Transfer pricing in the context of the management of earnings

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Abstract
On current context, of hard competition, has required companies a review of their process and organizational practices with the idea of ensure profitability and permanency in the market. In this global scenario is highlighted the growth of activities which are involving the flow of resources with lots of countries around the world, mediated principally by transnational companies. In some countries those operations were ruled and subject to taxation by methods that provide a regulation of market prices. In Brazil it wasn’t different. In face of complexity related with the exchange rate and tax policy concerning, the present work sought comprehensively analyze the methods of use of transfer pricing, which should be applied in international subsidiaries installed in Brazil and or companies which have transactions with tax havens in comparison with the legal requirements of other countries. To achieve the goal was chosen the single case study, in ALFA Company, Brazilian subsidiary of a multinational group, located in the south region of the country, which works as a trade commercial company of machines and components. The study justified inside the systematic adopted by the company where occur, recursively, relevant financial losses, caused by the attempt to standardize in a global level the process of price formation. The model reviewed resulted in a new systematic which offers significant reduction of financial losses, beyond the greater adherence to the tax laws and the exchange rate policy in Brazil, and for consequence an increase of net result to the shareholders.

Key words: Transfer Pricing, Importation, Exportation, Costs, Practicable Price, Parameter Price.

INTRODUCTION
The topic about transfer pricing can be considered recent, with the first studies started during the 90s of the last century, and has been each time more relevant according with its importance for the international trade markets. This subject, among others, about taxation, often keeps out for the lack of knowledge or for the low number of professionals which really know the rules and the techniques concerning and subject to a possible review by the tax authorities. Without the necessary care and attention to be in line with Brazilian law, the transnational companies increase their risk in a high level when we talk about investment from different countries in Brazil. The risk is referent to the lack of control of practicable prices between companies which belong to the same group or that have, directly or indirectly, operations (buy/sell) with other companies established in tax havens. These points can compromise the Brazilian subsidiary if the processes and operations are not well structured according with the local requirements, as the taxation is applied where the subsidiary is installed (taxing jurisdiction).

Nowadays the investors, before turns into a shareholder and realize an external direct investment, should study in detail this subject, as, beyond the logistic costs, importation/exportation factors and fiscal incentives, in order to analyze if exist tax obligation for transfer pricing. This factor can be considered of a high importance, because without analyzing these aspects, regarding the transfer pricing approaches and obligations, operations may seem very attractive. It can show a large margin of earnings to the shareholder, above average of the market, especially in international trade, importation and exportation. This kind of analysis includes different conceptions for the manufacturing models, raw material, personnel cost (work-force), and so on, for each country chosen to study.

In case of non-adherence to those policies, the difference between the market prices and the price used by the companies on their global operations, called price parameter, depending of the situation, should be

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added to the taxable income and increase the IRPJ and CSLL to be paid in case of Brazil. Amaral et al (1997) contextualizes that, saying that multinational companies with many subsidiaries installed in more than one single country, need to obey the local legal requirements, even if they generates additional problems to the corporations and cause higher cost of adaptation of those subsidiaries in some nations. The objective of this paper is to perform analysis of the methods and approaches which are accepted by the Brazilian law in relation to the transfer prices between subsidiaries of the same multinational corporation. In order to achieve this objective was analyzed case of the company ALFA, through interviews in deep and documental analysis, checking the process of pricing to make sure what is necessary about transfer pricing to make profitable company avoiding financial losses on the operations. Results of the study evidenced that company suffered financial losses due to the value of the taxes applied in the operations of the transfer pricing.

COSTS AND PRICE INSIDE INTERNATIONAL OPERATIONS
The globalization brought a number of phenomenons to the current context of corporation’s world. According with Pinheiro (2001) and Caparroz (2012) globalization, influenced the international market and contributed to change the global relations. To Vieira (2008), Brazil started processes of trade commercial opening around the 1988, with the objective to include the country inside the international market. “[…] the world is getting each day more horizontal and connected in its economic-financial relations” (LOZARDO, 2007, p.55). Globalization allowed flow of the financial resources from developed countries in the emergent economies. About this topic, Caparroz (2012) comments that little developed countries opened their economies to receive foreign investments of multinational companies. The changes which started to appear, regarding the globalization processes, required adaptations of the international operations to the conditions of the foreign countries.

