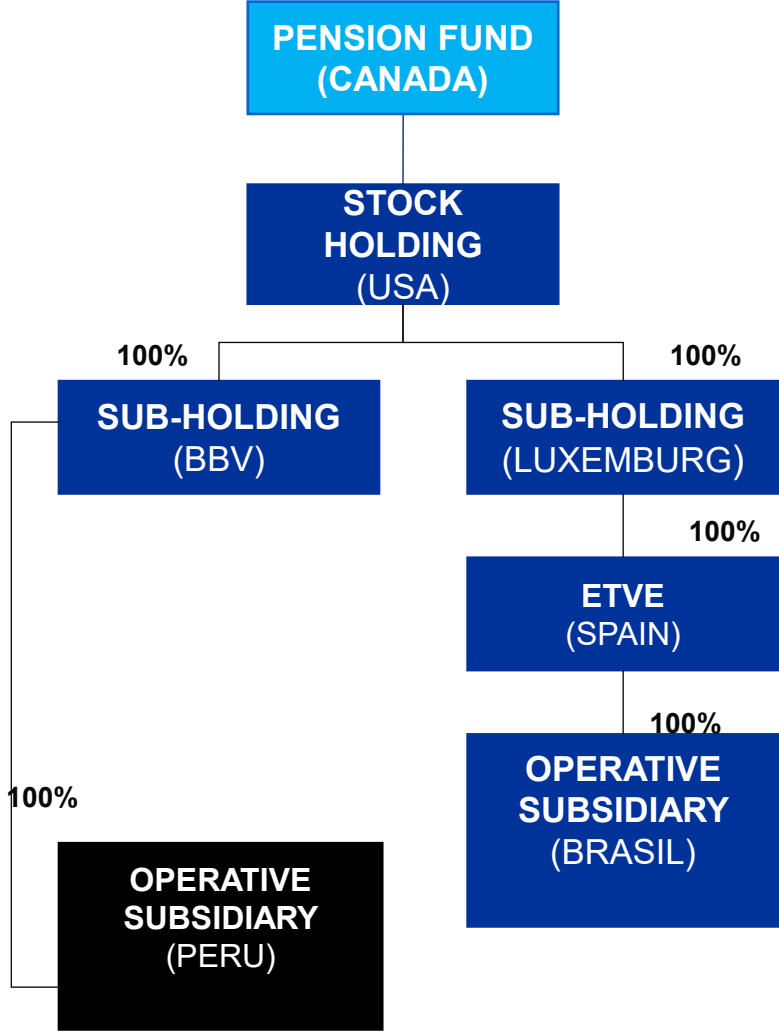
- Minority shareholders that are not related party could still carry out their transactions tax neutral?
- What should be the comparables for the transactions with independent parties in which one is a tax resident of a low tax jurisdiction?
- Are the tax neutral reorganization Brazilian rules overruled on cross-border transactions?

M&A Transactions - US Aspects

- Valuation of Intangibles
 - Identifying the intangibles and allocation of income between related parties
- Alignment of Business Model/Business Integration
 - New business model, product line and market strategies would require realignment of transfer pricing strategies
- Intercompany Financial Transactions
 - Changes in debt levels, interest rates, guarantees, etc.
- Supply Chain Restructuring
 - Post-M&A, companies may restructure their supply chains for efficiency, potentially moving production, distribution, or other functions.



M&A Transactions - Peru



QUERIES:

- 1. Tax effects for international reorganizations
- 2. Tax effects for transfer of shares
- 3. The most appropriate method if capital gains will arise?





Topic 7: APAs, MAPs and Litigation



APAs, MAPs and Litigation

- **MAPs** acceptable in cases of treaty countries
- Brazil allows **correlative transfer pricing adjustments** (art. 9(2) of the MC-OECD) in all double tax treaties (BEPS minimum standards)
- **APAs** expected to be regulated with the adoption of best practices
- **APAs valid for 4 + 2 years**
- **Administrative fees for submission of APAs:** R\$ 80,000 + 20,000 (extension)
- **Expected:** pre-filing meetings, segregated teams (APA officials \neq auditors), certain level of transparency (aggregated data), sector-APA (?)

