TRANSFER PRICING: ARM'S LENGTH PRINCIPLE *VERSUS* WORLDWIDE UNITARY TAXATION; CORRELATIVE AND SECONDARY ADJUSTMENTS, AND DOMESTIC LEGISLATION UNDER BRAZILIAN METHODOLOGY

MARCOS AURÉLIO PEREIRA VALADÃO

Professor of Law at Catholic University of Brasilia (UCB-Brazil); S.J.D. (SMU, TX-US), LL.M. International and Comparative Law (SMU), LL.M. (UnB, Brazil), LL.B. (PUC-GO, Brazil), B.S. (UnB, Brazil). Former Brazilian Member of the UN Committee of Experts on International Cooperation in Tax Matters. Tax Auditor for the Brazilian Federal Revenue Secretariat, and Chair of the 1st Section the Brazilian Federal Administrative Court of Tax Appeals (CARF).

I. INTRODUCTION

The aim of this study is to explain Brazilian Transfer Pricing legislation, which is a simplification of the traditional methodology,[1] and the interplay between the principle embodied in this methodologies

(arm's length principle) and the worldwide unitary taxation approach, taking into consideration the Brazilian approach to transfer pricing.

The study will also consider the interplay between Brazilian methodology and secondary and correlative adjustments, as it is the current practice worldwide.

Brazilian methodology is considered to be a simplification of the traditional approach, mainly because of the use of fixed (predetermined) margins for the resale price and cost plus methods. However, the Brazilian approach also presents other singularities, such as a specific comparable uncontrolled transactions method (CUP) for commodities and interest, and the use of safe harbors. These aspects will be addressed in the next section.

II. BRAZILIAN METHODOLOGY EXPLAINED[2]

2.1 . General view

Brazilian Transfer Pricing law was enacted in 1996, and entered into force in Jan. 1, 1997 (Federal Law n. 9,430/1996). The Federal Law 9,430/1996 was then modified by Laws n. 10,451/2002, n. 10,637/2002, n. 10.833/2002, n. 11,196/2005 (which introduced a modification to adjust exchange rate appreciation of the Real against foreign currency), n. 11.727/2008, and by Law n. 12,715/2012, which introduced important changes, such as allowing for a more flexible methodology for adjusting the profit margins to the Resale Price Method (RPM, also called RSP Method) and Cost Plus Method (CPM), establishing different margins for different economic sectors for the RPM, and a new methodology for CUP method regarding commodities. The old regulations were replaced by the Normative Instruction RFB n. 1.312/2012, issued by the Brazilian Federal Revenue Secretariat, as amended.[3] Regulations establishing the procedure of petition for changes of gross profit and mark up margins were established by the Ministry of Finance through Administrative Rule Number 222, issued in Sept., 2008. There are also other Regulations dealing with adjustments to exchange rate appreciation (issued in 2005, 2006, 2007, 2008 and 2011).[4]

1 The so-called traditional methodology is explained in the OECD Transfer Pricing Guidelines, and more recently in the UN Practical Manual Transfer Pricing Manual for Developing Countries (the latter brings also other countries practices in Chapter 10, Brazil, China, India and South Africa).

2 This Section is mostly based in a previous work of the author (with modifications and updates). See Marcos Aurelio Pereira VALADAO. Transfer Pricing Methodology in Brazil: a Simple and Efficient Approach to the Arm´s Length Principle. Tax Administration Review, n. 34, p. 75-88, dec/2012. Available at http://www.ciat.org/index.php/en/products-and-services/publications/review.html

3 The last modification was due to Normative Instruction RFB n. 1,395, of Sept. 13, 2013. RFB stands for Federal Revenue Secretariat of Brazil.
4 Law and regulations are available at: www.receita.fazenda.gov.br/Legislacao/LegisAssunto/ PrecosTransf.htm (Texts in Portuguese).