With the economic increases, the political relations between governments and the nations started to suffer a huge impact, as the flow of currency through countries was something that became a risk factor of the balance of trade of those involved into. Caparroz (2012) comments that, as inside Brazil doesn’t exist the free flow of foreign currency, all the operations between citizens and companies affiliates or not, should be intermediated by institutions accredited in the Central Bank of Brazil (BACEN), on buy and sell of foreign currencies.

Each country counts with a respective tax burden and other factors that influence the manufacture of goods, rights and services to be applicable internally and externally. The internal variables and policies of each nation not necessarily are a world constant. This criterion is based on the manner and tax law of each country/block/union, hardly comparable between other nations. In this scenario are considered the principal companies that operate those types of international transactions, the group corporations and the private multinational groups. Lozardo (2007) affirms that the multinational companies have a very important role in deepening of capitalism between the rich and poor nations. To Amaral et al (1997), the increase of operations between related companies located in distinct jurisdictions presents a complex tax problem, because at the beginning of those operations, the tax authorities were not prepared to control and manage this kind of processes.

Without the necessary monetary control of flow of foreign currency, the governments of many nations were forced to create public policies with the objective to rule the international trade operations. It was predictable that this market would present a risk of generating distortions of tax incidence over the earnings of those corporations. On the same line, was observed that “since the firsts jobs developed to avoid the double taxation in situations that involve international transactions […] already was outlined the worries about thematic of transfer pricing” (GREGORIO apud SCHOUERI, 2006, P. 6).

TRANSFER PRICING
Amaral et al (1997, p.11) concepts transfer price as “the practicable price in international operations between related parties” and says that the issue of transfer price concerns to the multinational corporations that operate globally and with cash flow centralized in tax havens. According to Gregório (2010), monetary politics and manufacture factors and models differ between nations, allowing manipulation of the legal rules in order to perform tax elisions.
Pinheiro (2001) argues that before the creation of Law 9.430/96, inside Brazil, tax authorities didn’t have control neither legal support in the reference about practicable prices, in order to establish taxes on the transfer pricing operations. Price Waterhouse Auditores Independentes (2000) comments that the creation of the Law 9.430/96 represents an advance of the national rules in face of progress and globalization. Amaral et al (1997) highlights that it seems that the creation of the Law 9.430/96 came to introduce rules against the “improper freedom” in the international operations, in the face of the worldwide consensus about income taxes over artificial prices between related parties.

In order to regulate international operations that involve transference of the financial resources Law 9.430/96 required definitions of the maximum price of importation, the minimum price of exportation and the maximum financial charges over loans and other mutual agreement, registered, or not, in the Central Bank of Brazil, in transactions between persons or companies established in Brazil and linked with to another located outside Brazil. The companies which have operations with tax havens were considered as linked too, even if the companies do not belong to the same group (MATOS, 1999).

To Amaral et al (1997), the rules of transfer pricing are inserted into the context of foreign trade on worldwide, in a way where it is impossible to Brazil to stay out of those rules. These legal measures aimed also to avoid the double taxation, which may occur when there were adjustments related to the transfer pricing, where are paid taxes (VAT) on the billing process of goods and are going to be paid again with the difference between the practicable prices and parameter prices.

Gregório (2010) comments that the theoretical model of the taxation policy of the transfer prices, introduced in Brazil, were inspired on the principles of the OECD’s model, which regulates the trade between associated countries, and specific topics of the tributary law of United States of America (EUA). Price Waterhouse Auditores Independentes (2000, p. 10) highlights that:

For what is exposed, the adoption of rules in the national tributary system decurr of a conformation of Brazil with the process of integration of worldwide economies. The formations of business groups and the necessity to establish rules which drive the relations between the companies that stimulate the intuition of rules of control of those global operations, settling to the fiscal and monetary interest of each country.