Advance Pricing Agreements - US Aspects

- Generally, APAs provide a binding agreement with one or more tax authorities on arm's length prices. No subsequent challenge by the IRS, if the conditions of the agreement are satisfied.
- General features of an APA:
 - Provide best transfer pricing method (mostly CPMs are used). Generally provides for a range of arm's-length results, rather than for a single result.
 - Identifies the taxable entities or product lines that are covered by the agreement
 - Applies to future intercompany transactions (generally for a 3 to 5-year term), but roll-back to the extent of non-statutory barred prior years.
 - Provides for an option for renewal on a less time consuming basis.



Advance Pricing Agreements - US Aspects

- Type of APA
 - Unilateral
 - Applicable to a single taxpayer and a tax administration of the country where the taxpayer subject to taxation
 - Provides certainty only in one jurisdiction. As there is no formal agreement with the foreign tax authority, it may potentially lead to disputes in another jurisdiction, which can be resolved by MAPs. Specifically, application to a rollback period may result in double taxation.
 - Quicker to negotiate as there is only one tax authority involved.
 - Less costly.
 - Bilateral/Multilateral
 - Involves two or more tax authorities (home and host country) and the taxpayer.
 - Reduces the risk of double taxation as both countries agree on the transfer pricing method. Includes a mutual agreement procedure (MAP) to resolve disputes between tax authorities.
 - Often take more time to negotiate due to the involvement of multiple parties and coordination.
 - IRS generally prefers bilateral/multilateral APAs over unilateral APAs.



Advance Pricing Agreements - US Aspects

Process

- Pre-filing conference
 - This phase is the initial step in the APA process.
 - Taxpayers are encouraged to engage in confidential discussions with the IRS before formally submitting an APA application. Application on an anonymous basis can be filed.
 - The purpose is to identify potential issues, understand the IRS's expectations, and assess the feasibility of an APA.
- APA Application
 - The application is a comprehensive document that provides detailed information about the controlled transactions under review.
 - Key components of the application include a thorough description of the controlled transactions, the proposed transfer pricing methodology, a functional and risk analysis, financial projections, and comparable data.
 - Applicant must consent to extend the statute of limitations for years covered by the APA. Application can be withdrawn at any time before finalization of terms.



Advance Pricing Agreements - US Aspects

Process

- Review and Evaluation
 - Once the APA application is submitted, it undergoes a thorough review and evaluation by the IRS.
 - The IRS assigns a team of experts who assess the application's compliance with transfer pricing regulations and the arm's length standard.
 - During this phase, the IRS may request additional information or clarification from the taxpayer.
 - The functional and risk analysis, as well as the choice of transfer pricing method, are closely scrutinized to ensure they align with the economic substance of the controlled transactions.
- Negotiation
 - Negotiations between the taxpayer and the IRS are a critical part of the APA process.
 - The goal is to reach a mutual agreement on the appropriate transfer pricing methodology and pricing terms.
 - Negotiations are typically open and transparent, with both parties presenting their arguments and evidence.
 - The process may involve multiple rounds of discussions and may take some time to conclude.
 - A successful negotiation results in an agreed-upon transfer pricing methodology and pricing terms for the covered transactions.



Advance Pricing Agreements - US Aspects

Process

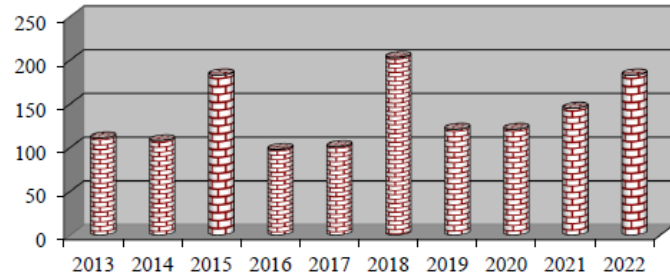
- Annual Compliance Report and Requirements
 - Taxpayers must file with the IRS annual reports and documentation that demonstrate ongoing adherence to the agreed-upon transfer pricing methodologies. The annual compliance reports typically include financial and operational data for each related party involved in the covered transactions.
 - Annual reporting requirements involve the submission of detailed information and documentation to the IRS.
 - The annual compliance process typically follows a strict timeline, with specific due dates for reporting. Failure to comply with these timelines can trigger an IRS audit or even the cancellation of the APA.
 - If there have been significant changes in the taxpayer's business operations or external market conditions, it's important to address these changes in the annual compliance reports.



