tax bulletin

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The Administrative Council of Tax Appeals

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Dear Readers:

The purpose of this **Tax Bulletin # Administrative Council of Tax Appeals** is to inform our clients and those interested in the main issues being discussed and decided in this court.

In this 103rd issue of our note, we comment on a decision in which the Administrative Council of Tax Appeals (*Conselho Administrativo de Recursos Fiscais* - CARF) ruled that the merger of shares has the legal nature of transfer, with the possibility of booking goodwill, provided that it is supported by a valuation report.

We also comment on a decision in which the Superior Chamber of Tax Appeals (*Câmara Superior de Recursos Fiscais* - CSRF) understood that the shares received by financial institutions in replacement of membership titles to former Bovespa and BM&F are not included in current assets, neither are they subject to PIS and Cofins.

To directly access the text referring to each of these topics, click on:

Merger of Shares – Goodwill – Capital Reserve – Isolated Fine

Demutualization – Financial Institutions – PIS – Cofins

Schneider, Pugliese, Sztokfisz, Figueiredo e Carvalho Advogados is available to its clients should they have any questions on the decisions commented on in this newsletter.

Enjoy your reading!

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“MERGER OF SHARES. LEGAL NATURE. POSSIBILITY OF DEDUCTION OF THE AMORTIZATION OF GOODWILL FOR THE COMPUTATION OF REAL PROFIT.
The merger of shares is a corporate transaction through which all the shares issued by a corporation are incorporated to the equity of another company, converting the former into the latter’s full subsidiary. The goodwill absorbed by the daughter company when being merged into the mother company will be considered as being purchased, so it will be subject to deductible amortization for income tax purposes, provided that such goodwill is justified by a valuation report produced by an independent and specialized company based on future profitability.
PAYMENT OF GOODWILL ON THE MERGER OF SHARES. PROOF. ISSUING PRICE OF SHARES BASED ON VALUATION REPORT.
The issuing price of the merging company’s shares and their transfer to the holders of merged shares is precisely what represents the payment of goodwill in the merger of shares. The issuing price shall be grounded in equity value, market value or future profitability. If a general meeting approves the issuance of shares at market value or future profitability, the proof of payment is only possible through the presentation of a valuation report for these shares, produced by an independent and specialized company. (...)
ISOLATED FINE DUE TO THE LACK OF COLLECTION OF TAX ESTIMATION. EX OFFICIO FINE DUE TO THE LACK OF PAYMENT OR UNDERPAYMENT OF TAXES. DIFFERENT MATERIAL ASPECTS. NEW WORDING GIVEN BY MP 351/2007. APPLICABLE TO THE LACK OF COLLECTION OF TAX ESTIMATION AFTER DECEMBER, 2006. (...)”

This decision deals with an Infraction Notice issued to charge Corporate Income Tax (*Imposto de Renda Pessoa Jurídica* - “IRPJ”) and isolated fine due to the lack of payment of the income tax computed by estimation, concerning the years of 2008 and 2009.

Tax Authorities understood that the merger of shares is not a purchase of shares, so it could not be considered a sale and purchase transaction, being similar to barter. For this reason, such agents stated that the deal performed could not trigger goodwill. Moreover, such goodwill registered upon the issuance of shares was not supported by an accounting fact, since it only considered the amount booked as corporate capital, disregarding the amount booked as capital reserve. Finally, Tax Authorities understood that there was no actual payment of goodwill in the deal – it existed only on the records -, and that there was corporate reorganization with the purpose of using undue tax benefit, with the creation of “goodwill of one’s own self”.

The taxpayer filed an Administrative Defense claiming, preliminarily, that the statute of limitation applied for the write-off of goodwill amortization and that the notice was null, because of the lack of grounds concerning the argument that the merger of shares does not correspond to a purchase of shares.

Concerning the merits, the taxpayer argued, in summary, that the merger of shares is a legal deal that implies the purchase of shares, being similar to a subscription of capital. This is confirmed by the fact that it is necessary to respect the rule that provides for the segregation of the purchase cost. Besides that, the taxpayer claimed that, even if the deal characterized barter, which is not the case, Tax Authorities do acknowledge that barter is a way of purchasing/transferring investment, based on the understanding that such transaction triggers capital gain. Concerning the payment of goodwill, the taxpayer argued the form of compensation is irrelevant; there must only be onerous compensation. The payment does not have to be necessarily in cash. Regarding the “goodwill of one’s own self”, the taxpayer claimed this occurs when the deal is carried out between related parties, which did not happen in this case.

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Concerning the goodwill value, the taxpayer sustained that, when disregarding the value booked as capital reserve, tax agents disregarded the issuing price of new shares, since such price corresponds to the merging company’s cost for purchasing the investment. It also emphasized that the merging company issued shares without nominal value, which do not correspond to the value of corporate capital, and that the Corporations Act provides that the portion of the price that exceeds the capital must be booked as capital reserve. Finally, it stated that tax law does not condition the computation of cost to a technical report or study; the cost is only subject to the approval of its veracity. Furthermore, the Corporations Act only demands the valuation of the merged company, as per the report presented, not of the merging company also.

The notice was partially affirmed by the Judgment Office (*Delegacia de Julgamento* - DRJ), which rejected the claim for application of the statute of limitation since the statute of limitation for the formalization of tax credits resulting from undue reduction of the income at year-end begins on the date of each annual amortization, not on the date of the original booking. Concerning the legal nature of the merger of shares, it acknowledged this is a way of transferring shares from the company that will become full subsidiary to the merging company, and its payment is made through the shares issued by the merging company due to the increase of its corporate capital. Besides that, it understood that the amount paid for the shares that exceeds its equity value may be registered as goodwill, provided that: (i) it is supported by a valuation report produced by an independent and specialized company; and (ii) it results from an increase of the merging company’s capital. In other words, the DRJ disregarded the full amount of goodwill registered in the capital reserve account in this case. Finally, the DRJ considered that the isolated fine could be applied simultaneously with the ex officio fine, since they refer to different factual situations and have different calculation basis. This decision was subject to Ex Officio Appeal and Voluntary Appeal.

