

# Brazil's Transfer Pricing Changes and Impact on U.S. Foreign Tax Credit

By Ralf Ruedenburg, CPA, Partner

The Brazilian government recently issued draft legislation, Provisional Measure 1152 (MP 1152) to align the transfer pricing system in Brazil with the transfer pricing guidelines of The Organisation for Economic Co-operation and Development (OECD). MP 1152 was issued by Jair Bolsonaro but has to be ratified under the new Brazilian government lead by Luiz Inácio Lula da Silva within 120 days after the issuance date. The next session of the Congress in Brazil begins on February 2, 2023. Beginning January 1, 2024, the application of the new OECD-based rules would be mandatory but early adoption for fiscal year 2023 would be possible.

The new rules could help Brazil get into the OECD; but also, importantly, could ensure that U.S. multinationals can continue to credit taxes paid in Brazil against their U.S. tax bills.

## New U.S. Foreign Tax Credit Rules Caused Concern

In years prior to 2021, U.S. multinationals were able to apply Brazilian tax payments to their U.S. tax liabilities and the IRS did not have many reasons to challenge that position. After updated foreign tax credit regulations were published, questions arose whether that position still stands.

Foreign income tax rules must largely conform to U.S. tax laws, especially with regard to the sourcing of income, allowable deductions and the application of the arm's-length principle. The arm's-length principle says that transactions should be valued as if they were between unrelated parties, each acting in their own best interest. In limited circumstances, tax treaties might maintain creditability if similar rules do not exist in foreign tax jurisdictions. However, as a tax treaty between the U.S. and Brazil does not exist, this option is not available. The new rules apply to foreign taxes paid or accrued in tax years beginning on or after December 28, 2021.

The current Brazilian transfer pricing rules do not conform to U.S. tax laws as they do not include the application of the arm's-length principle. U.S. regulations specifically require that any "allocation to or from the resident of [income](#), gain, deduction, or [loss](#) with respect to transactions between such resident and organizations, trades, or businesses owned or [controlled](#) directly or indirectly by the same [interests](#) (that is, any [allocation](#) made pursuant to the [foreign country's transfer pricing](#) rules) is determined under arm's-length principles, without taking into [account](#) as a significant factor the [location](#) of customers, users, or any other similar destination-based criterion."

Thus, creditability of taxes paid in Brazil could be denied, even if taxpayers apply arm's-length principles in their transactions. Arm's length-principles must be implemented by the foreign tax jurisdiction. That is currently not the case in Brazil.

## Changes to Brazilian Transfer Pricing Rules and Impact on U.S. Foreign Tax Credit Rules

The arm's-length principle will be adopted by the Brazilian legislation if MP 1152 will be ratified within 120 days after its issuance. The application of that principle will make sure that one of the requirements to conform to U.S. law will be met and that U.S. multinationals can continue to apply Brazilian tax payments to their U.S. tax liability.

Other significant changes to the transfer pricing rules in Brazil will include the following:

- Selection of the most suitable method for the operation – the rules will make the Transactional Net Margin and Profit Split methods available to taxpayers
- Adoption of comparability analysis

- Introduction of compensatory adjustments (adjustments are possible until the end of the financial year)
- Introduction of specific rules for intangibles
- Inclusion of specific provisions to regulate intragroup services
- Introduction of the definition of cost contribution arrangements
- Application of transfer pricing rules to business restructurings
- Inclusion of all financial transactions under the scope of transfer pricing rules

U.S. multinationals should monitor whether the new rules are finally implemented by the current government and evaluate the eligibility for foreign tax credits as they relate to Brazil.

### **Contact Us**

As always, if you need any assistance, please reach out to your PKF O'Connor Davies client service team or Ralf Ruedenburg, CPA, at [rruedenburg@pkfod.com](mailto:rruedenburg@pkfod.com).

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