According to the Pinheiro (2001) after the creation of Law 9.430/96, many companies began to analyze legal points and tributary systems more favorable, when compared with other nations, to try to avoid the events that would be taxed. Studying operations with reference of tax elisions, Pinheiro (2001), found evidences of the indirect transferences through linked companies, where the bigger part of earnings were destined to the other companies in tax havens or with favorable taxation. According with Amaral et al (1997, p. 79) “the Law 9.430/96 included rules to block the use of the called ‘tax havens’ also as way of tax evasion in international trades”.

The indirect earnings transference is made through the manipulation of transfer pricing practiced between the corporations of the same economic group, overpaying the acquisition costs and underpricing the prices in territories of high taxes levels and proceeding conversely in countries of low taxes level. The understanding of manipulation is, as a difference between the price used or simply stipulated by a group of companies linked and the price which will be used if the transactions, was realized by independent companies acting in the similar situations (Amaral et al, 1997).

Through transfer pricing, lots of transnational companies sought to accomplish certain obligations making use of the illegal acts. The Decree-Law 1.598/77, in its article 60th and 61st, and the changes made by Degree-Law 2.065/83, distinguish profit distribution, that according with the income tax rules happens when one of the related parts are favored by overbilling from outside Brazil or the underpricing sales in Brazil. In the same way, if a company that is using the subsidiaries of the same group to benefit itself to increase its profit through transfer pricing; it may be considered a crime. Amaral et al (1997) affirms also that this kind of situation happens when verified that company is deviating earnings to the other linked companies, which are located in the countries, where the taxes are lower inside the operations.
FEDERAL TAX LAW
Following example of the other countries Brazilian government issued the rules principles in order to regulate transfer pricing, based on the marketing features for products, goods, services and intangible, through Law 9.430/96. The Law disposes about the federal chargeability related with taxation where it generates several obligations for the multinational companies established in Brazil, with operations with linked companies, to present and develop transfer pricing methods. According with Nepomuceno (2003) until that was common the practice of the foreign companies with subsidiaries established in Brazil, to practice artificial prices, through increasing the importation prices and decreasing the exportation, with the aim to concentrate profit outside Brazil, reducing in Brazil tax revenue and the balance of trade. According Nepomuceno (2003) the term “linked”, used as a base for transfer pricing should be understandable as relations that the shareholders maintain with subsidiaries into a certain limit of percentage so in as outside of the national territory, specified in the article 2nd of the Normative Instruction Nr. 38/97. Normative Instruction Nr. 38/97 argues that also groups of companies as mentioned above are featured as linked companies, in the same way as persons which have operations tax havens are considered as linked companies too.

The same understanding presents Price Waterhouse Auditores Independentes (2000) that understands that the same classification is applied to the companies which have operations in tax havens, as is specified in the Declaratory Executive Act 03/11 and Normative Instruction Nr. 1.037/10, with addition of the list of countries considered as tax havens, exposed in the Normative Instruction 1.045/10. Brazilian tax Law 11.727/08 considers a tax haven country where income taxation stay below of 20% (twenty percent) with bank secrecy for the owner and transactions involved, deposits in original currency or which conced tax benefits for non-residents. The methods applied in Brazil are, even for importation or exportation, very similar as exposed by OCDE and USA, being different only in the way of calculation method of the taxes. According with Matos the transfer pricing law define three methods to calculate the costs or the deductible expenses to calculate the income tax over goods, services and imported rights for linked persons or from tax havens. The three methods mentioned are identified in the Brazilian Taxation Law as below:

- **PIC - Brazil or CUP - Comparable Uncontrolled Price**: exposed on the article 8th by the Law 9.430/96, represented by the arithmetic average of prices of goods, services and rights, identic or similar, exported to Brazil by linked, or established in tax haven, companies compared with the same transaction of the exporter with a 3rd parties customer in similar conditions in whatever part of the world. The PIC method has the premise that the commercial invoices are comparable inside the practicable business by the linked companies with 3rd parties. It is understandable that, if the exporter is located outside Brazil, sells to the Brazilian subsidiary with the amount superior compared with a 3rd party customer located in a foreign country or inclusive in Brazil, these operations should be taxed by the transfer pricing by the difference between the commercial invoices for the same or similar product, service or right.

- **PRL – Brazil or RPM – Resale Price Method**: The PRL is defined according the Law 12.715/12 on the article 48th like the arithmetic average of the prices of sale in Brazil, of goods, services or right imported in similar business conditions and with a specific minimum profitable margin depending of the segment of the trade destiny. It is understandable that if the Brazilian company imports goods, services or rights with a higher price compared with the sale price of the same part, resulting in losses, low level of the profit or negative difference, the company should add to the base of calculation the value of the income tax and social contribution. The method PRL is normally used into trade companies with resell operations, because in this situation the basic structure remain unchanged.

- **CPL – Brazil or CPM - Cost Plus Method**: The method CPL is knew according with Price Waterhouse Auditores Independentes (2000) as the average cost of production, services or rights, added with the taxes and fees paid because of the country where is established the exporter company, adding in the total of this operation the profit margin of 20% (twenty percent). In case that the linked exporter or established in tax haven cannot achieve the target of the amount specified by this method, the
difference compared with the parameter price should be added to base of calculation of Income Tax and Social Contribution.

- PCI – Brazil (Prices defined on stock exchange and futures for importation): According to the Law 12.715/12, in its article 18-A, when a company had import trade relations with products imported featured as commodities and, in this case understands that the products are subjected to quotation in stock exchange, internationally recognized. The method applicable should be the PCI, and the calculation is exposed into the article 16th on the Normative Instruction Nr. 1.312/12 on the 2nd paragraph showing that the prices of the imported goods declared by the persons established inside Brazil, should be compared with the quotation prices on the stock exchange, adjusted for more or for less of the market premium, at the date of the transaction.

Matos (1999) argues that the transfer pricing calculation in importation should be realized on the period of tax based on net income calculation, which should be done every three months or once in the fiscal year, according to the type of calculation of each company. These methods considers face value of the product, and in this way is not possible to employ, at the same time two methods to the same good, service or right imported, so the companies can choose the approach that is more appropriate to the case and that generates less adjustments or additions.

The Law 9.430/96 seeks to avoid transferences in an illegal way to other countries outside Brazil. Export operations prices can’t be lower than the normal market price, following the same inverse policy of import operations, reducing the costs of linked companies. According with Price Waterhouse Auditores Independentes (2000), after defined the rules of deductibility of costs and expenses of importation, the Law 9.430/96 determines an inverse operation, ruling about the minimum level of the exportation prices of Brazilian companies. According with the Normative Instruction Nr. 38/97 and complemented by the Normative Instruction Nr. 1.312/12 the methods created were the following:

- PVEEx – Brazil or CUP - Comparable Uncontrolled Price: The PVEEx method is exposed by the article 21st of the Normative Instruction Nr. 38/97, which shows that the revenue of sale in exportation operations can be determined defining as arithmetic average of the sale prices effectuated by the own company, to other customers (3rd parties, no featured on point of linked companies), or other national exporter of goods, services and or rights, identical or similar, during the same period of income tax calculation in similar payment terms. This method is more simple when compared with the other about export operations, however this implies to find out operations in the local internal market (Brazilian Market) with the same or similar goods, services or rights, in order to compare the prices of the 3rd parties. According Price Waterhouse Auditores Independentes (2000), with this approach the Brazilian tax authorities want to make sure, if, effectively, the Brazilian companies are offering the same products or services with market prices, even for the linked companies as for other companies which the company can have transactions without a link. According to the Normative Instruction Nr. 1.312/12 the price calculated with this method should be compared with the arithmetic average of prices operated with linked companies and tax havens, if the parameter price be lower than the calculated with the PVEEx which is the arithmetic price average used to other non-linked companies the difference should be add to income taxes.