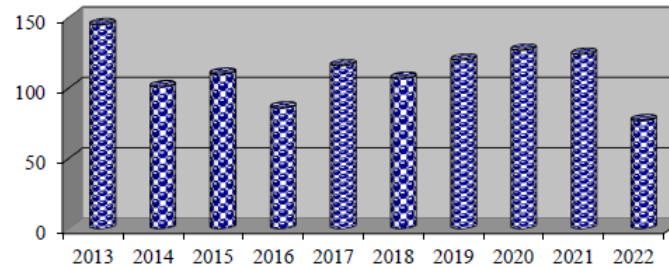
Advance Pricing Agreements - US Aspects

Recent IRS APA Statistics

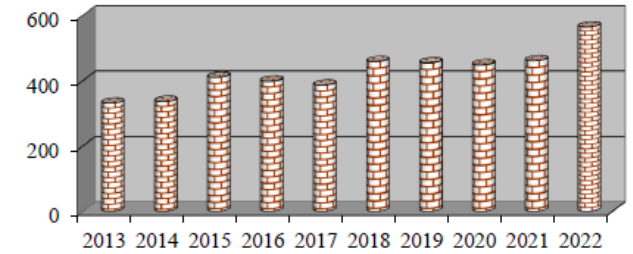
Applications Filed
2013-2022



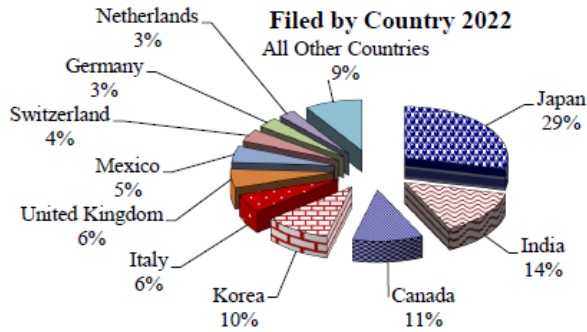
APAs Executed
2013-2022



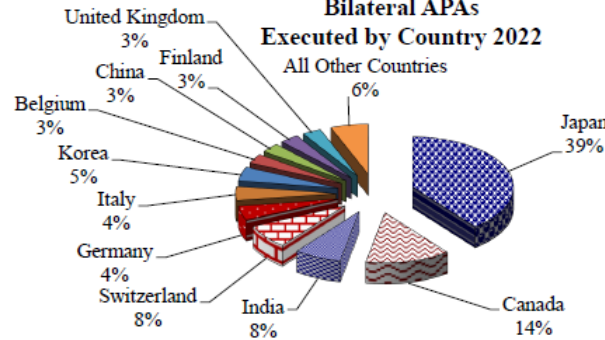
Pending APAs
2013-2022



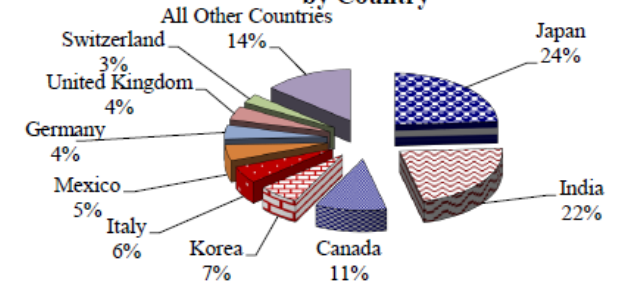
Bilateral APAs
Filed by Country 2022



Bilateral APAs
Executed by Country 2022



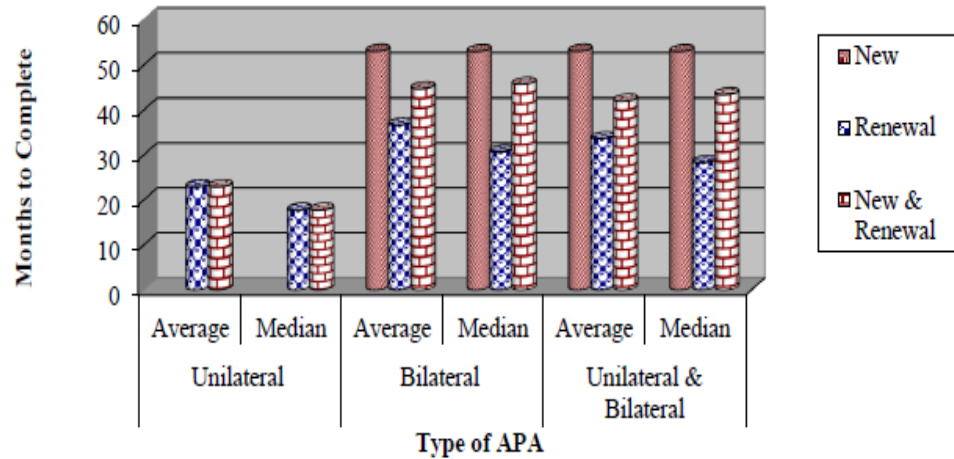
Pending Bilateral APAs
by Country



Advance Pricing Agreements - US Aspects

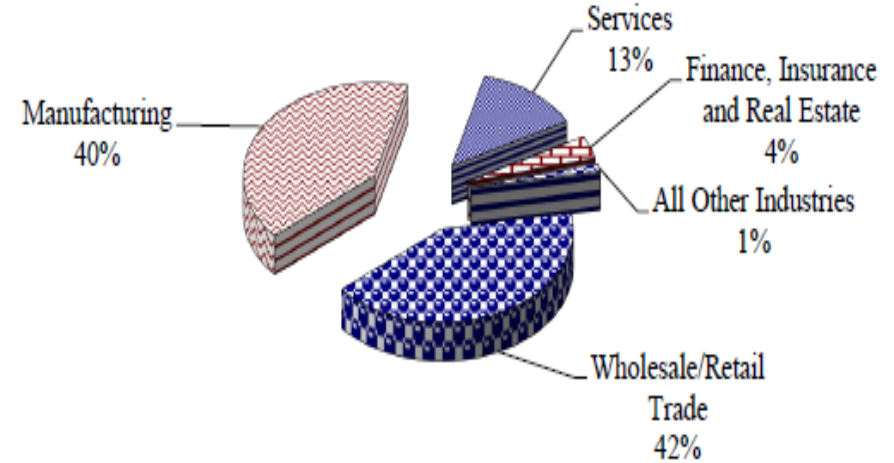
Recent IRS APA Statistics

Months to Complete New and Renewal APAs Executed in 2022



Median completion time continued to rise in 2022 to 43.4 months (from 35.1 months in 2021 and 32.7 months in 2020).

APAs Executed in 2022 by Industry



Advance Pricing Agreements - US Aspects

Factors to Consider Before Seeking an APA

- Complexity of Transactions
 - APAs are ideal for complex transactions involving intangibles, unique business models, or multiple jurisdictions
- Predictability
 - Consider the predictability of your industry and market conditions.
 - APAs provide certainty and can be beneficial in industries with fluctuating prices or evolving business models.
- Risk Mitigation
 - Assess the potential transfer pricing risks associated with your transactions.
 - APAs can help mitigate audit-related risks and reduce the likelihood of disputes with tax authorities.
- Compliance Cost
 - While APAs can be expensive, they may result in long-term cost savings by avoiding disputes and penalties.
- Disclosure Concerns
 - Voluntary disclosure with no assurance that there will be an agreement, could expose to an adjustment for all open years. Thus, pre-filing conference on an anonymous basis becomes very important.