CARF unanimously denied relied to the Ex Officio Appeal, affirming the decision taken by the Judgment Office concerning the legal nature of the merger of shares, in the sense that there was actual purchase by the merging company.

Regarding the Voluntary Appeal, CARF concluded that the dispute concerns the actual amount of goodwill booked due to the merger of shares. It stated that, although the tax legislation does not require a valuation report concerning the price of shares issued for capital increase, tax law demands documental proof of all transactions booked, which, in this case, encompasses the proof of actual payment of the amount booked as investment, comprising the purchase cost and goodwill. In this case, since the payment was not performed in cash, but instead in shares, the proof is more complex and subjective concerning the documents gathered.

On this matter, CARF understood the valuation of the merged company’s shares could only have been made based on its equity value before the merger of shares. According to CARF, any valuation different from this method, such as market value or future profitability, would be a guess with no economic or financial grounds if not performed by a specialized company. Therefore, it understood there was actual evidence concerning only the equity value of the merged company’s shares at the time of the merger of shares. Therefore, the value actually paid for the purchase of the merged company’s shares, which is the transaction value for tax purposes, corresponds only to the value of shares issued that was fully booked as capital. Hence, for the purposes of composition of goodwill, the counselors considered only the value booked as capital, disregarding the amount booked as capital reserve. Concerning the statute of limitation, CARF affirmed DRJ’s decision.

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Finally, CARF denied relief to the Voluntary Appeal, by quality vote, concerning the simultaneous imposition of isolated fine and ex officio fine, for understanding these are distinct and autonomous fines.

“COFINS. DEMUTUALIZATION OF BOVESPA AND BM&F. ONEROUS TRANSFER OF SHARES RECEIVED IN REPLACEMENT OF FORMER MEMBERSHIP TITLES TO SUCH STOCK EXCHANGES.
The revenue earned by Financial Institutions on the transfer of shares received in replacement of membership titles to former Bovespa and BM&F is not subject to Cofins.
Since the STF understood that turnover is the gross revenue resulting exclusively from the sale of products and provision of services, when acknowledging the unconstitutionality of section 3, § 1 of Law 9,718/98, such revenue is exempt from Cofins, since it does not result from the activities developed by Financial Institutions.
The revenue of Financial Institutions’ activities is the one deriving from the financial intermediation provided to clients – that is, fees and commissions earned by such institutions. We highlight that the sale and purchase of shares is not an activity developed properly by Financial Institutions.”

This concerns a Special Appeal tried by the Superior Chamber of Tax Appeals (*Câmara Superior de Recursos Fiscais* - CSRF) regarding a dispute related to the imposition of Contribution to the Program for Social Integration (*Contribuição para a Programa de Integração Social* - “PIS”) and Contribution to Finance Social Security (“Cofins”) on revenues earned by a financial institution on the transfer of shares received due to the demutualization of São Paulo Stock Exchange (“Bovespa”).

Until 2007, Bovespa was incorporated as a civil association and the participation in its management took place through the purchase of membership titles. In that year, the association turned into a corporation and its membership titles were converted into shares, with an amount higher than the one those titles used to have.

The financial institution on point then booked the shares received as noncurrent assets, since it had no intention of transferring such assets. For this reason, Tax Authorities issued an infraction notice, claiming that the taxpayer should have booked such shares as current assets, because the purchase and sale of shares is part of its corporate purpose, and the gains earned in subsequent sales of such shares should be included in its turnover, being subject to the imposition of PIS and Cofins.

The company then filed an administrative defense, to which the Judgment Office (*Delegacia da Receita Federal do Brasil de Julgamento* – DRJ) denied relief. A Voluntary Appeal was filed and the Administrative Council of Tax Appeals (*Conselho Administrativo de Recursos Fiscais* - CARF) granted relief to the Appeal, reverting the first-instance decision. The General Attorney’s Office of the National Treasury (*Procuradoria-Geral da Fazenda Nacional* - PGFN) then filed a Special Appeal claiming there was precedent divergence, since CARF had considered valid the infraction notice in similar demutualization cases.

By quality vote, the CSRF accepted the Special Appeal and, by majority of votes, denied relief. The Superior Chamber confirmed the arguments brought by the company in its Voluntary Appeal and counterarguments to PGFN’s Special Appeal, according to which the new Bovespa shares should not be booked as current assets, since there was no intent to sell them.

Concerning this matter, the counselors noticed that “*the original investment was not carried out with the purpose of obtaining any gain upon its sale. It was a noncurrent asset, since it was primarily purchased with the purpose of allowing participation to such enterprise and of triggering the development of its activities*”.

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The financial institution had also argued that, since the commercialization of shares is not part of its corporate purposes, any revenue earned with their sale will be comprised in section 3, § 2, IV of Law 9,718/98. Therefore, it could not be included in the calculation basis of PIS and Cofins. The leading vote of the decision also agreed with the position presented by the company on this matter, stating that the sale and purchase of shares in the market would mean a deviation of financial institutions' purposes, triggering a great amount of insecurity to its investors.

As result, CARF's decision that granted relief to the taxpayer's Voluntary Appeal was affirmed and the infraction notice was fully cancelled.

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