It is worth noting that the bill of law which became the Brazilian TP Legislation (Law 9,430/1996) made express reference to the OECD practices on TP, which is based on the arm´s length principle (also called *bona fide* arm's length price based upon comparable transactions).[5]

The methodology introduced by the law adopted the traditional transaction-based methods (CUP, CPM, and RPM) but denied the use of transactional profit-based methods, i.e., the profit split method and the transactional net margin method (TNMM), both present in the OECD TP Guidelines, and the formulary apportionment. Regarding the CUP, for export or imports, the law introduced a methodology that is similar to OECD practices, but Law n. 12,715/2012 introduced a simplification for CUP regarding goods that are considered commodities. However, with regard to the cost plus and resale price methods, instead of making use of comparable transactions, the law established fixed margins for gross profits and mark up.

Despite of the fact that Brazilian methodology basically adopts the three traditional transaction methods, i.e., CUP, RPM, and CPM, the law differentiates between imports and exports operations, by establishing separate sets of rules for imports and exports. It is important because Brazilian methodology adopts fixed margins, which are different for import and export operations, and also because some operations are subject to transfer pricing adjustment only for exports, which is the case of royalties, technical assistance, and scientific and administrative fees (when it represents payments for technology transfer).

The methods, under the Brazilian law, are as follows: PIC (Comparable Uncontrolled Price for Imports) and PCI (Price under Quotation Method for Imports) that are variations of CUP Method for imports, and PVEx (Price of Sale for Export Method) and PECEX (Price under Quotation Method for Exports) are variations of CUP for exports. While PIC and PVEx follows the general standards, PCI and PECEX are applicable only to goods and rights available in organized markets through mercantile and futures exchange. PRL (Resale Price Less Profit Method) for imports, PVA (Wholesale Price in the Country of Destination Less Profit Method), and PVV (Retail Price in the Country of Destination Less Profit Method) for exports are variations of the Resale Price Method (RPM), with fixed margins, while the law establishes differences regarding it is applicable to import or exports, with different profit margins. CPL (Cost of Production plus Profits Method) for imports, and CAP (Cost of Acquisition or Production plus Taxes and Profits Method) for exports, are the same Cost plus Method (CPM) with different set of rules and fixed margins regarding imports and exports.

5 The arm´s length principle is embodied in the Art. 9, par. 1, of the United Nations Model Double Taxation Convention between Developed and Developing Countries and the OECD Model Tax Convention on Income and on Capital, and is central for the OECD Transfer Pricing Guidelines Multinational Enterprises and Tax Administrations (2010) (OECD TP Guidelines). See, e.g., Stig SOLLUND & Marcos Aurelio Pereira VALADAO. The Commentary on Art. 9 –The Changes and Their Significance and the Ongoing Work on the UN Transfer Pricing Manual. Bulletin for International Taxation, v. 66, n.11, p. 608-611, 2012.

The following table depicts the Brazilian approach *vis a vis* the OECD TP Guidelines, and UN Practical Manual (except for Chapter 10):

BRAZIL		**OECD/UN – *correspondent methods***
Imports	**Exports**	
PIC & PCI	PVEx&PECEX	Comparable Uncontrolled Price (CUP)
PRL (20% and other margins)	PVA (15%)&PVV (30%)	Resale Price Method (RPM)
CPL (20%)	CAP (15%)	Cost Plus Method
N/A		Transactional Net Margin Method (TNMM)
N/A		Profit Split Method

There are also special rules for loans, applicable to either payment or receipt of interest, which were published in January 2013,[6] as a consequence of the modifications introduced by Law 12,715/2012.

2.2. Persons and Transactions subject to TP in Brazil

2.2.1 Related Persons

Transactions subject to TP regulations are those performed between related parties,[7] but not limited to it. As defined in the law[8]and regulations, related parties are juridical persons (legal entities) or individuals that have common interests (branch, controlled companies, participation holders, exclusive distribution rights, shareholders, owners, etc.), in accordance to a set of rules established by tax regulations that include the Brazilian juridical entity and:

6 Normative Instruction RFB n. 1.322, of January 16, 2013.
7 The translation of this term from Portuguese, in the strict sense, would be "linked persons" or "connected persons", however this term would not reflect the correct meaning of the law because the law and regulations implies a broader concept which is closer to the term "related parties", which includes both individuals and juridical persons.
8 Law n. 9,430/1996, art. 23.

