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The Administrative Council of Tax Appeals

Specific tax report n° 94 • Year VIII • January 2016

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 94th edition of our newsletter, we will comment on a decision in which the Administrative Council of Tax Appeals ("CARF") canceled the assessment of the Corporate Income Tax ("IRPJ") and of the Social Contribution on the Net Income ("CSLL") on the premium amortization based on future profitability, as it viewed that the mere fact of there being a company established exclusively for ownership interest in the takeover does not automatically lead to the conclusion that the premium may not be discounted from the tax bases of such taxes.

We also commented on a decision in which the CARF ruled for the application of the most favorable interpretation to the Taxpayer in case of concomitant conducts that can lead to sanctions separately, when there is no express legal authorization for the accumulation of sanctions.

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

IRPJ and CSLL – Premium – Future Profitability – Operating Company

Regulatory fine – Concomitance of Violations – Most favorable interpretation

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

Enjoy your reading!

souza, schneider,

"MATTER: CORPORATE INCOME TAX IRPJ
Calendar year: 2008, 2010
[...]
EXPENSES WITH PREMIUM AMORTIZATION.
If the premium at the acquisition of the investment effectively occurred and is not the result of operations among companies of the same economic group (internal premium), the rejection of the expense with its amortization grounded on the utilization of the so-termed 'operating company' does not apply."

The decision in question deals with the Tax Assessment Notice issued for the collection of the IRPJ and CSLL, relative to 2010, due to the rejection of premium amortization expenses based on future profitability, arising from the acquisition of investment in ownership interest.

In the present case, in February 2007, a share purchase agreement was entered into between a Parent Company and four individuals, with the purpose of transferring to the Parent Company the total shares representing the capital of Company A which, in turn, held 100% of the shares of Company B.

After that, the Parent Company assigned to its Subsidiary ("Operating Company") all the rights and obligations of the mentioned purchase and sale agreement.

In November 2007, the Parent Company increased the capital of the Operating Company which, on the same day, acquired at a premium the shares representing the total capital of Company A, through the payment made to four individuals, holders of those shares.

Subsequently, in July 2008, Company A transferred to the Parent Company the totality of Company B's Shares and, three months later, Company B took over Company A and the Operating Company, so that the premium generated in the initial investment, deriving from the acquisition of Company A's shares by the Operating Company, was then utilized fiscally by Company B.

When performing the audit procedure, the Tax Authorities viewed that the mentioned corporate reorganization only sought the tax economy by the Taxpayer, meaning there was no business purpose in such transactions. According to the Tax Authorities, the only objective of the corporate events was to enable the deduction, at the ascertainment of the tax bases of the IRPJ and of the CSLL, of the expenses with the amortization of the premium generated in the investment.

Furthermore, the Tax Authorities claimed that it was not sufficiently proven that said premium resulted from future profitability, since the statement required by the law as proof of this future profitability was prepared after the date of acquisition of Company A's shares by the Operating Company.

Due to such, a Tax Assessment Notice was issued to demand the IRPJ the CSLL on the undue deduction of expenses with the premium amortization.

The Tax Assessment Notice was opposed by the Taxpayer, who claimed, in sum, the presence of business reasons to perform the transactions that were disregarded by the Tax Authorities, the existence of a statement of future profitability of Company A, prior to its acquisition by the Operating Company, and the inexistence of a legal provision to add the expenses with premium amortization to the CSLL basis.

When analyzing the matter, the Federal Revenue Judgment Office (“DRJ”) dismissed the objection filed in relation to the amortization of the premium. This decision then led to the filing of a Voluntary Appeal with the CARF.

In the trial of the Appeal, the Councilor who rendered the concurring opinion, decided to cancel the assessment, under the following arguments: **(i)** the formation of the premium is not the result of business carried out among companies of the same economic group, and the operation did not result in the so-termed “internal premium”; **(ii)** the Taxpayer submitted proper documentation to prove that the profitability statement is contemporary with the date of execution of the purchase agreement of Company A’s shares; **(iii)** the utilization of the expression “operating company” used by the auditors in a derogatory way cannot be an obstacle for the deductibility of the expenses with premium amortization; and **(iv)** the transaction had a business purpose.

The Councilor further considered that the establishment of a company exclusively for participation in a corporate transaction is not a violation of tax laws, and that the restrictive interpretation of articles 7 and 8 of Law no. 9,532/97, carried out by the Tax Authorities, is contrary to its purpose, since it limits the cases of tax use of premium amortization.

Therefore, by majority vote, the CARF partially granted the Voluntary Appeal, in order to rule out the rejection of premium amortization expenses.

