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## THE NEW CONCEPT OF TAX HAVEN BY BRAZILIAN FEDERAL REVENUE AND THE CONSEQUENT APPLICATION OF THE TRANSFER PRICING RULES

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On 23<sup>rd</sup> June 2008, the Law n° 11727 was published ("Law 11.727/08") as a result from the conversion of the Provisional Measure n° 413, enacted on 3<sup>rd</sup> Jan 2008 ("MP 413/08") which amended certain provisions of the Brazilian Tax Law in force.

Among the changes brought by Law n° 11.727/08 - which will certainly raise more questions and discussions - are those related to the expansion of the current concept of **Tax Haven** in Brazilian Law, as well as the **transfer pricing rules**, intercompany transactions with countries considered as tax havens or tax jurisdictions with "Privileged Tax System", a concept used in the new legislation.

According to the changes brought by the new law, Brazilian tax authorities will consider as Tax Haven or Privileged Tax System countries or territories:

I) in which tax is levied at maximum rate of 20% or is not levied on the income;

II) which grant fiscal benefits to non-residents - individual or legal entity: a) without requirements for substantive economic activity in the country or territory, b) subject to non-practice of substantive activity in the country or territory;

III) in which taxes on the foreign incomes are not levied, or are at maximum rate below 20%, and

IV) which do not allow access to information regarding corporate records, property ownership or economic operations carried out.

The change brought by Law n° 11.727/08 - considering the concept above described - increased even more the taxation on legal entities which are included in this new concept, as from now on Brazilian companies trading with companies with Privileged Tax systems will be taxed according to the calculation of the transfer pricing, regardless of the relation between such companies.

The direct consequence of this new rule will be that jurisdictions that are known as tax havens will be directly affected, as is the case of Delaware, in the USA, aside from places like Panama, Cayman Islands and Virgin Islands, for example.

According to the Brazilian Federal Revenue, a rule will be edited until the end of the year providing two lists; the first list regarding the jurisdictions that would be considered "tax havens" and another list for the "systems with tax haven characteristics", which will help the Federal Revenue Office to understand and analyze situations that were not previously expected.

The justification given by the Government for such changes is the need to avoid the loss of tax revenue, due to the artificial allocation of revenue and expenditure in operations of property sales, rights or services, between legal entities located in different tax jurisdictions.

In this context, it is also important to mention the 'parameter price', which is the price established through the transfer pricing methods in the Brazilian legislation, and that will be considered as reference in comparison with the price effectively practiced by the company in operations with the countries that are classified into the new concept.

With the parameter price, the Federal Revenue Office determines the standard price, according to the pre-established<sup>1</sup> methods, by the average of market prices, preventing the practice of random prices in the import and export operations.

Unfortunately, as in many other situations

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<sup>1</sup> Methods for determination of parameter prices:

**In Importation:**

1. Method of Independent Compared Prices (PIC);
2. Method of Resale Prices less Profit (PRL Resale), with profit margin of 20% (twenty percent);
3. Method of Resale Prices less Income (PRL Production), with profit margin of 60% (sixty percent) and
4. Method of Production Cost plus Profit (CPL), with a margin of 20% (twenty percent).

**In Exportation:**

1. Method of Sales Prices in exports (PVEx);
2. Method of Wholesale Prices in the country of destination, less the income (PVA), with a margin of 15% (fifteen percent);
3. Method of Retail Prices in the country of destination, less income (PPV), with a margin of 30% (thirty percent) and
4. Method of Acquisition or Production Cost plus Taxes and Income (CAP), with a margin of 15% (fifteen percent).

in Brazil, the enacted improvement of Tax Law, aiming at increasing the tax collection and avoiding tax evasion just created presumptions on several jurisdictions in a generic and audacious way, making some legitimate international operations too burdensome or impracticable.

The Tax Department of Almeida Advogados is able to clarify any doubts resulting from those legislative changes, as well as work in any procedure for companies which have international operations with countries that may be included in the new concept of "tax haven". We remain at your disposal for any clarifications that may be deemed necessary.