- PVA – Brazil or RPM – Resale Price Method: Following the article 22nd of Normative Instruction Nr. 38/97, determine with base on the method PVA, defined as the arithmetic average of the prices of sale of goods (for this method is just applicable for tangible transactions) practicable on the wholesale market, in similar payment terms, less the fees and taxes (VAT) paid for it inside the destination country (in this case it is very important to know where the products are resell, as sometimes the linked companies or tax havens located companies just intermediate the operation in one country and sell to another one, the one which should be analyzed by this approach is final destination country), and profit margin of 15% (fifteen percent) over the total price. To provide evidences of the prices of the transactions is necessary to demonstrate commercial trade invoices of all operations. The practicable price calculated with this method should be compared with the arithmetic average of prices operated with linked companies and tax havens, if the parameter price be lower than the calculated with the PVA which is the arithmetic price average used to other non-linked companies the difference should be add to income taxes.
PVV – Brazil or RPM – Resale Price Method: In a similar way as the PVA method, PVV according with the article 23rd of the Law 12.715/12, is defined as the arithmetic average of the prices of sale of goods (for this method is just applicable for tangible transactions) practicable on the retail market, in similar payment terms, less the fees and taxes (VAT) paid for it inside the destination country (in this case it is very important to know where the products are resell, as sometimes the linked companies or tax havens located companies just intermediate the operation in one country and sell to another one, the one which should be analyzed by this approach is final destination country), and profit margin of 30% (thirty percent) over the total price. To prove the prices on the transactions is necessary to have commercial trade invoices for the retail sale companies. The practicable price calculated with this method should be compared with the arithmetic average of prices operated with linked companies and tax havens. If the parameter price be lower than the calculated with the PVV which is the arithmetic price average used to other non-linked companies the difference should be add to income taxes.

CAP – Brazil or CPM – Cost Plus Method: The method CAP, according with the article 24th of Normative Instruction Nr. 38/96, is determined as the cost of acquisition or production plus a profit margin, defined as an arithmetic average of costs of production and acquisition of goods, services and rights, exported, added the fees, freights, insurance, taxes and contributions (VAT) paid in Brazil and a contribution margin of earning of 15% (fifteen percent) over the sum of costs and taxes. According with 4th paragraph of the Normative Instruction Nr. 38/97 on the article 24th, if the company in Brazil uses an exporter trade company to do the exportation the parameter price applicable is the price of sale for the trade company, even if this last add some extra profit margin to export. The practicable price calculated with this method should be compared with the arithmetic average of prices operated with linked companies and tax havens, if the parameter price be lower than the calculated with the CAP which is the arithmetic price average used to other non-linked companies the difference should be add to income taxes.

Pecex – Brazil (Prices defined on stock exchange and futures for exportation): similar with the importation method PCI was created the Pecex for the exportation model which is cited on the article 19th of the Normative Instruction Nr. 38/97, and is defined as the average daily amount of the quotation of commodities subjected to the public prices on stock exchange. As Brazil is highly recognized on the international market because of the exportation of agriculture commodities this model is considered very important. The calculation according with the article 34th of Normative Instruction Nr. 1.312/12 on its paragraph 6th which exposes that the revenues of export operations with linked companies or established in tax havens. For this method is not obligated the percent of 90% (ninety percent) of difference of the average of prices with non-linked companies as for the other export methods. The practicable price calculated with this method should be compared with the arithmetic average of prices operated in an international stock exchange.

