Tax Bulletin of the Administrative Council of Tax Appeals

specific tax report

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Dear Readers:

In this 57th edition of our Tax Bulletin of the Administrative Council of Tax Appeals ("CARF"), we will comment on a decision in which the Superior Chamber of this Council ruled out the nullity of the tax assessment, determined by CARF's judgment chamber, under the claim that the material error in the ascertainment of the taxable event was not characterized.

We also examined a decision dealing with the application of treaties to avoid double taxation on profits earned abroad by a Brazilian company.

Enjoy your reading.

Error in the Verification of Taxable Event Occurrence

"RULING OUT OF THE NULLITY OF THE APPEALED APPELLATE DECISION. MATTER SUBJECT OF ADMINISTRATIVE LITIGATION."
The appealed appellate decision ruled, by majority vote and based on Appellate Decision no. 102-47.747, that the tax assessment notice was null and void, as it derived from an error in the verification of the occurrence of the taxable event. Regardless of the nullity pointed out by the Chamber of origin, it must be ruled out by this Full Panel, since: (i) administrative litigation involves the legality of the tax basis adjustment made by the assessment authority; and (ii) the tax assessment notice contained an interpretation that all distributions were made in the calendar year of 1995, with reference to December 31, in addition to the benefit to the taxpayer, due to the lack of knowledge regarding the specific date on which there was the credit.
Special Appeal granted. The members of the panel agree, by unanimous vote, to grant the appeal, to be remanded to the court of origin for the other matters to be heard."

The case at hand deals with the tax assessment notice issued for the collection of the Withholding Income Tax ("WHT") due on the distribution of dividends that integrate the statement of the Taxpayer's Earnings in the calendar year of 1995.

In fact, the Tax Auditors verified that the amounts stated in the payment receipts were not the same as those in the Statement of Taxpayer's Earnings, and for this reason, issued the WHT payment requirement for the ascertained difference, on December 21, 2000.

In its objection, the Taxpayer claimed, in sum, that: (i) the requirement was ineffective, since, pursuant to article 150, § 4, of the National Tax Code ("CTN"), the 5 (five)- year term provided for the Tax Authorities to compute the collection of the WHT by the Taxpayer had expired, taking into account that the date to start counting the term would be the date of each payment made; (ii) the adjustment of the WHT tax basis would be illegal, since there is no law supporting this adjustment; and (iii) the calculation of the late payment interest through the SELIC rate was illegal.

The assessment was partially upheld by the 1st tier of the administrative court, causing the filing of a voluntary appeal, in which the Taxpayer repeated the claims presented in the objection.

In hearing the case, the panel granted the voluntary appeal, which led to the nullity of the assessment, under the claim that the Tax Auditors made a mistake in the ascertainment of the occurrence of the taxable event, since, despite the number of dates stated in the payment receipts, the Tax Auditors considered Dec. 31, 1995 as the taxable event date, in disregard of the ascertainment period of the WHT.

Summoned by CARF's appeal, the National Treasury filed a Special Appeal claiming, in brief, that the Tax Auditors adjusted the tax basis of the Taxpayer's WHT, since, in accordance with the Law, the paid dividends are taxed as to the gross value and not the transferred net value. Note that the subject matter of the Special Appeal diverges from the reason for which CARF's appellate decision declared the nullity of the assessment.

After the Special Appeal was granted, the Superior Chamber of Tax Appeals ("CSRF") ruled in its favor, determining there is no nullity of the tax requirement, since (i) the principal object of the litigation would be the adjustment of the tax basis of the WHT; and (ii) the setting of Dec. 31, 1995 as a parameter by the Tax Auditors would be valid, as this date is more beneficial to the Taxpayer.

Furthermore, on this second basis, the Reporting Judge stated as follows: "*The Tax Assessment Notice contained an interpretation that all distributions were made in the calendar year of 1995, with reference to December 31, more beneficial to the Taxpayer, due to the lack of knowledge regarding the specific date on which there was the credit.*"

Thus, due to the foregoing, the Judgment Panel of the CSRF ruled that the Special Appeal filed by the National Treasury should be granted, canceling the appealed decision and determining that the case be remanded to CARF's judgment Chamber so that the matters object of the litigation could be fully heard.

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Profits Earned Abroad – Treaties to Avoid Double Taxation

"Calendar year: 2002
MOTIONS FOR CLARIFICATION.
The motions for clarification are to be granted regarding the part proving that there was omission in the appellate decision under the motions."

The Appellate Decision, whose synthesis is transcribed above, deals with the analysis of Motions for Clarification filed against the Appellate Decision rendered by the former Taxpayers' Council, currently the Administrative Council of Tax Appeals, ruling that the assessment was to be maintained (i) relative to the profits of the Portuguese subsidiary in 1998 and 2001, due to the characterization of the profit availability at the time the Motion Petitioner used the investment in the Portuguese subsidiary to form the capital of a third company; (ii) relative to the profits of the Spanish subsidiary of 2001 and 2002, under the claim that the taxes are charged on the available dividends, pursuant to article 10 of the Agreement for the Avoidance of Double Taxation entered into between Brazil and Spain, and not on the subsidiary's profits, this being the reason why the protection stated in article 7 of the mentioned Agreement does not apply.