1 – the parent company when it is domiciled in a foreign country;

2 – a foreign branch or subsidiary of the Brazilian entity;

3 – a non-resident individual or legal entity, domiciled abroad, when it holds at least 10 % of the shares or control of the Brazilian company;[9]

4 – a legal entity domiciled abroad in which the Brazilian company holds at least a 10 % participation or is a controlled company;[10]

5 – a foreign company that are under common corporate or administrative control, or when at least 10 % of the shares of each belong to a common shareholder;

6 – a non-resident individual or legal entity, domiciled abroad that jointly with a juridical person domiciled in Brazil hold at least a 10 % participation or control a third legal entity;[11]

7 – an individual or legal entity resident abroad that is associated in any form of condominium, consortium or co-ownership in any enterprise, in accordance with Brazilian Law definition;

8 – a non-resident individual who is a relative to the third degree of kinship, or is the spouse (legally or by common law) of any director or directly or indirectly controlling partner or shareholder;

9 – an individual or legal entity resident abroad, that acts as exclusive agent and distributor (or private concessionaire) for purchase and sale of goods, services and rights;

10 – an individual or legal entity resident abroad, to whom the legal entity in Brazil acts as exclusive agent and distributor (or private concessionaire) for purchase and sale of goods, services and rights.[12]

In addition, transactions performed between parties that are not related parties in a "uncontrolled transaction" when the transaction is performed through an "interposed person", which is a third party that is not directly associated to the related parties, but is engaged in business (international transactions of the same nature) connecting the two related parties, through a previously conceived scheme, are also subject to TP adjustments. In general, it applies when the interposed person acts as "conduit company". It is a specific anti-avoidance provision.

9 It is simplification of the legal provision which remits to the concept of associate and controlled corporations as defined in Law n. 6,404/1976, art. 243, §§ 10 and 20 (Brazilian Corporate Law), which states:

> Article 243. The annual management report shall list the investments of the corporation in associated and controlled corporations and shall mention any changes occurring during the fiscal year.
> Paragraph 1.Corporations are associated when one holds ten per cent or more of the capital of the other without controlling it.
> Paragraph 2. A corporation is controlled when a controlling corporation has rights of a partner, either directly or through other controlled corporations, which permanently assure it prevalence in voting and the power to elect the majority of the officers.

10 Id.

11 Id.

12 Article 23 of Law n. 9,430/1996.

Other transactions examined under Brazilian Transfer Pricing Regulations are those performed by individuals and legal entities in Brazil with any individual or legal entity residing or domiciled, in a country that do not tax income or that tax income up to a maximum rate of 20 percent, and operations performed with persons entitled to privileged tax regimes in a foreign jurisdiction, regardless of whether the latter is a related part. This rule also applies to jurisdictions that offers secrecy to ownership structure of legal entities or does not allow for identification of the beneficial owner.[13]

It is worth noting that the concept of related parties under Brazilian TP legislation is more comprehensive than the similar concept under the OECD TP Guidelines and the UN Practical Manual approaches, which are based on the Art. 9º of the Model Conventions (which refers to "associated enterprises").[14] Furthermore, it applies also to branches and subsidiaries, in line with the separate entity approach, adopted by the OECD and UN Model Conventions, despite of the fact that there some discrepancies between the current version of the two Models regarding art. 7º. However, as a long as the activity of the company in the other state is exercised through a permanent establishment, or a subsidiary, it requires the application of the arm's length principle in order to determine the tax base for the income tax in the other country. In this regard the UN Model Convention Commentaries (2011) states:

