tax bulletin

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The Administrative Council of Tax Appeals

Specific tax report n° 105 • Year IX • December 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 105th issue of our note, we comment on a decision in which the Superior Chamber of Tax Appeals (*Câmara Superior de Recursos Fiscais* - CSRF) denied relief to a Special Appeal filed by the National Treasury, allowing the inclusion of the estimated taxes, which had been offset and not homologated, in the negative balance of the period. We also comment on a decision in which CARF analyzed the imposition of IRPJ and CSLL on profits earned by daughter companies situated abroad and subject to a fiscal year different from the one applicable in Brazil, as well as the regular enjoyment of goodwill generated by the purchase of such investment.

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

IRPJ and CSLL – Offset of estimated taxes – Inclusion in negative balance

IRPJ and CSLL – Different fiscal year – Enjoyment of goodwill

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.

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"OFFSET. WRITE-OFF OF ESTIMATIVES CHARGED IN A PER/DCOMP. IMPOSSIBILITY.
In case an offset is not homologated, the debts will be charged based on the Request of Reimbursement/Offsetting Statement (Pedido de Ressarcimento ou Restituição/Declaração de Compensação - Per/DComp), and, as consequence, the estimated taxes cannot be written off in the computation of the tax payable or of the negative balance assessed in the Statement of Economic-Fiscal Data of Legal Entity (Declaração de Informações Econômico-fiscais da Pessoa Jurídica - DIPJ)."

The decision on point deals with the possibility of including estimated taxes paid through offset, even if not homologated, in the negative balance computed in the end of the period.

In the case on hand, the offset of credit of CSLL negative balance was partially homologated. The portion of the credit that was not acknowledged corresponds to estimated taxes offset throughout the calendar year, and said offsetting requests were not homologated.

After being notified of the decision that partially homologated the offset, the taxpayer presented an administrative defense sustaining the credits are valid, since, although the estimated taxes were not homologated, they were still being discussed in the administrative sphere. Moreover, it argued that the offsetting statement has the effect of confession of debt, as provided by section 74, § 6, of Law No. 9,430/96.

Considering these arguments, the first-instance administrative court (DRJ) denied relief to the administrative defense under the argument that, since the offsets related to estimated taxes were not homologated, the credit used as negative balance could not consider them, because they were not liquid and certain in this case.

The taxpayer then presented a voluntary appeal, repeating its arguments that, considering the effect of confession of debt through the offsetting statement, the impossibility to include it in the negative balance implied a double charge.

CARF granted relief to the appeal, stating that the offset extinguishes tax credits, under the condition of subsequent homologation (in accordance with section 74, §2, of Law No. 9,430/96). Moreover, it mentioned IRS's position in Answer to Internal Inquiry No. 18/06, issued by COSIT, according to which the fact that the offset of estimated taxes is homologated or not does not influence its inclusion in the negative balance of the period.

In turn, the National Treasury filed a special appeal under the argument that the negative balance including estimated taxes whose offset was not homologated has no liquidity and certainty. Moreover, it argued that the legislation does not allow conditional offsets, as happened in the situation on point. It also mentioned Opinion PGFN/CAT No. 88/2014, which deals with the possibility of charging estimated taxes after the calendar year ends.

Despite the decision not having mentioned the precedent used as paradigm, CARF has issued some decisions denying the possibility to include the estimated taxes offset and not homologated in the negative balance. One of these decisions is Decision No. 1402-002.167, according to which the interpretation of Opinion PGFN/CAT No. 88/2014 leads to the conclusion that the estimated tax offset cannot be charged, so it cannot be included in the negative balance.

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After analyzing these arguments, CSRF accepted the Treasury's Appeal, but denied relief. As grounds, the CSRF mentioned precedents that had accepted the argument that the prohibition to include the estimated taxes offset would trigger a double charge. The reason is that the taxpayer would be charged in the offsetting procedure, which would trigger the payment of the estimated taxes, or win this proceeding, case in which the offsetting of estimated taxes would be homologated. In any case, it would be correct to consider that the advanced payment of taxes was duly performed, so it can be included in the negative balance assessed in the period.

"INCREASED FINE. PROOF OF WILLFUL MISCONDUCT. IMPOSSIBILITY. The mistaken interpretation of tax legislation is not sufficient to attribute willful or sham misconduct to the taxpayer. The Tax Administration has the duty to prove the willful misconduct, which did not occur in the case on point. (…)
DAUGHTER COMPANIES SITUATED ABROAD. FISCAL YEAR. MISTAKE IN THE COMPUTATION OF THE TAXABLE BASIS. Since the taxpayer has proven that the daughter company abroad is subject to a fiscal year different from the one provided by Brazilian legislation, and that the mistaken consideration of this fact led to an error in the computation of the taxable basis presented by Tax Agents, the taxation of the portion unduly charged must be excluded.
WRITE-OFF OF EXPENSES OF AMORTIZATION OF GOODWILL. VEHICLE ENTITY. IRREGULARITIES OF THE REPORT. CHARGE MAINTAINED. Since it was proven that the taxpayer used a vehicle entity with the sole intent of reducing the taxable profit and that there were irregularities in the report presented, the charge is valid."

This decision deals with Infraction Notices issued to charge Corporate Income Tax (*Imposto sobre a Renda da Pessoa Jurídica* - "IRPJ") and Social Contribution on Net Profit (*Contribuição Social sobre o Lucro Líquido* - "CSLL") on profits earned by daughter companies situated in Argentina, Uruguay and the Netherlands. Besides the taxation of such profits, Tax Agents also intend to write off deductions related to amortization of goodwill, allegedly assessed through the use of vehicle companies. The Infraction Notice also imposed the increased fine provided by section 44, §1, of Law No. 9,430/1996, on these alleged infractions.