METHOD
The chosen method of research was single case study, in order to provide comprehensive approach to the as it is understandable that it presents a better adherence to the objective and the questions that guide this study. The central elements of this research refer to evaluate the pricing process of the company ALFA ensuring to make a profitable business in Brazil.

According with Goode (1975) the single case study is not a specific technique, been more a way to organize social data preserving the unitary feature of the social object studied. The same perception is presented by Hartley (1994) for who the approach of the single case study is not a method itself, but it is a strategy of research which consists in a detail investigation of one or more organizations, or groups inside an organizations, with the aim to provide a contextual analyze and the processes involved on the phenomenon under study. Following the idea of Yin (2005) the single case study refers to the thorough and deep study of one or more objects. Demo (2006) highlights the adaptation of method of single case study to investigate the contemporary phenomenon inside the context of real life, always when the border between phenomenon and context is not clearly defined.
For Yin (2005) the modality of single case study is chosen as an option of research by the social researchers. This happens because its approach looks show a research with different objectives, inclusive those objectives can explore facts of real life where the subject wasn’t fully explored, on a description of a fact which is in study or under an investigation, explaining rarely phenomenon that does not exist possibilities and the use of experimental collection data. Yin (2005) understands that the single case study is appropriate to answer questions as “how” and “why”, those are explicative questions and address operational relations which happen during the time more often than frequencies or incidences. According with Yin (2005) “[…] method can be understandable as the way, the form, the manner of thinking. It’s a form of approach in a level of abstraction of phenomenon. It’s a group of procedures or mental operations used into the research”.

The single case study was realized at ALFA Company, a corporation of wholesale trade operations and services. Since was founded, mid of the 70s decade of the last century, the ALFA Company at the beginning started its activities as manufacturer, and its operations were characterized with the use of drawback model, as the company bought raw materials and components on the external market, manufactured, and exported the finished goods directly to the company’s headquarter or to final foreign customers.

Around 2007 ALFA Company passed for two incorporations and new shareholders restructured all operations. One of them refers to the manufacturing. The manufacturing costs, principally regarding the personnel costs related with the production work inside the Brazilian market, were considered impracticable to keep the company competitive with the emergent market, as China, for example, which started to conquer space and “take” many customer of ALFA Company with low and attractive prices. The economic group, to which company ALFA belongs, opted to close the productions and transform the subsidiary in a wholesale trade and service provider, with a organizational structure leaner, that started to buy the finished goods from its headquarter and from the Chinese subsidiary, offering to Brazilian customers only technical assistance of maintenance, repairs and trainings.

RESULTS
The Company ALFA suffered significant process of restructuration since the incorporation, and the most relevant change was to converse the manufacture plant to a subsidiary focus on import and resell operations. During this period several managerial processes were changed and some operations and controls failed in order to provide information for new managers, implying some legal problems in calculating and paying taxes, due to the inadequacy of the approach with the reality of the local subsidiary in Brazil, focusing now wholesale operations and services. This kind of problem is common in the multinational operations, as according with Leone (2000), because of the lack of the knowledge in higher in relation to the federal Laws that regulate international trade.

As ALFA Company is a subsidiary of an international group and should reach targets according with the internal rules which guide the interests and objectives of the company, Beulke e Bertó (2006) exposes that the costs system must be based on the budgeting system, with sales targets, costs and results. Lima (1969) comments that if there is a cost budgeting, also, is possible to compare the real events vs the budgeted events. In this way the organization should align its costs to reach the expected results.

Nowadays, inside the strategy setting, the activity that is contributing with around 80% (eighty percent) of the gross sales, is resell of spare parts, and for this reason is considered the most important by the company management team. Inside those 80% (eighty percent) around 98% (ninety eight percent) are spare parts imported from linked companies of the group which ALFA belongs to. The other 20% (twenty percent) of the gross sales is divided in 5% (five percent) to 3rd parties’ customers and the other 15% (fifteen percent) remain to activity of support the headquarter warranty activities on the customers plant and internal repairs made by the repair shop team inside ALFA’s office.

