



New Transfer Pricing Challenges in Brazil

Impacts of Law no. 14.596/2023 in the payment of royalties

Introduction

Since 1991, whenever a Brazilian company had to pay royalties for the use of industrial property rights ("IPR") to a related foreign company, the respective contract had to be registered at the National Institute of Industrial Property (INPI). Among several rules, the payments were subject to limits ranging from 1% to 5% of the net sales revenue of the contracted products, depending on the sector of activity - these limits were also applied for tax deductibility purposes.

With the entry into force of Law 14.286/2021, this legal environment changed dramatically - at the end of December 2022, it eliminated the requirement for registration of contracts with the INPI for purposes of remittance of royalty payments. More recently, Law No. 14.596/2023 instituted the transfer pricing regime for dealings in intangible assets, creating a new rationale for the tax deductibility of remuneration relating to industrial property rights.

In this publication, we will briefly address the challenges posed to businesses by the new transfer pricing rules, as well as some approaches that may be useful for companies that need to deal with these issues.

Law no. 14.596/2023

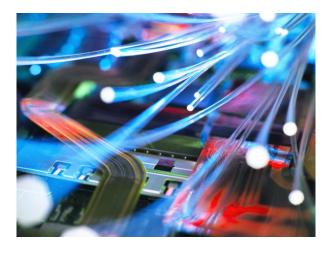
Law no. 14.596/2023 changed the legislation of the Corporate Income Tax (IRPJ) and the Social Contribution on Net Profits (CSLL), establishing new transfer pricing rules.

On June 15, 2023, Law no. 14.596 was published by the Federal Government, amending the Corporate Income Tax (IRPJ) and Social Contribution on Net Profits (CSLL) legislation to modify the Brazilian Transfer Pricing rules.

Law no. 14.596 aims to align the Brazilian Transfer Pricing rules with the guidelines of the Organization of Economic Cooperation and Development (OECD) guidelines, allowing multinational groups to apply global standards on intercompany transactions without specific adjustments for Brazilian entities.

In addition, the new law brings express and specific provisions on:

- i. Business restructuring, cash flow, commodities, cost contribution agreements, guarantees, insurance, intangibles, intercompany financing, and services;
- ii. Revocation of the tax deductibility limits for payment of royalties and the need to register technology transfer agreements with the Nacional Institute of Industrial Property (INPI) and the Brazilian Central Bank (BACEN)
- iii. Maintenance of the thin capitalization rules;
- iv. Adoption of the arm's length principle for controlled transactions.



The application of the new rules is optional for calendar year 2023, becoming mandatory from 2024.

The choice for early must be made bythe end of September 2023, through an electronic process on the e-CAC portal.

The date for the new transfer pricing rules to come into effect - One of the key points of discussion, accelerating the need for companies to review their current portfolio of intangible assets and adapt their contractual framework to the new transfer pricing rules - has not been changed by Congress and the Executive Branch.

OECD and Intangible Assets

Intangible Assets

The OECD guidelines defines "intangible" asset" as something other than a physical or financial asset that has an economic value and can be used in business activities - in which case its use or transfer would be rewarded when the transaction takes place between independent parties in comparable circumstances.

Law no. 14.596/2023 adopted a very similar definition, indicating that the assessment of what can be considered an intangible asset should be based not on its accounting definition, but on whether such an asset is subject to remuneration in comparable situations between unrelated parties.

DEMPE Framework

DEMPE is an acronym for Development, Enhancement, Maintenance, Protection, and Exploitation. This expression is a concept created by the OECD to evaluate transfer pricing cases involving intangible assets, both to identify the identities performing DEMPE activities and to ensure an arm's length return.

In transactions of intangible assets under transfer pricing rules it is important to check how the economic group is structured, where the research and development teams are allocated, who owns the intangible assets within the economic group, how they are used, and what risks the company is willing to take.

All these points are fundamental to define the calculation of a market-based compensation, which is usually defined by the functions that each company performs, the risks assumed in each operation, and the assets (tangible and intangible) required to perform the organization's activities.

In this sense, the DEMPE framework is necessary for companies to perform risk analyses related to the activities performed by each company within their economic group, as well as to define how profits will be distributed and the financial capacity to pay for the development of intangible assets and to protect them.



