

Pricing Intercompany Transactions: Transfer Pricing Regulations in Brazil

Introduction

Establishing a presence in Brazil may immediately subject the foreign (Israeli) company to permanent establishment rules in Brazil and to transfer pricing regulations, both in Israel and in Brazil.

Contrary to the Israeli regulations, **Brazilian Transfer Pricing regulations often deviate from the OECD guidelines and do not apply the arm's length standard, potentially conflicting with the Israeli regulations.**

Permanent Establishment

Permanent establishment rules are set in the Brazilian legislation and in the tax treaty with Israel. If a permanent establishment is deemed to exist, the income associated with such activities (sales) will be subject to taxation in Brazil. Permanent establishment may arise in Brazil, for example, when agents or representatives of the Israeli company perform sales activities within Brazil and submit invoices directly to a Brazilian client, or otherwise bind the foreign (Israeli) company.

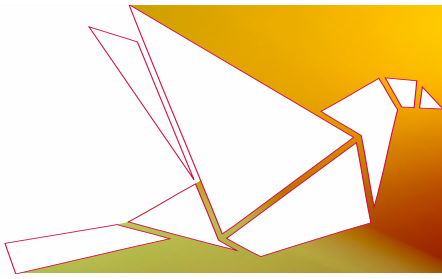
Transfer Pricing Regulations

Permanent establishment risks may be managed by formalising and establishing a local presence in Brazil. Companies may, in some cases, elect to be taxed on actual or deemed income; this is also reflected in the Brazilian transfer pricing regulations.

Brazilian transfer pricing regulations are aimed to prevent deviation of profits from Brazilian companies (e.g. subsidiaries) to foreign companies, though do not follow the OECD's transfer pricing guidelines or the BEPS measures adopted throughout the world.

Most of the Brazilian transfer pricing methods set **pre-determined fixed margins** ranging from 20% to 40%, pending on the measured activity and the industry, for both export and import transactions, which may be applied differently to services and/or products. These margins may require the Israeli company to limit its [otherwise arm's length] remuneration from the transaction, and thus may create a conflict with the Israeli tax and transfer pricing legislation.

For example, the Brazilian transfer pricing regulations may limit the mark-up (profit) of the Israeli company to 20% or require that the Brazilian company present a minimum of 20% to



40% gross margin. Additional safe harbours apply to loans (interest) and export transactions. Thus, any intercompany transaction should be carefully regulated from both the Israeli and the Brazilian part, to verify compliance.

Summary of the transfer pricing compliance must be filed together with the tax return, and is often calculated on a per-product basis. Thus, **the advance preparation of transfer pricing documentation is strongly recommended, to avoid heavy adjustments and non-compliance.**

The foregoing is only general information and does not constitute any legal or other advice.

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