Tax Bulletin

The Administrative Council of Tax Appeals

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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 83nd edition of our newsletter, we comment on the decision where the **The Administrative Council of Tax Appeals** (*Conselho Administrativo de Recursos Fiscais, CARF)* canceled the fine provided for in art. 74, §15 of Act No. 9,430/96, applied to the dismissed credit amount requested for reimbursement, based on the principle of benign retroactivity provided for in article 106 of the Brazilian Tax Code ("CTN").

We also comment on the decision where CARF dismissed the requirement for Corporate Income Tax (IRPJ) and Social Contribution on Net Earnings (*Contribuição Social sobre o Lucro Líquido, CSLL)* on the valuation of equity securities during the process of demutualization of stock exchanges, understanding that the associations can be spun off, thus dismissing the alleged return of capital by the associations.

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.

Enjoy your reading!

SOUZA, SCHNEIDER, PUGLIESE e SZTOKFISZ ADVOGADOS

"Subject: TAX ON MANUFACTURED GOODS - IPI
Date of the taxable event: 31/07/2010
FINE. REVOCATION.
The revocation of the fine provided for in Article 74, §15, of Act No. 9,430/96 dismisses its enforcement, present in Article 116 of the Tax Code (CTN)."

The decision in question refers to an Assessment Notice issued to enforce a fine on the credit amount of the dismissed request for reimbursement, as provided for in Article 74, §15 of Act No. 9,430/96.

Generally speaking, the Auditors found that the Taxpayer applied for reimbursement before the Federal Revenue Service, and such applications were rejected, thus entailing the application of an individual fine of 50 percent on the value of the credit addressed in the application.

Challenging the decision, the Taxpayer claimed, among other arguments, that enforcing the aforementioned fine would be unreasonable, since there was no intention of avoiding, delaying or reducing the tax amount. Moreover, the Taxpayer claimed it was a rightful application made in good faith, and based on a Resolution of the Brazilian Federal Senate.

The DRJ (Judgment Office of the Brazilian Federal Revenue Service) dismissed the Challenge and upheld the tax credit, claiming the legitimate fine enforcement under the regulations in force.

After the Taxpayer filed a Voluntary Appeal, the CARF canceled the assessment, basing its decision on the issue of Provisional Measure ("MP") No. 656/14, which revoked the enforcement of the fine on dismissed requests for reimbursement.

Thus, based on the principle of benign retroactivity provided for in Article 106 of the Brazilian Tax Code ("CTN"), CARF upheld the Voluntary Appeal and canceled the fine enforced on the credit amount of the dismissed request for reimbursement.

"SUBJECT: CORPORATE INCOME TAX - IRPJ
Calendar Year: 2007
STOCK EXCHANGES INCORPORATED AS CIVIL NPOs. DEMUTUALIZATION. SPIN-OFF POSSIBILITY.
Value increases of equity securities, resulting from appreciation of the equity of stock exchanges incorporated as civil NPOs do not constitute income or capital gain for the member brokerage firms, which authorizes the exclusion thereof from the taxable income calculation, provided it is not distributed and constitutes a reserve for timely, mandatory capitalization. The civil associations are subject to spin-off, which is not limited to legal entities specifically covered by the Corporations Act (Act No. 6,404/1976). The demutualization of stock exchanges – a reorganization of their corporate structure from civil nonprofit associations to public companies – does not result in taxable income subject to corporate income tax (IRPJ) and social contribution on net earnings (CSLL) at the brokers due to the appreciation of equity securities (valued by the book value, adjusted per the net worth of the stock exchanges) exchanged for shares. The Tax Authorities' claim of return of the stock exchanges' equity to the member brokerage firms is, therefore, unreasonable."