2. There is general acceptance of the arm's length principle embodied in the OECD Model Convention, under which the profits attributable to a permanent establishment are those which would be earned by the establishment if it were a wholly independent entity dealing with its head office as if it were a distinct and separate enterprise operating under conditions and selling at prices prevailing in the regular market. The profits so attributable are normally the profits shown on the books of the establishment. Nevertheless, this principle permits the authorities of the country in which the permanent establishment is located to rectify the accounts of the enterprise, so as to reflect properly income which the establishment would have earned if it were an independent enterprise dealing with its head office at arm's length. The application of the arm's length principle to the allocation of profits between the home office and its permanent establishment presupposes for most countries that the domestic legislation authorizes a determination on the basis of the arm's length principle.[15]

13 Normative Instruction RFB No. 1.037, issued in June 4, 2010, as amended, brings a list of jurisdictions that are subject to this treatment. The Brazilian legislation defines low-tax jurisdiction as countries or legal dependencies that do not tax income or do it under 20% rates; and defines non-transparent as countries or legal dependencies whose legislation allows for secrecy about the shareholders structure or ownership of legal entities, i.e., does not allow for identification of the beneficial owner. Ordinance (Portaria) n. 488, issued in Nov. 28, 2014, by the Ministry of Finance, lowered the referred tax rate to 17% (seventeen percent), for countries, dependencies and regimes that are in line with the international standards of fiscal transparency.
14 See OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (2010), Paris, OECD, Par. 11, p. 19.
15 United Nations Model Double Taxation Convention between Developed and Developing Countries. UN, NY, 2011, p. 140.

2.2.2 Targeted Transactions

Brazilian TP rules are applicable to transactions with goods, services and rights between related parties, and other situations, as described in the Subsection above. However, Brazilian Transfer Pricing Regulations are not applicable to payment for imports of royalties, and for technical assistance, and scientific and administrative fees (when it represents payments for technology transfer).[16] It is because these expenses are subject to limited deduction (up to five per cent of the turnover derived from it). They are also subject to withholding tax in the remittance of income. These limited deductions replace TP regulations application, and in some cases would lead to an analogous result derived from its application.

Payment of interest derived from loans and similar operations are also subject to specific TP regulations (below Subsection 2.3.2). TP legislation also establish specific rules for back to back transactions when the good is traded without being subject to actual import and export operations.[17]

2.3 Comparable Uncontrolled Transactions Method

The traditional CUP, in the Brazilian approach is similar to the traditional methodology, however it presents two different sets of rules for imports (PIC) and exports (PVEx) and two simplified approaches, for commodities and for loans, as describe below.

2.3.1 CUP for Commodities (PCI and PECEX)

When the prices of the goods and rights are available in organized markets through mercantile and futures exchange it is mandatory for the taxpayer to apply the Price under Quotation Method for Imports (PCI), and Price under Quotation Method for Exports (PECEX).[18] The aim is to avoid discussions on comparability of uncontrolled transactions when there is a defined market that sets the price globally. The law defines the price as the average daily price of goods or rights subject to public prices in commodities futures and internationally recognized exchange markets – it applies to PCI (imports) and PECEX (exports).

TP Law and regulations allow for adjustment of the price regarding the market premium at the date of the transaction, and other adjustments which depend on the conditions of the transactions. When there is no transaction available in the organized market in a specific date, it is possible to consider international recognized database for price research.

16 Law 9,430/1996, art.18, § 9º.
17 Normative Instruction RFB n. 1,312/2012, art. 37.
18 Law n. 12,715/2012 introduced articles 18-A and 19-A to Federal Law n. 9,430/1996. See also Normative Instruction RFB n. 1,312/2012, as amended, arts. 16-19, 34-36-A, which also lists the products subject to this methodology.