Mutual Agreement Procedures - US Aspects

Overview

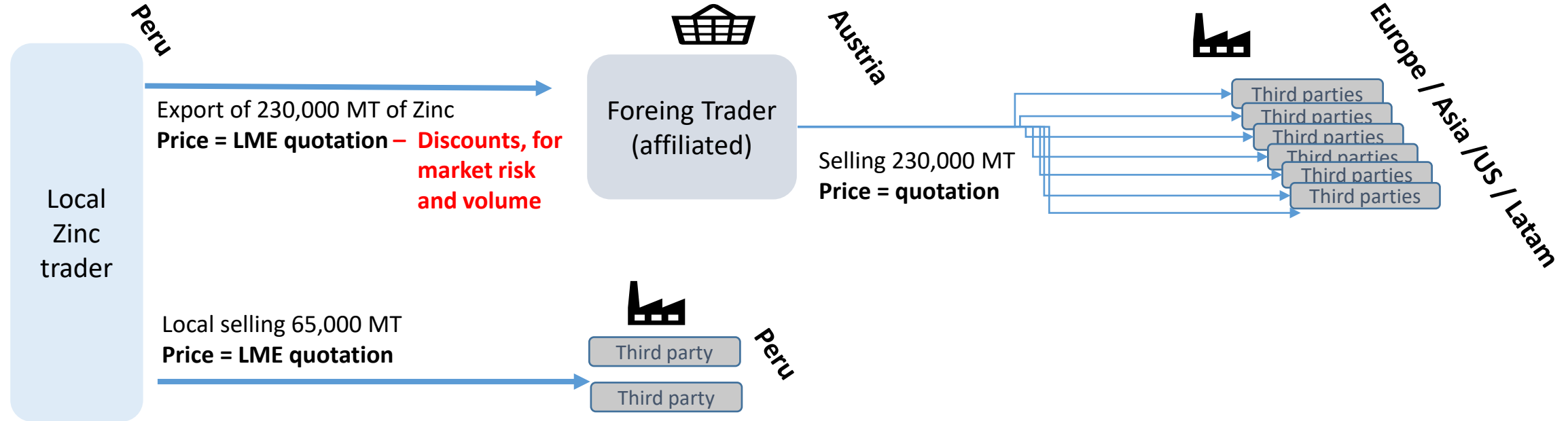
- When the taxpayer believes that the actions of the United States or a treaty country result or will result in the taxpayer being subject to taxation not in accordance with the applicable U.S. tax treaty.
- The taxpayer submits a formal request to the competent authority (the IRS), which should include detailed information on the transfer pricing issue, the affected tax years, and the relief sought.
- After receiving the MAP request, competent authorities from both countries engage in consultation and negotiation.
- MAP can be bilateral (involving only two countries) or multilateral (involving more than two countries)

Benefits

- It could resolve double tax issues for rollback period in an APA, even if such adjustment relates to a barred year.
- Generally, not as costly as an APA. However, APA becomes necessary to provide certainty for future years.
- Provides certainty in all the jurisdictions involved.

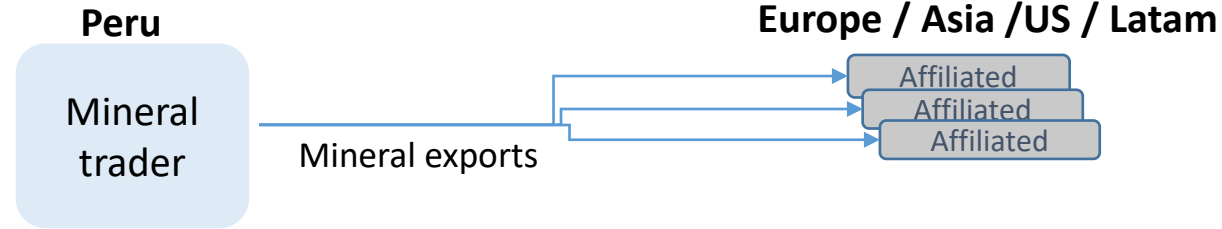


Tax Court Resolution N° 03658-3-2021



Analyzed transactions	Sale of zinc to affiliated trader abroad
Method	Comparable uncontrolled price
Comparables	SUNAT (local internal comparables) vs. Company (foreign external comparables).
Tax court	The local sales are not comparable, as they are made to end customers for their transformation into zinc oxide. On the other hand, the sale to a related trader is carried out for the purpose of the subsequently trading of the same commodity without transformation.

