

KNOW HOW AND EFFECTIVE SERVICES

Denis Borges Barbosa

In some recent specific cases, Brazilian tax auditors have rejected the deductibility of some expenses classified as technical assistance, under the assumption that the related costs were not proven. The auditors indicated which costs they were prepared to accept, specifically payment for personnel, studies and technical material.

The auditors have some apparently reasonable grounds for requesting such evidence, as those three cost items are specifically listed in the provision of the Income Tax Regulations (RIR) dealing with technical assistance as being the acceptable causes of deductibility.

The legal provision under analysis actually indulges in insurmountable confusion between technical services and technical assistance. The latter is a category where pay-per-hour or general professional services are classified, and the rationale of cost-plus pricing is adequate. Technical assistance is the Brazilian Tax legal term for know how and related confidential information agreements. For such contracts, pricing is contingent on a per-value or running royalties basis, as the utility to be paid is in fact the proprietary or at least non-public domain information, as considered in its competitive worthiness.

Since 1975, however, the examination of the deductibility of technical assistance expenses was delegated by IRS to the Patent Office (INPI), which effected the assessment on an ex ante basis. INPI was always very clear in its distinction between the technical service category (non confidential services to be assessed on a per-hour or flat fee basis) and know how contracts (confidential information agreements usually paid on a running royalty basis). INPI distinctions are regarded in this context the adequate interpretation of the RIR provision mentioned above and are to be considered as being the settled law.

The 1964 law regulating technical assistance deduction was never changed in its literal wording. Only the interpretation embodied in INPI practice has been applied for 25 years.

To our knowledge, only in one prior instance the IRS actually checked on the cost content of a know how contract, in all other cases deferring to the ex ante screening by INPI. Albeit the law allows IRS to check on the effectiveness of the confidential information bought, it was not supposed to request evidence of cost items.

In this context, the adequate strategy is to assert the long standing INPI interpretation of the law, on the basis of the agreement registration regularly carried out by such agency, if it is actually the case. Our contention is that not only precedent is on our side, as also international practice, the legal literature, and common sense.