Tax Bulletin

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The Administrative Council of Tax Appeals

Specific tax report nº 81 • Year VII • December 2014

Dear Readers:

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

In this 81th edition of our newsletter, we comment on the decision of the Tax Appeals Administrative Council (Conselho Administrativo de Recursos Fiscais, "the CARF") decided that the offsets made with a negative balance formed by estimates also settled through non-validated offsets should be validated to prevent double charging to the taxpayer.

We also comment on a decision by the Tax Appeals Board (Câmara Superior de Recursos Fiscais, "CSRF") which established that, in the absence of an explicit statutory provision, the amounts received at a premium upon the issue of equity shares for limited liability companies should be included in the taxable earnings.

In order to access directly the text for each theme, click:

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

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Souza, Schneider, Pugliese e Sztokfisz
ADVOGADOS

"TAX OFFSETTING. USING NEGATIVE BALANCES FORMED BY FORMER OFFSETTING. POSSIBILITY. Any regularly declared offsetting has the effect of eliminating the tax credit, being tantamount to payment for all purposes, including the formation of a negative balance.
If the offsetting that forms the negative balance is not validated, the Treasury may enforce the offset debt through the regular procedures, i.e., tax foreclosure.
The disallowance of the negative balance used by the Appellant entails double collection of the same debt, since, on one side, the collection of the debt arising from the non-validated collection of the estimated Corporate Income Tax (IRPJ) shall proceed, and, on the other hand, the negative balance shall be reduced, creating another debt with the same source."

The final decision in question addresses the non-validation of offsetting made by the Taxpayer due to insufficient negative balance used thereby for such offsetting - such insufficient negative balance arises from the non-validation of corporate income tax (IRPJ) and social contribution on net earnings (CSLL) offsetting that has formed such balance. In the Decisory Order that reviewed the offsetting, the Tax Authority decided for the absence of the entire negative balance indicated, since a portion of the offsetting that made such balance up has not been validated.

Against this Order, the Taxpayer submitted the due Disagreement Statement, claiming, among other issues, that: (i) the offsetting of estimates that formed the negative IRPJ and CSLL balance used to offset the Taxpayer's debts were still being discussed at the administrative level; (ii) under Article 151 of the Brazilian Tax Code ("CTN"), the tax credit resulting from the non-validation of the estimates offsetting was suspended by virtue of appeals filed; and (iii) offsetting has the same effect as payment, canceling the tax credit as provided for in Article 156 of the CTN under a termination condition.

When reviewing the Disagreement Statement submitted by the Taxpayer, the DRJ rejected the highlighted claims, on grounds that the non-validation of the offsetting forming the negative balance estimates remains valid while other decision does not reverse it, which prevents the Taxpayer from using such credit. The aforementioned decision has been subject to a Voluntary Appeal, where the Taxpayer belabored its point, holding that, under Article 170 of the CTN and Article 74, § 2 of Law no. 9,430/1996, estimates offsetting eliminates the tax credit and should be considered for purposes of calculating the negative balance.

The CARF acknowledged the arguments put forward by the Taxpayer and granted the Voluntary Appeal. This is because the CARF understood that the non-validation of the offsetting made with a negative balance formed by estimates whose settlement based on offsetting has not been validated as well entails double collection. Indeed, if the non-validation of the estimates is confirmed, the Taxpayer would be required to settle these and, consequently, to settle the debts offset using the negative balance arising from the estimates. According to the CARF, the procedure followed by the Tax Authority by not validating any offsetting made using negative balance consisting of estimates whose offsetting is still under discussion has generated a "procedural imbroglio", since it creates a "ripple effect" when collecting debts.

By denying the validity of the procedure followed by the Tax Authority, the CARF asserted that Article 156 of the CTN and Article 74, § 2 of Law no. 9,430/1996 provide that the offsetting is a way to eliminate a tax credit under condition that the validation thereof is terminated. Therefore, offsetting a non-validated estimate still under discussion at the administrative level does not change the negative balance formed thereby. Thus, while a decision on any administrative appeal against the non-validation of the Corporate Income Tax and Social Contribution on Net Earnings estimate offsetting, the Tax Authority cannot indirectly collect such debt by reducing the negative balance formed by the offsetting under discussion in other cases.

Therefore, once the IRPJ and CSLL estimate is offset, such offsetting should be computed for purposes of calculating the negative balance, irrespective of being validated or not. Even in case of final non-validation, the Taxpayer would be required to settle the estimates – after all, these would be judicially enforced –, which would confirm the negative balance used. In any event – validation or not – the Taxpayer's negative balance, according to the CARF, would be maintained.

"SUBJECT: CORPORATE INCOME TAX - IRPJ
Calendar Year: 1999
The premium on the purchase of equity shares of limited liability companies must be included in the corporate results of the fiscal year. Since there is no provision requiring the exclusion thereof for purposes of determining the income tax calculation bases, it should be included in the taxable earnings.
PREMIUM ON THE SUBSCRIPTION OF SHARES. PUBLIC COMPANY ('S/A'). LIMITED LIABILITY COMPANY ('LTDA')."