Development

Process that considers the entire process of asset development, including the implementation of strategic plans for its creation.



Enhancement

Continuous process of improvement and modernization of intangible assets.



Maintenance

The process of maintaining intangible assets to ensure their performance and their ability to generate revenue for the business.



(<u>(a)</u> Protection

Process of protecting the rights associated with intangible assets and the defense of their industrial property rights.



(国) Exploitation

Ability to generate profits by transferring, licensing, or leasing intangible assets.

What's Next?

Challenges faced by companies in Brazil after the recent updates in transfer pricing rules.

The entry into force of Law 14.596/2023 has increased pressure on companies to adapt their current royalty schemes to the new transfer pricing rules, as this will significantly impact multinationals operating in Brazil.

As 2024 approaches, taxpayers still do not have a clear view of how transfer pricing rules will be evaluated by Brazilian authorities and how the local file should be drawn up.

However, some actions are recommended so that companies do not fall behind and fail to comply with the new rules.

The OECD has a step-by-step plan for analyzing transactions involving intangible assets:

- 1. Establish the company's core competencies and identify its related intangible assets as well as the associated risks;
- 2. Identify contractual and other intercompany arrangements;
- 3. Check which companies in the group perform DEMPE activities;
- 4. Define whether the contractual risks are in line with the parties' conduct;
- 5. Delineate the transactions associated with DEMPE activities;
- 6. Set arm's length prices for the defined transaction.

NNB Advogados has a multidisciplinary team specialized in intellectual property rights, tax planning and transfer pricing legislation, and is prepared to support companies in adjusting to the new transfer pricing rules.



Evaluation of the company's current scenario

The first three steps of the OECD plan involve an in-depth assessment of the company's current situation: its contracts, its intangible assets, and its corporate research and development (R&D) structure.



Preliminary studies and next steps

The third, fourth, and fifth stages are based on studies of current contracts and how they relate to existing intangible assets within the company's economic group, as well as all transactions associated with DEMPE activities that would be remunerated in a normal transaction between unrelated parties.



Transfer pricing studies and contract restructuring

The last stage is associated with transfer pricing studies and renegotiation and restructuring of the company's contracts related to intangible assets.

For more information, contact one of our professionals below.

Marcelo Natale

Partner +55 11 2842 7600

manatale@nnbadvogados.com.br

Cassandra Alcalde

Partner +55 11 2842 7601 calcalde@nnbadvogados.com.br

Carlos Eduardo Eliziario de Lima

Partner

+55 11 2842 7650

carloslima@nnbadvogados.com.br

Daniel Avila Failla

Partner +55 11 2842 7640

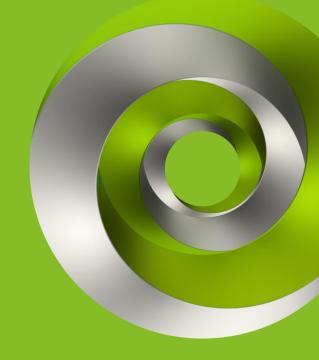
dafailla@nnbadvogados.com.br

https://nnbadvogados.com.br/
contato@nnbadvogados.com.br
https://www.linkedin.com/company/nnbadvogados/

Tel.: +55 (11) 2842-7600

Av. das Nações Unidas, 14.261 – 6º andar, bloco A, conj. 06-126, Parque da Cidade Office Cidade Moncões

04794-000 - São Paulo/SP, Brasil



About this publication

This publication has been written in general terms and for informational purposes only, and therefore should not be used to cover any specific demands or needs. Application of the concepts set forth in this publication will depend on the particular circumstances of each scenario, and we recommend that you obtain professional advice from a lawyer before acting or refraining from acting with respect to any of the matters mentioned in this publication.

About NNB Advogados

NNB Advogados is a Brazilian law firm providing legal services to various industries, with relevant experience to support clients in their day-to-day activities and in specific negotiations in multiple jurisdictions. Our structure is currently composed of more than 30 professionals, fully dedicated to the legal practice, with extensive expertise to meet all your legal demands.



Natale, Nicacio e Berry Sociedade de Advogados is a law firm located in São Paulo/SP, Brazil, at Avenida das Nações Unidas, nº 14.263, 6th floor, Block A, room 6-126.