2.3.2 Special rules for loans

TP legislation limits deduction for payments above the market rate plus spread as describe in the law, and impose a minimum taxable income derived from interest received from loans and similar operations in controlled transactions. According the TP legislation, interest paid or credited to a related person, due to the a loan agreement, would only be deductible for purposes of determining taxable income to the amount not exceeding the calculated value based on the interest market rate plus a margin percentage, as spread. The interest market rate is considered to be:

> I – for transactions performed in U.S. dollars with pre-fixed rates shall be used the market rate for sovereign bonds issued on foreign markets in U.S. dollars by the Federative Republic of Brazil;
>
> II – for foreign transactions in Brazilian reais with pre-fixed rates shall be used the market rate for sovereign bonds issued on foreign markets in Brazilian reais by the Federative Republic of Brazil;
>
> III – for the remaining cases shall be used the rate London Interbank Offered Rate - LIBOR for deposits in U.S. dollars for six months.[19]

The spread margin percentage that shall be added to one of the rates described above to determine the maximum deduction admitted by tax administration is established by the Minister of Finance based on market average rate.

On the other hand, taxpayer earning interest in controlled transactions, as described in the law, must recognize a minimum interest income which is calculated by using the same parameters as described above to limit deduction from interest paid on the loan.

2.4 Resale Price and Cost Plus Methods with Fixed Margins

2.4.1 Resale price method with fixed margins for imports

Under this methodology, in order to determine the arm's length transfer price, the resale price that the resale company charges to an unrelated company is reduced by a fixed gross profit margin. The result is the deemed acceptable transfer price (arm´s length presumption) for a controlled transaction.

19 Items I, II, and III, § 6th, art. 22, of Law n. 9,430/1996, as amended. See also Normative Instruction RFB n. 1,312/2012, as amended, arts. 38, 38-A, and 39 for detailed regulations.

It is also possible to elaborate this system to consider the influence of value added costs in Brazil, when other inputs are combined with the product traded between associated enterprises and the final good is resold. In this case the price would be calculated having regard to the proportional participation of the good negotiated between associated parties in the good resold to an independent enterprise. This is called *participation ratio*, which is 100% in a simple resale. If the product traded between related parties is not subject to any manufacturing modification, the participation ratio will be of 100%, since the price of input (which now is the good itself) will be equal to the resale cost of good (final product).

This methodology reduces the weakness of using the resale price method when the reseller adds substantially costs to the product traded between associated parties. The resale price to be considered shall be that agreed upon the reselling company with an independent client (uncontrolled transaction). The method is called PRL.[20]

The formulas are:

Resale Price with manufacturing

TP (arm's length) = PV – GPMV,

Where:

- TP (arm's length) = transfer price at arm's length.
- PR = participation ratio = (price of input) ÷ (cost of production of the good)
- PV = participation value of the good transferred to the associated enterprise in the net resale price = net resale price of the good x PR;
- GPM = gross profit margin = the value of gross profit margin ratio, as determined by law or tax regulations.
- GPMV = gross profit value = GPM x PV = (GPM?) x (price of input ÷ cost of production of the good) x (net resale price of the good)
- TP (arm's length) = PV – GMPV = PV (1 – GPM%)

If the operation is a simple resale (participation ratio is 100%) it becomes:

TP (arm's length) = NRP – GPM x NRP,

Where:

20 For details see Normative Instruction RFB n. 1,312/2012, as amended, arts. 12-14.

- TP (arm's length) = transfer price at arm's length.
- NRP = net resale price
- GPM = gross profit margin = the value of gross profit margin ratio, as determined by law or tax regulations.
- TP(arm's length) = NRP – GPM x NRP = NRP – GPM% x NRP
- TP (arm's length) = NRP (1 – GPM%).

The calculations have to consider each product separately; the so-called basket approach is not allowed. The gross profit margin, under Brazilian methodology, will be set forth by law. The margin may vary depending on the economic sector of the activity performed by the company subject to transfer pricing adjustments.

Different fixed margins for different economic sectors

In 2012, Law 12,715/2012 adopted different margins for specific economic sectors, but in general it maintained 20 percent as a prescribed margin.[21] Accordingly, the margins for the RPM for imports are:

I - forty per cent, for the following sectors:

a) pharmaceutical chemicals and pharmaceuticals;

b) tobacco products;

c) equipment and optical instruments, photographic and cinematographic;

d) machinery, apparatus and equipment for use in dental, medical and hospital;

e) petroleum, and natural gas (mining industry), and

f) petroleum products (derived from oil refineries and alike);

II - thirty percent for the sectors of:

a) chemicals (other than pharmaceutical chemicals and pharmaceuticals);

b) glass and glass products;

c) pulp, paper and paper products; and

d) metallurgy; and

21 The margins apply to simple resale operations and manufacturing operations.

III - twenty percent for the other sectors.

