

memorandum to clients

12.08.2016

IRS Ruling No. 1,674/16 – Changes in the taxation of profits earned abroad

Ruling No. 1,674 of the Internal Revenue Service (“IRS Ruling No. 1,674/16”) was published on Nov.29.2016 amending IRS Ruling No. 1,520, of Dec.04.2014, which, in turn, governs the taxation of profits earned abroad by legal entities situated in Brazil.

Among the relevant amendments brought by IRS Ruling No. 1,674/16 we shall mention: **(i)** the modification of the definition of undertaxation regime; **(ii)** the option for accrual basis for the taxation of affiliated companies; **(iii)** the extension of the list of legal entities that may enjoy the presumed credit of 9%; **(iv)** the modification of deduction of transfer pricing adjustments and thin capitalization; and **(v)** change concerning the legal entities obliged to file a Statement of Active and Passive Revenues.

Regarding the first matter above, article 21, § 3 of IRS Ruling No. 1,674/16 began to provide expressly that the definition of undertaxation regime comprises the countries or locations with favorable taxation rules and the privileged tax regimes referred to in articles 24 and 24-A of Law No. 9,430/96, listed in articles 1 and 2 of IRS Ruling No. 1,037/2010, respectively.

This amendment may trigger questionings, since articles 84.III of Law No. 12,973/14 expressly provides that the undertaxation regime is the one in which profits are taxed at a nominal rate lower than 20%, not mentioning countries and locations referred to by articles 24 and 24-A of Law No. 9,430/96. Therefore, this definition was enlarged by the Ruling on point.

Concerning the second matter, IRS Ruling No. 1,674/16 includes article 19-A to IRS Ruling No. 1,520/14. Such provision authorizes that the taxpayer opts to recognize profits from affiliates abroad on accrual basis. The amendment was made to govern article 82-A of Law No. 12,973/14, included by Law No. 13,259/16, which allows the option for accrual basis even to affiliates that do not comply with the conditions set forth by article 81 of Law No. 12,973/14. In other words, although the rule is that such profits shall be recognized on cash basis, the amendment that had authorized the option for the accrual basis was ruled.

To this extent, the option mentioned by article 19-A of IRS Ruling No. 1,520/14 shall be made via Fiscal Accounting Bookkeeping (*Escrituração Contábil Fiscal - “ECF”*), being irreversible for the whole year and applying to all affiliates abroad.

In turn, the third matter mentioned above refers to the deduction of the 9% presumed credit established by article 87, § 10 of Law No. 12,973/14, as amended by Law No. 13,043/14. Considering that such provision grants the benefit to industries in general, IRS Ruling No. 1,520/14 was amended to include the “other extraction industries” in item V of article 28, along with the ore extraction industries already comprised in the original wording.

The forth matter concerns the deduction of transfer pricing adjustments and thin capitalization. Considering the original wording of IRS Ruling No. 1,520/14, article 23, § 2, IV used to limit the deduction of such adjustments from the tax due in Brazil, whereas § 3 allowed the deduction up to the limit of the calculation basis of such tax due because of the adjustments. After the enactment of IRS Ruling No. 1,674/16, that provision became clearer, since § 3 was revoked and § 2, IV now provides that the deduction is limited to the calculation basis of the tax due in Brazil because of such adjustments, without the possibility of generating tax losses.

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Finally, the fifth matter concerns the obligation to inform active and passive incomes in the ECF if the legal entity performs the consolidation of results, uses the 9% presumed credit or opts for tax deferral for the period of 8 years.

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