Nowadays the reality of the Brazilian subsidiary is very complex in terms of processes and operations, with importation and exportation of goods and intangibles, inclusive realizing payments of royalties and other types of technologies to foreign countries. The other point which is considered as a difficult is the calculation of the methods of transfer pricing, due to the great mix of products (around 20.000 different
parts) that have to be available to the customers. This great mix of different parts imported from a variety of the countries implies specific methods of calculation of the transfer prices.

In case that the company ALFA chose to use the PIC approach to all the items, it would meant that should be selected the same number of parts and asked the headquarter of ALFA Company, invoices to confirm the prices used to sell the same products to customer 3rd parties (non-linked companies), but this task initially looks impracticable bear in mind due to the proportion of the high number of parts sold during the years. In case that the easiest procedure to ALFA Company was apply the CPL method, that is more simple and easy to demonstrate it, but unfortunately this method would request the headquarters to open its production costs, considered impracticable.

At the end remains the last method, PRL which, according with ALFA market segment should achieve a profit margin of 20% (twenty percent). On the option of the PRL approach the costs were not the same to each imported part, according with Beulke e Bertó (2006) that affirms that the variable costs change in a direct and unitary relation with the sales volume. This method provides the use of weighted average and to have a better understanding of how this method works is of fundamental importance for the breakdown of all the amounts in each premise to get the cost to be used as base of the PRL approach.

Starting with the conception of the method PRL 20% were considered a database created through the ERP system of ALFA Company with all the units resold to 3rd parties (non-linked or situated in tax havens). As above mentioned, this database has thousands of items per invoice that were issued to the most different Brazilian customers. According with the article 12th of Normative Instruction Nr. 1.312/12 to calculate the PRL is initially necessary to calculate arithmetic average for each single product resold, in the same way as the price of sale is necessary to include all the taxes, commissions, interest and discounts. If the company sold the same part lots of times in each year calendar and, if the sales did not have the same price of sale for the referent part, it is necessary to sum all the total of prices of sales to all the quantities sold and divide this amount by the quantity sold during the same period. The results of this count are going to be the average price of sale of the period. To go the next item of the law is necessary to deduct of the average price of sale the average of all the factors which are considered sales deductions as VAT, commissions and discounts. The remaining amount is the net average price of sale, which really remains to cover the costs and left a profit margin to the company.

Following the item II of the above mentioned Normative Instruction, it is necessary to calculate how much of the net average of the price of sale is composed of intercompany or tax havens operations, and to calculate that is necessary take the average of the acquisition price FOB (the pure price of the spare part exposed on the Importation Declaration) divided by the total cost of the spare part. This calculation will rise up how much of the total cost presented on the company inventory is related with transfer pricing. This percentage should be multiplied by the net average price of sale generating the net average price of sale applicable for transfer pricing. For ALFA Company the percentage of participation of cost to apply to transfer pricing is variable around 70% (seventy percent) to 90% (ninety percent) of the total cost is the FOB amount. From the net average price of sale should be discounted the 20% (twenty percent) as profit margin according to the segment of ALFA Company. The result is known as parameter price.

The parameter price should be compared with the average of the FOB prices imported (practicable price). If the price FOB be higher compared with the parameter the difference should be added to income tax and social contribution. In case of ALFA Company the adjustment of all the importation operations of spare parts via PRL were around R$ 16.000.000,00 (sixteen million) to be add to the taxable income of the periods of 2006 to 2010, and this amount will represent a P/L and cash flow effect of around R$ 5.440.000,00 (five million four hundred forty thousand) referent of IRPJ and CSLL with rate together of 34% (thirty four percent).