2.4.2 Resale price method with fixed margins for exports

For exports the predetermined margins are fifteen percent when the operation in the export country is a wholesale operation (so-called PVA method), and thirty percent when it is a retail operation (so-called PVV method).[22]

2.4.3 Cost plus method with fixed margins for imports

CPM also applies predetermined gross profit markup for imports (so-called CPL).[23] The basic functionality of this method is very similar to the non-predetermined margin cost plus method. The deemed arm's length price is found by adding a 20% gross profit margin to the cost of the products, services or rights (or identical or similar items) of the supplier.

The formula is:

TP (arm's length) = CP + GPM x CP = CP x (1 + GPM)

Where:

- TP = transfer price at arm's length.
- CP = Cost of products, services or rights
- GPM = gross profit markup (20%)

2.4.4 Cost plus method with fixed margins for exports

For export operations, the cost of acquisition or manufacturing plus taxes and gross profit method (CAP),[24] adopts a fixed gross profit markup of 15%, the formula is the same of the previous method for imports, however in this case there is no room to use comparables for cost of the products, services or rights, which must be the actual manufacturing costs of the exports.

This is a preferable method for exports products, other than listed commodities, because it does not depend on foreign data.

22 For details see Normative Instruction RFB n. 1,312/2012, arts. 31-32.
23 Id., art. 15.
24 Id., art. 33.

2.5 Safe harbors

The Brazilian approach to resale price and cost plus methods with predetermined margins is not a safe harbor; they are mandatory methods depending on the choice of method and transactions performed.[25] A brief description of two safe harbor under Brazilian TP regulations follows.

- Taxpayers which have a net profit originating from export sales to related parties (before taxes on income), taking into consideration the current taxable year and the two preceding years, of at least 10% over such sales, will not have to make TP adjustments regarding income deriving from exports (subject to restrictions).

- Taxpayers are not subject to TP adjustments in exports when it is shown that net export revenues in taxable year is equal to or less than 5% of its total net revenues of the same period.

It is important to note that these two safe harbors[26] are not available to transactions with listed commodities (where PECEX method is mandatory), and to transactions with low tax or non-transparent jurisdictions, as defined by Brazilian TP Regulations.[27]

III. BRAZILIAN APPROACH TO TRANSFER PRICING AND WORLDWIDE UNITARY TAXATION

3.1. Unitary Taxation, formulary apportionment and arm´s length principle

For some reasons, such as lack of comparables, uncertainty in the real costs of intangibles (which are also part of the costs of tangible goods), new configuration of business strategies challenging the definition of permanent establishment, the e-commerce, it is becoming more and more complex and costly to apply the arm´s length principle in order to establish a fair distribution of tax basis.[28]Competing with the arm´s length approach, the most common model to split the tax basis is the unitary taxation with formula apportionment (also called global formulary apportionment). In other words, unitary taxation can be considered as a solution for the transfer pricing dilemma in the modern economic environment.[29]Under unitary taxation approach the aim is to identify the portion of corporate worldwide income that is associated with the corporation's business activities in each state, instead of quantifying the amount of net income earned by the component parts of a unitary business. It is used in the US for the state income

25 Safe harbors are options to taxpayers, in addition, safe harbors must take into consideration specific situations, and can be of two types: a) all inclusive (all operations of a kind are covered); and b) de minimis approach, where low value operations are disregarded.
26 For details see Normative Instruction RFB n. 1,312/2012, as amended, arts. 48-59.
27 See supra note 13.
28 See, e.g., Sol PICCIOTO.Is the International Tax System Fit for Purpose, Especially for Developing Countries? ICTD Working Paper 13, p. 13-27, available at http://www.ictd.ac/sites/default/files/ICTD%20WP13_0.pdf

29 Id. at. 29-32 . The OCED TP Guidelines argues against it, and explicitly rejects formulary apportionment. See OECD Transfer Pricing Guidelines, see supra note 5, at 37-41.

tax, and other countries also have similar approaches, it is also under consideration by the EU (CCCTB)[30]. Given this scenario it is worth evaluating how this methodology deals with Brazilian approach to TP, which is addressed in the next subsection. However, it is worth warning that due to lack of data's and other studies on these aspects of this problem, the following approach is admittedly perfunctory.