Tax Court Resolution N° 03658-3-2021



Analyzed transactions	Mineral exports to affiliated companies
Method	Net margin method (operative margin) US functional currency or Peruvian currency?
Accounting for derivative financial instruments	Fair value accounting
Comparables	Comparable 1, 2 y 3: Fair value accounting Comparable 4, 5, 6 y 7: Hedge accounting
Company argument	Tested party: The fair value provisions of DFI are eliminated (comparability adjustment). Comparables: Comparables 1 to 7 are applicable.
Tax Administration argument	Tested party: The comparability adjustment is not accepted. Comparables: Only comparables 1, 2, and 3 are accepted because they use fair value accounting.

Tax Court Resolution N° 03658-3-2021

Tested party	Comparables
(+) Sales	(+) Sales
(+) Cost of sales	(+) Cost of sales
= gross profit	= gross profit
Selling and administrative expenses	Selling and administrative expenses
DFI commodities	
= operating profit	= operating profit
	DFI currency
Income and financial expenses	Income and financial expenses
= profit before taxes	= profit before taxes

Tax court	<p>Comparable currency: US functional currency</p> <p>Adjustments: Only comparables 1, 2, and 3 are accepted when applying fair value accounting.</p>
-----------	---



Topic 8: Challenges for Implementation



Challenges for implementation

“In House” Perspective

- ✓ Understand and learn new rules;
- ✓ Develop Transfer Pricing Local Team;
- ✓ Implement new guidelines (local & global aspects).



Challenges for implementation

“In House” Perspective

- Adjust Global TP Policy – TP and Customs aspects; Interaction with HQ, When to adjust (2024/2025)? Business communication;
- Preparation & development of functional analysis (characterization of companies). Essential to know the company's business. Consider economic aspects. Less operational activities and more analytical activities;
- New treatment of intangible assets. Technology sector - open the possibility of remunerate foreign companies for R&D activities. Old royalty rules "blocked" it;
- Potential change in interaction with tax authorities. Less objective rules. Increased subjectivity considering economic aspects. Tax litigation will increase?

Challenges for implementation

“In House” Perspective

- Adjust Global TP Policy – TP and Customs aspects; Interaction with HQ, When to adjust (2024/2025)? Business communication;
- Preparation & development of functional analysis (characterization of companies). Essential to know the company's business. Consider economic aspects. Less operational activities and more analytical activities;
- New treatment of intangible assets. Technology sector - open the possibility of remunerate foreign companies for R&D activities. Old royalty rules "blocked" it;
- Potential change in interaction with tax authorities. Less objective rules. Increased subjectivity considering economic aspects. Tax litigation will increase?

Challenges for implementation

“In House” Perspective

- Potential true down/true up ("one time adjustment"). Legal nature of true up/down? Foreign exchange contracts, cash inflow/outflow? Accounting entries? Withholding taxes? Tax impacts (indirect, customs);
- Currently, most of TP support documentation is found within the organizations. Under the new rules, the documents will be found outside the companies. How to access the benchmarking database? Global & Local database will be accepted?
- Multinational's HQ that have knowledge of OECD TP rules can help in the process. But it is important to have on board local people who are familiar with the Brazilian tax environment, interaction with local tax authorities and the particularities of the new rules;
- APA – Pre-filing formal procedures; Time for implementation;



Questions & Answers



Adhesion of Brazil to the OECD: Critical analysis of the new Brazilian transfer pricing rules by the major trading and investment partners

Co-Chairs

Thais de Barros Meira BMA Advogados, São Paulo

Lars Gläser Glaeser Law Tax Boutique, Vienna

Speakers

Alex Cordova Rodrigo Elias & Medrano Abogados, Lima

Ivan Garcia Ferreira Siemens, São Paulo

Claudia Pimentel Receita Federal do Brasil, Brasilia

Victor Polizelli KLA, São Paulo

Pallav Raghuvanshi Greenberg Traurig, New York City, NY

Rapporteur

Teresa Novais Correa Meyer BMA Advogados, São Paulo





the global voice of
the legal profession®