Due to this decision, the Taxpayer then filed Motions for Clarification claiming the following: (i) contradiction in the Appellate Decision for the application of article 7 of the Agreement for the Avoidance of Double Taxation entered into between Brazil and Portugal when analyzing the taxation of profits of the subsidiary in Portugal, whereas at the time of the analysis of the taxation of profits of the subsidiary in Spain, article 10 of Agreement for the Avoidance of Double Taxation entered into between Brazil and Spain was applied; (ii) omission as to the interpretation of article 10, item 1, of the Agreement made between Brazil and Spain, as the Appellate Decision dealt with the issue of paid dividends, but was silent regarding the fictitious dividends; (iii) omission as to article 23, item 4, of the Agreement made between Brazil and Spain, since article 10 of this Treaty may not be applied separately, but together with article 23 of the Treaty.

Therefore, due to these issued raised in the motions for clarification, the Reporting Judge decided to convert the judgment into an investigation, specially to verify the information of the subsidiary in Spain with the Spanish Tax Authorities. This investigation found that the company located in Spain is not a subsidiary of the Motion Petitioner and that it ascertained losses in the fiscal years of 2001, 2002, 2003, and 2004.

First, the Reporting Judge pointed out that a different treatment was given to the subsidiaries located in Portugal and Spain, as the assessments referred to different periods. According to the Reporting Judge, for the periods of 1996 and 1997, there was the position that the assessment on the subsidiary in Portugal should not prevail, "*considering that the taxation on the profits of the subsidiary abroad created by article 25 of Law no. 9,249/95 collided with article VII of the*

Brazil-Portugal Convention". However, for the assessment period of the subsidiary in Spain (2001 and 2002), the Reporting Judge viewed that article 74 of Provisional Measure (MP) 2,158-34/01 altered the date on which the dividends are deemed to be available, for which reason article 10 of the Agreement between Brazil and Spain was applied. So, the Reporting Judge recorded the position that there is no contradiction in the Appellate Decision under the Motion, considering the different grounds used for the subsidiary in Portugal and the subsidiary in Spain.

Next, the Reporting Judge expressed a position stating that the Appellate Decision under the Motion was clear when determining that *"the concept of paid dividend does not include the one effectively paid to a partner only, but also the one the partner is already entitled to, thus including the dividend made available to the partner pursuant to article 74 of Provisional Measure no. 2,158-34"*. Therefore, the Reporting Judge ratified the position in the Appellate Decision, stating that article 10 of the Agreement entered into between Brazil and Spain encompasses paid and fictitious dividends.

As to the alleged omission of article 23, item 4, in the Brazil-Spain Agreement, although the Taxpayer did not mention this argument in the Voluntary Appeal, the Reporting Judge affirmed that this issue will be heard due to its relevance. Concerning the merits of the matter, the Reporting Judge stated that *"such information [outcome of the investigation], certainly contradicts the information provided by the motion petitioner, still in the audit phase, when, in reply to the order, it affirmed that its subsidiary Iliama Spain had ascertained profits of R$ 741,341.26 and R$ 7,113,998.55 in 2001 and 2002"*.

Due to such, after ordering the Taxpayer to reply and not obtain any clarification, the Reporting Judge assumed that *"these profits had been earned by another foreign company, controlled directly or indirectly by the motion petitioner and based in a country with which Brazil does not have an agreement to avoid double taxation. Or otherwise, by a subsidiary based in a country with which Brazil has an agreement to avoid double taxation but is located in a region expressly excluded from the respective agreement, as is the case, for instance, of the Madeira Island"*.

Furthermore, the Reporting Judge pointed out that this position does not imply the novation of the assessment, as the assessment was issued because the Taxpayer had failed to subject the profits earned abroad to taxation, regardless of the location of the invested company, and due to the fact that there was no change to the rule supporting the requirement (article 74 of MP no. 2,158-35/01).

Therefore, the Reporting Judge ruled against the claims of omission of article 23, item 4, of the Brazil-Spain Agreement, based on the argument that the taxpayer had failed to prove the factual assumption for the application of this rule, namely the existence of profits in Spain.

Lastly, a decision was rendered, according to which, the Councilor stated that the assessment was upheld by the Appellate Decision under the Motion, based on article 74, of MP no. 2,158-35/01, meaning article 10 of the Brazil-Spain Agreement was only mentioned in order to oppose the arguments presented in the Taxpayer's defense.

That is, the Councilor, when rendering his opinion, followed the Reporting Judge as to the conclusions that the Brazil-Spain Agreement was not applied, but based on other arguments. Also, based on this position, the Councilor's position was that there was no omission in the Appellate Decision under the Motion, but an error in the judgment due to the failure to verify the assumptions for the application of the Agreement between Brazil and Spain in the present case, meaning the filing of Motions would not be the correct procedure to correct the defect in the decision's content.

By majority vote, the Motions were granted for clarification only, meaning no modification effects were attributed thereto.

A Councilor representing the Taxpayers presented a diverging opinion, since he believes it is possible to check in the case records that the profits originated in Spain and therefore the Treaty is to be applied to the present case. He affirmed that article 10 was only mentioned in the decision of the voluntary appeal, and that this is the proper time for the taxpayer to challenge the application of article 23. Within this context, he viewed that article 10 must be analyzed together with article 23 and, if the taxation in Spain is possible, the profits should not be taxed in Brazil. In this sense, he declared modification effects to the Motion so as to exclude the taxation of profits in Spain.

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