3.2. Relations between Unitary Taxation and Brazilian Methodology

Brazilian TP legislation is considered to be a simplified methodology to apply the arm´s length principle. However, it may resemble the formulary apportionment due to the use of formulas based on predetermined profit and mark up margins. But this resemblance is weak because the predetermined margins are a substitute for the numbers found through comparability analysis; at least it is the principle that supports the predetermined margins. For this reason, it is possible that all the accounting methodology to calculate the tax basis which is available in the OCED approach that can be used to migrate to a formulary apportionment is not available in Brazil. It is still a simplification. As a consequence, one can say that the impact of the adoption of worldwide unitary taxation, through formulary apportionment, towards the Brazilian methodology is almost impossible to foresee. It is because there would be a need to change the tax accounting methodology.

In other words, it seems that worldwide unitary taxation would not be compatible with the Brazilian methodology in the general sense, because albeit Brazil applies fixed margins (which apparently is similar to a formulary approach), the Brazilian methodology is indeed a simplification of the traditional transaction methods, and the worldwide unitary taxation are more like a transactional profit split method. Brazil does not adopt transactional profit methods. Actually, transactional profit split method can be considered a starting point to a worldwide unitary taxation approach (with formula apportionment), on an activity-by-activity basis. One can conceive a sort of a multilateral APA for applying it. However, this type of methodology would not be applicable in Brazil under the current circumstances, for the same reasons Brazil does not adopt "transactional profit methods".

Finally, it is worth mentioning again that the Brazilian TP legislation does not apply to royalties and know how transfers in imports, which are an important part of the discussions on transfer pricing. These rules also apply to both controlled and uncontrolled transactions. Actually, a move toward worldwide unitary taxation, could impact taxation of non-MNEs with international transactions. Thus, it is predictable that it would imply an extensive change in Brazilian income tax law.

30 The Common Consolidated Corporate Tax Base (CCCTB) is the EU approach to unitary taxation to share the income tax base for profits generated within the EU countries through formula apportionment. It is based in the assumption that "companies operating in more than one Member State in the Internal Market is to provide companies with a consolidated corporate tax base for their EU-wide activities". For additional details see http://ec.europa.eu/taxation_customs/taxation/company_tax/ common_tax_base/

IV. CORRELATIVE AND SECONDARY ADJUSTMENTS AND DOMESTIC LEGISLATION IN BRAZIL

4.1. Correlative Adjustments and Brazilian Legislation

Correlative adjustments are necessary when there is double taxation as a consequence of TP adjustments performed in two different countries. Art. 9º, paragraph 2º, of the OECD and UN Model Conventions deals with this issue, and set forth recommendations in the commentaries on how tax administrations of the country parties deal with this problem. Tax treaties also bring mutual agreement procedure (MAP) clauses (art. 25 of the Model Conventions) which a helpful tool to achieve consensus.

However, when it comes do correlative adjustments, which depends on tax treaties, Brazilian tax legislation presents two particular aspects, as follows.

None of the 29 Brazilian DTAs in force allow for correlative adjustments, because they do not bring the paragraph two of the art. 9º of the Model Conventions.

It is not a consensus, but it is generally accepted that internal law only (without a DTA) would not allow tax administration to negotiate increases and decreases of the tax base for income tax, especially in consideration to the strict legality principle that governs the application of tax law in Brazil.