Concerning the claim that part of the profits earned by daughter companies abroad was not taxed by IRPJ and CSLL charged in Brazil, the taxpayer argued that the apparent inconsistency derived from the fact that the Brazilian fiscal year, which ends on December 31, is different from the Argentine and Dutch fiscal years applicable to the activities developed by the foreign entities (export of meat), which end on September 30 and June 30. Regarding this matter, the Judgment Office of the Internal Revenue Service (*Delegacia da Receita Federal do Brasil de Julgamento* - "DRJ") accepted the arguments presented by the taxpayer in its Defense.

In turn, when examining the Ex Officio Appeal, the Reporting Counselor pointed out that the Brazilian legislation provides that the profits earned by foreign entities shall be assessed in accordance with the legislation of the country of residence of the daughter company or affiliate, and that there is no rule stating that the profit shall be assessed based on a balance sheet elaborated on December 31. Therefore, the counselors concluded that the profits to be considered in the computation of IRPJ and CSLL imposed on profits earned by foreign entities are the ones assessed in the end of the fiscal year as provided by the legislation of the countries involved.

Notice that the Reporting Counselor stated that this reasoning only applies to Uruguayan entities, since, based on the provisions of article 7 of the Treaties to Avoid Double Taxation entered into between Brazil and Argentina and between Brazil and the Netherlands, the profits earned by residents of those jurisdictions are not taxable in Brazil, so section 74 of Provisory Law No. 2,158/2001 does

not apply. These conclusions are also applicable for CSLL purposes, since Law No. 13,202/2015 provides that treaties against double taxation executed by Brazil comprise this contribution.

However, most Counselors disagreed with the vote concerning this specific matter, and the winning vote was that the profits earned by the Dutch entity and by the Argentine entities are subject to taxation in Brazil, as set forth by section 74 of Provisory Law No. 2,158/2001. Therefore, this court only cancelled the charges related to the computation of the profits earned by Uruguayan and Argentine entities concerning the periods not encompassed by the fiscal years applicable to such entities. Moreover, the decision did not cancel the imposition of taxes on the profits earned by one of the Uruguayan entities, concerning which there was no proof that it was subject to local rules concerning the periods related to the fiscal year.

Then, the Panel examined the deductibility of the goodwill assessed by the taxpayer on the purchase of shares of entities situated in the State of Delaware, United States. Their capital was paid off through the assignment of shares of the entities situated in Uruguay and Argentina, by their former mother entities. With the merger of the North-American entities, the taxpayer began to deduct the amortization of goodwill assessed in the transaction.

Concerning this matter, Tax Agents wrote off the enjoyment of goodwill based on the argument that the taxpayer's actual interest was to purchase the entities situated in Argentina and Uruguay instead of the mother companies. For this purpose, Tax Agents considered that the capital of the entities situated in Delaware only comprised the investment in such entities, and also the short period of time between the stages of structuring and sale of the entities. Moreover, Tax Agents indicated there were irregularities in the appraisal reports that allowed the enjoyment of goodwill, since they only refer to audit reports concerning said entities.

Counselors understood that the validity of the enjoyment of goodwill should be examined based on the theory of business purpose, aiming to verify if the transaction was based on an economic or business-related reason or if it was implemented with the sole intent of saving taxes. In the case on point, the counselors understood there was no indication that the use of the North-American entities was a condition for the business. Hence, they rejected the possibility to enjoy the goodwill triggered by the transaction, considering also the irregularities pointed out in the appraisal reports.

The Voluntary Appeal also discussed the application of the increased fine of 150% on the charges related to the alleged infractions related to the enjoyment of goodwill. In accordance with the vote issued by the Reporting Counselor, the application of such fine only applied to cases in which there is tax evasion, sham or collusion, which were not present in the case on point. Concerning this matter, the reporting counselor noticed that "the mistaken interpretation of legislation is not sufficient to attribute to the taxpayer the willful or sham misconduct.

In summary, CARF granted partial relief to the Voluntary Appeal, excluding from the charge the portion related to profits earned after the end of the fiscal year of Argentine and Uruguayan entities, reducing the increased fine that had been imposed, and affirming the charge in what concerns the taxation of profits earned abroad, in accordance with section 74 of Provisory Law No. 2,158-35/2001, and the cancellation of expenses related to goodwill.

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

Henrique Philip Schneider (philip.schneider@schneiderpugliese.com.br)
Eduardo Pugliese Pincelli (eduardo.pugliese@schneiderpugliese.com.br)
Cassio Sztokfisz (cassio.sztokfisz@schneiderpugliese.com.br)
Diogo de Andrade Figueiredo (diogo.figueiredo@schneiderpugliese.com.br)
Flavio Eduardo Carvalho (flavio.carvalho@schneiderpugliese.com.br)
Rodrigo Tosto Lascala (rodrigo.tosto@schneiderpugliese.com.br)
Maria Carolina Maldonado Kraljevic (mariacarolina.maldonado@schneiderpugliese.com.br)
Sérgio Grama Lima (sergio.lima@schneiderpugliese.com.br)
Pedro Paulo Bresciani (pedro.bresciani@schneiderpugliese.com.br)
Pedro Guilherme Ferreira Bini (pedro.bini@schneiderpugliese.com.br)
Roberta Marques de Moraes (roberta.moraes@schneiderpugliese.com.br)
Tatiana Ergang Barros (tatiana.barros@schneiderpugliese.com.br)
Henrique Rodrigues e Silva (henrique.silva@schneiderpugliese.com.br)
Andréa Marco Antonio (andrea.antonio@schneiderpugliese.com.br)
Guilherme Almeida de Oliveira (guilherme.oliveira@schneiderpugliese.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

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