This is about an assessment notice issued for collection of the Corporate Income Tax (IRPJ) due to the failure to add a premium reserve when purchasing limited liability company shares, for purposes of determining the taxable earnings and disallowing expenses related to interest on own capital ("IOC").

By gainsaying, the Taxpayer claimed that, under Article 182, § 1, of Law no. 6,404/76 and Articles 442 and 443 of the RIR/99 (Income Tax Regulation), the amounts resulting from premium on the subscription of shares should not pass through the result, neither be added to the net earnings. The Taxpayer further argued that the expenses disallowed as IOC are actually included in the redemption price of its shares, not being subject to the deductibility conditions.

Given the unfavorable decision issued by DRJ, which kept the tax credit in question, the Taxpayer filed a Voluntary Appeal with the CARF, dwelling on the previously claimed points and holding that the decision issued by DRJ was contradictory, since it sometimes understood that the amount embedded into the share capital of the Appellant corresponds to premium for the issuance of shares, and sometimes claimed that the aforementioned amount does not correspond to premium.

When reviewing the issue, the CARF held that, unlike the claims of DRJ, the premium on the purchase of limited liability company shares should be handled the same as the premium on the purchase of a public company's shares, i.e., it should not be added to net earnings. Therefore, the Voluntary Appeal to remove the requirement related to the non-addition of premium was partially granted.

Concerning the IOC, the CARF understood that the disallowance of financial expenses should be upheld, since, although the agreement provides that the amounts payable correspond to a part of the redemption price of the shares, the legal nature of such payments corresponds to IOC, being subject to the deductibility conditions provided for in tax regulations.

Based on the appeal partially granted by the CARF, the National Treasury filed a Special Appeal with CSRF,

Souza, Schneider, Pugliese e Sztokfisz Advogados claiming that, under Article 38 of Decree-Law no.1,598/77, premium is exempt from taxation only if not booked in the capital reserve account of corporations incorporated as “Companies”.

The CSRF granted the Special Appeal filed by the National Treasury by understanding that the exemption provided for in Article 38 of Decree-Law no.1,598/77 – which provides that amounts received as premium on the issue of shares intended to form capital reserves should not be included in the net earnings – apply strictly to publicly traded companies.

Therefore, in the absence of an express statutory provision, any amounts received as premium on the issue of limited liability company shares should be taxed.

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Team responsible for preparing The Administrative Council of Tax Appeals Bulletin:

Igor Nascimento de Souza (igor.souza@souzaschneider.com.br)

Henrique Philip Schneider (philip.schneider@souzaschneider.com.br)

Eduardo Pugliese Pincelli (eduardo.pugliese@souzaschneider.com.br)

Cassio Sztokfisz (cassio.sztokfisz@souzaschneider.com.br)

Fernanda Donnabella Camano de Souza (fernanda.camano@souzaschneider.com.br)

Diogo de Andrade Figueiredo (diogo.figueiredo@souzaschneider.com.br)

Flávio Eduardo Carvalho (flavio.carvalho@souzaschneider.com.br)

Rafael Fukuji Watanabe (rafael.watanabe@souzaschneider.com.br)

Vitor Martins Flores (vitor.flores@souzaschneider.com.br)

Rodrigo Tosto Lascala (rodrigo.tosto@souzaschneider.com.br)

Laura Benini Candido (laura.candido@souzaschneider.com.br)

Marina Lee (marina.lee@souzaschneider.com.br)

Pedro Lucas Alves Brito (pedro.brito@souzaschneider.com.br)

Tiago Camargo Thomé Maya Monteiro (tiago.monteiro@souzaschneider.com.br)

Viviane Faulhaber Dutra (viviane.dutra@souzaschneider.com.br)

Flavia Gehlen Frosi (flavia.frosi@souzaschneider.com.br)

Thomas Ampessan Lemos da Silva (thomas.ampessan@souzaschneider.com.br)

Maria Carolina Maldonado Kraljevic (mariacarolina.maldonado@souzaschneider.com.br)

Gabriela Barroso Gonzaga Ferreira Porto (gabriela.porto@souzaschneider.com.br)

Ana Cristina de Paulo Assunção (anacristina.assuncao@souzaschneider.com.br)

Vanessa Carrilo do Nascimento (vanessa.nascimento@souzaschneider.com.br)

Sergio Grama Lima (sergio.lima@souzaschneider.com.br)

Pedro Paulo Bresciani (pedro.bresciani@souzaschneider.com.br)

Renata Ferraioli (renata.ferraioli@souzaschneider.com.br)

Luana da Silva Araujo (luana.araujo@souzaschneider.com.br)

R. Cincinato Braga, 340 • 9º andar • 01333-010 • São Paulo • SP
tel 55 11 3201 7550 • fax 55 11 3201 7558

Brasília Shopping • SCN quadra 5, Bloco A • Torre Sul • 14º andar • sala 1406 • Brasília • DF • 70715-900
tel 55 61 3251 9400 • fax 55 61 3251 9429

www.souzaschneider.com.br