As a consequence, Brazil does not accept to make correlative adjustments when there is a claim of double taxation as consequence of TP adjustments.[31] On the other hand, due to the simplicity of Brazilian methodology, which is more predicable than the traditional methodology, it does not cause to much impact in terms of hidden tax costs. This particular aspect results in less demand for correlative adjustments.

4.1. Secondary Adjustments and Brazilian Legislation

Secondary adjustments are those performed after the primary TP adjustment is made, in order to restore the position exactly to what it have been had the transactions taken place at arm´s length price prices (it is different form correlative adjustment, see the next subsection). In the Commentary on art. 9º, par. 2º, of the OECD Model Convention it states as follows:

31 RFB issued an interpretation stating that rules set forth in Conventions to avoid double taxation do not interfere with Brazilian transfer price adjustments. It took into consideration that there is no contradiction between art. 9o of the OECD Model Convention and Brazilian TP legislation. See Revenue Rulling n. 12, July 19, 2000, issued by the General Coordination on Taxation (Cosit) of the RFB (Decisão Cosit n. 12, de 12/19/2000, Processo de Consulta). Available at http://decisoes.fazenda.gov.br/netacgi/nph-brs?s10=@DTPE+%3E=+20000701+%3C=+20000731&s9=NAO+DRJ/$.SIGL.&n=-DTPE&d=DECW&p=1&u=/netahtml/decisoes/decw/pesquisaSOL.htm&r=1&f=G&l=20&s1=COSIT&s6=SC+OU+DE&s3=&s4=&s5=&s8=&s7=

9. These secondary adjustments, which would be required to establish the situation exactly as it would have been if transactions had been at arm's length, depend on the facts of the individual case. It should be noted that nothing in paragraph 2 prevents such secondary adjustments from being made where they are permitted under the domestic laws of Contracting States.

10. The paragraph also leaves open the question whether there should be a period of time after the expiration of which State B would not be obliged to make an appropriate adjustment to the profits of enterprise Y following an upward revision of the profits of enterprise X in State A. Some States consider that State B's commitment should be open-ended—in other words, that however many years State A goes back to revise assessments, enterprise Y should in equity be assured of an appropriate adjustment in State B. Other States consider that an open-ended commitment of this sort is unreasonable as a matter of practical administration. In the circumstances, therefore, this problem has not been dealt with in the text of the Article; but Contracting States are left free in bilateral conventions to include, if they wish, provisions dealing with the length of time during which State B is to be under obligation to make an appropriate adjustment [...] [at this point it remits to Commentary on art. 25 – Mutual Agreement Procedure]. [32]

Under Brazilian income tax legislation, there is no specific provision regarding secondary adjustments. Secondary adjustment is, in fact, are adjustments to tax liability that reflect a deemed transaction, therefore it requires a law provision imposing such adjustment. Considering that Brazil does not adopt par. 2º of the art. 9º of the Model Conventions and that there is no specific provision allowing tax administration to make a secondary adjustment or imposing the taxpayer such adjustments, one can say that, in Brazil, unless it is a fraudulent or irregular transaction, there is no secondary transfer pricing adjustments in a regular basis.

32 See OECD Model Convention (2010), p. 183; it is reproduced in the UN Model Convention (2011), p. 174.

V. FINAL REMARKS

Despite of the fact that lots of the details of the Brazilian TP laws and regulations were omitted here (these details give room to some adjustments for specific situations), Brazilian methodology is far simpler than the OCED Transfer Pricing Guidelines. It is worth mentioning that the recent UN Practical Manual on Transfer Pricing for Developing Countries brings four country practices (Brazil, China, India and South Africa) that can be very useful to developing countries.

The simplified Brazilian methodology also presents other features when the issues of unitary taxation, correlative and secondary adjustments are under discussion.

It seems that the adoption of unitary taxation would severely impact Brazilian income tax legislation, nevertheless it is a field that demands additional research. On the other hand, in the case of correlative and secondary adjustments, Brazilian legislation, considering tax treaties and internal law, simply does apply them. The first aspect is due to absence of par. 2º of art. 9º in Brazilian DTAs, and the latter is simply because there is no internal law provision allowing for it in regular transactions.