“Matter: Accessory Bookkeeping Obligations; Fiscal Year: 2006, 2007, 2008, 2009 SANCTION. CONDUCT DIVERSITY. MOST FAVORABLE INTERPRETATION. In circumstances in which diverse conducts are detected, individually subject to specific sanctions but which, when considered jointly, there are no legal provisions on the sanction to be applied, there is a clear situation capable of attracting the most favorable interpretation referred to in article 112 of the National Tax Code. In the case at issue, the applied sanction is even more unfounded when it is verified that, due to the identity of facts and the period reported in separate administrative proceedings, the same tax authorities concluded there are different legal provisions. In this case, there was a more severe punishment, whereas in the other case, a milder one was applied.”

The decision in question concerns a Tax Assessment Notice issued for the collection of a regulatory fine of 0.02% per day in delay, calculated on the gross revenue of the legal entity at the base period, limited to 1%, as a result of the failure to submit magnetic bookkeeping. The assessment refers to the calendar years of 2005 to 2008 and is grounded on article 12, item III, of Law 8,218/91.

To issue the Tax Assessment Notice, the Tax Authorities reported that the Taxpayer was notified several times for the submission of its magnetic bookkeeping, however, it failed to present part of the requested digital files. Moreover, the Taxpayer submitted some files in a format other than the one required under the legislation.

When failing to submit files in the requested format, the tax legislation provides for the application of a fixed fine of 0.5% on the gross revenue of the period, therefore an inferior sanction from the one applied in the event of delay/failure to submit documents, mentioned above, which may reach 1% of the gross revenue of the period. In the case under analysis, although the Taxpayer engaged in both conducts, it was assessed only by the higher fine, for failing to submit the requested documents, which in the situation in question, reached its maximum amount of 1%.

Upon the filing of an Opposition by the Taxpayer, it was then dismissed by the Federal Revenue Judgment Office ("DRJ"), which reiterated the issued tax assessment notice, viewing that the violation that should prevail in the assessment would be the failure to submit the requested digital files – which would be an objective criterion – and not format divergences.

Dissatisfied with the decision, the Taxpayer filed a Voluntary Appeal with the CARF, defending the nullity of the assessment due to the following: **(i)** the Tax Authorities did not consider, when issuing the assessment, the determinations contained in article 112 of the National Tax Code ("CTN"), which imposes the obligation to interpret the most favorable tax legislation to the defendant in the event of doubt in relation to the "nature or concrete circumstances of the fact, or to the nature and extension of its effects" and in relation to the "nature of the applicable sanction"; and **(ii)** the legal uncertainty caused by the auditors' conduct, since the same Auditors applied to this case a divergent (and more serious) sanction from the one applied in another proceeding of the Taxpayer, of identical factual context, relative to the calendar year of 2004, in which the Tax Authorities considered that, in addition to not delivering the requested documents, the files were submitted in a different format from the one specified in the legislation, and therefore only applied a fine relative to the latter violation, provided for in article 12, item I, of Law no. 8,218/91 (the less serious one) – subject, in that other case, to the instructions of article 112 of the CTN.

When examining such arguments, the CARF then ruled out the regulatory fine for failure to submit documents, as it viewed that, upon the verification of association of the Taxpayer's conducts that are individually subject to a specific sanction, considering that "there is no legal or normative provision clearly defining that the accumulation of sanctions that we are hereby attributing to the audited taxpayer is to be applied" and, furthermore, in the event of doubts as to the applicable sanction, the interpretation that is most favorable to the Taxpayer is the one to be applied, pursuant to the mentioned article 112 of the CTN.

Moreover, the opinion of the Rapporteur Councilor, followed by the unanimous opinion of the other judges, pointed out the clear lack of grounds of the assessment, given the fact that the same Auditors opted for a different legal provision in administrative cases on identical facts.

Due to such, the CARF, by unanimous decision, granted the Voluntary Appeal in order to cancel the imposed regulatory fine.

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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)
Flavio Eduardo Carvalho (flavio.carvalho@souzaschneider.com.br)
Vitor Martins Flores (vitor.flores@souzaschneider.com.br)
Rafael Fukuji Watanabe (rafael.watanabe@souzaschneider.com.br)
Rodrigo Tosto Lascala (rodrigo.tosto@souzaschneider.com.br)
Maria Carolina Maldonado Kraljevic (mariacarolina.maldonado@souzaschneider.com.br)
Rodrigo Leal Griz (rodrigo.griz@souzaschneider.com.br)
Laura Benini Candido (laura.candido@souzaschneider.com.br)
Thomas Ampessan Lemos da Silva (thomas.ampessan@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)
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
São Paulo , SP , Brasil , 01333-010
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 , Brasil , 70715-900
tel +55 61 3251 9403 , fax +55 61 3251 9429

souzaschneider.com.br

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