The amount calculated generates questions about the use of one single method to all products in order to fix criterion to perform transfer pricing. The ALFA’s team of management checked the impacts and understudied that the addition in around 90% (ninety percent) were sales of machines and equipment, where contribution margin was practicably zero, as this types of machines and equipment the contribution margin stays with the exporter, in this case the headquarter of ALFA Company, was around the 20% (twenty percent) and it means that wasn’t possible to add more 20% (twenty percent) in Brazil to use the method PRL.
It’s important to note that with the FOB price are paid on the importation all the custom duties, non-recoverable taxes and inclusive paid the VAT of the sale of the equipment in Brazil, turning the final price so high that will be impossible to sell it. As strategy of the ALFA’s group, during the periods were sold machines and equipment with zero contribution margin with the aim of increase the market share in comparison with the competitors which work in the same way and inclusive using other illegal ways to do business.

Nowadays, the company ALFA is trying to be flexible in terms of prices and payments terms, but management team still doesn’t know how taxation of the transfer prices could affect its business model. So the company is studying a new approach to calculate transfer pricing, changing of PRL to PIC method and this method was used for the machines and equipment resold cases, those which are generating the huge addition of income taxes.

Following the idea of PIC approach, were checked all the data available of the machines and equipment which are part of this group, where were highlighted the information about the manufacture year, serial numbers, model, technical specifications, FOB amount, the documents of importation as well as the invoices. Using those data were sent to the ALFA’s headquarter an Excel spreadsheet to be checked and returned new invoices with the same/similar machine or equipment sold to third parties.

PIC method was understandable that the own headquarter of ALFA company did not attempt to the prices which it sold to its subsidiary (ALFA), even that ALFA’s headquarter did transfer pricing documentations for legal rules in its country, but this method didn’t allow to know the impacts of the transactions and how they interfere in Brazil. Those points were discovered when received invoices of the request mentioned above there were effectively sales of the same/similar machine and equipment sold to third parties with a low price compared with ALFA’s acquisition price.

With the invoices information received was possible to reverse the effect in around 80% (eighty percent) of the sample sent to headquarter to find same/similar machines sold to 3rd parties. This task unfortunately was exhaustive, as depends of direct cooperation of employees from the headquarter and sometimes the need of information turns into a challenge to the nations where, the understanding is necessary to attend the transfer pricing at both ends. The effect of 5.440.000,00 (five million four hundred forty thousand) were reversed around R$ 3.900.000,00 (three million nine hundred thousand), remaining a net income tax and social contribution of around R$ 1.540.000,00 (one million five hundred fourty thousand) between machines, equipment and spare parts.

FINAL REMARKS
Transfer pricing rules are regulated through laws, normative instructions and complemented by decrees. However this subject is in constant changing and because of this reason is very important to pay attention to the changes to avoid any surprises during a tax review by the tax authorities. This is important as the interests between the nations can change according with the control of those rules, in this way is possible increase or decrease those factors over the operations of imports and exports with the aim of protect the trade balance and national industrial factories established at Brazil.

In this paper were analyzed procedures of the ALFA Company in order to develop better form to organize its operations of import and export, in relation to the taxation on the transfer pricing. The points highlighted are that sometimes the international groups would like to act in the same way worldwide, doing the operations and applying prices. These points are not normally possible to apply regarding the differences of conceptions between the nations/jurisdictions and the most important factor, taxes and the rules of transfer pricing. The transfer pricing obligations started to be treated by ALFA Company as a priority inside the operations and transactions with related parties, as before resell any part or component in Brazil a few factors of incidence should be analyzed as manner of control prices of sale and at the same time avoiding double taxation. Of course, the facts that happened with the “bad business” made in the prior years with the sales under a certain margin makes the company work more carefully principally inside the machine business for Brazil, and started to look other ways to attend the customer without generate more risk for the transitioned parts. The adjustment made regarding the prior year because of transfer pricing was considered a loss for the shareholder, and, bearing in mind the size of the structure in Brazil is too relevant the amount exposed and paid to the government. The impact wasn’t even badly
because there are the method of uncontrolled price as a way, as on the other hand the equity of ALFA Company could stay with a negative sign compromising all the investment and the profitability of the prior years.

REFERENCES