The decision in question addresses two Assessment Notices issued for the collection of Corporate Income Tax ("IRPJ") and Social Contribution on Net Earnings ("CSLL"), plus default interest, ex officio fine and individual fine for failure to pay the estimated tax of a securities and foreign exchange brokerage firm. As the Tax Authority understood it, the company **(i)** allegedly failed to keep records of capital gain earned upon the divestiture of a BM&F equity security, entered as fixed assets, occurred when the aforementioned security was fully paid at another company of the group; and **(ii)** allegedly failed to report non-operating gains earned upon receipt of shares relating to its interest in Bovespa's equity.

The opinion of the Enforcing Authority was based **(i)** on dismissing Ordinance MF No. 785/77, which the Authority deemed illegal; **(ii)** on the income tax applicability in case of dissolution of an association or return of the equity ot the members; and **(iii)** on the impossibility of association spin-offs, which would mean that the demutualization would entail the dissolution of the association and that the increases in the face values of the equity securities should be subject to taxation as capital returns.

Challenging the decision, the notified company claimed that the increase in the face value of the equity securities of the stock exchanges, as a result of demutualization, does not constitute income or capital gain. The demutualization of the stock exchanges would not have resulted in the return of equity to the members, but rather replacement (subrogation) - to the member brokerage firms - of equity securities with Bovespa Holding and BM&F S.A. shares; thus, the capital return theory would not apply to the matter.

Therefore – the Taxpayer continued – provided that it was not distributed and that it constituted a reserve for timely, mandatory capital increase, the amount resulting from the difference between the value of the equity securities and the shares would not be taxable under the aforementioned Ordinance MF No. 785/77.

Furthermore, under Article 2,033 of the Brazilian Civil Code, which refers to Article 44 of the same Act, the Taxpayer argued that non-profit civil associations may be subject to spin-off, and the demutualization would not mean, from this perspective, the dissolution of the association.

Upon review of the company's claims, the Judgment Office of the Brazilian Federal Revenue Service ("DRJ") dismissed the issue, consequently filing the ex officio appeal required by the applicable law. When reviewing

the case, the Tax Appeal Board ("CARF") upheld the decision in favor of the Taxpayer, rejecting the appeal.

The Winning Vote, cast by the Chairman of the Panel, starts stressing the legal nature of civil association spin-offs, which, within the context of demutualization, does not constitute the liquidation of the company. As a result, the equity transferred to the members, now shareholders, does not constitute equity return subject to taxation. Challenging the Tax Authority's claim of violation of Art. 61 of the Brazilian Civil Code, the Rapporteur's Vote explained that, in the case at hand, the association dissolution does not apply; what happened was clearly a partial spin-off.

Continuing his vote, the Chairman of the Panel highlights the correction of the procedure to update equity securities as set forth in Ordinance MF No. 785/77, as the Taxpayer has done, pointing out the similarity of this procedure with the equity method. Further, he dismissed the Tax Authority's claims that the aforementioned Ordinance would have "established a tax break," claiming that this normative act had only established criteria to evaluate the brokerage firms' investment.

Finishing his vote, the Chairman Member completed: *"associations may, indeed, be legally subject to spin-offs, and the equity securities of stock exchanges incorporated as associations should be valued for accounting purposes at the brokerage firms for the value of the net worth of the stock exchanges, in the same way as investments valued by the equity method (método da equivalência patrimonial, MEP), per the criteria defined by an explicit provision of Ordinance MF No. 785/1977"*. And, based on this understanding, he dismisses the alleged capital return.

The Winning Vote was followed by three other Members of the Board; thus rejecting, by majority vote, the *Ex Officio* Appeal filed by the DRJ.

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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)
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)
Gabriela Xavier Urbani (gabriela.urbani@souzaschneider.com.br)
Pedro Guilherme Ferreira Bini (pedro.bini@souzaschneider.com.br)
Roberta Marques de Moraes (roberta.moraes@souzaschneider.com.br)
Tatiana Ergang Barros (tatiana.barros@souzaschneider.com.br)
Alberto Frederico Teixeira Soares Carbonar (alberto.carbonar@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

Souza, Schneider, Pugliese e Sztokfisz Advogados