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The Administrative Council of Tax Appeals

Specific tax report n° 95 • Year VIII • February 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 95th edition of our newsletter, we will comment on a decision in which the Administrative Council of Tax Appeals ("CARF") ruled that the losses of subsidiaries abroad are to be offset against its profits before being added to the net income of the subsidiary resident in Brazil.

We also commented on a decision in which the CARF ruled that bonuses in kind have the same tax treatment as unconditional discounts.

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

Profits Abroad – Offsetting Losses of Subsidiaries

Bonuses in Kind – Unconditional Discounts – Tax Effects

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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"MATTER: CORPORATE INCOME TAX - IRPJ
Calendar year: 2010
IRPJ/CSLL. TAXATION OF PROFITS EARNED BY A SUBSIDIARY ABROAD. OFFSETTING OF LOSSES FROM PREVIOUS PERIODS.
Upon the verification of losses in the previous period, subject to the offsetting against profits to be taxed in Brazil in future periods, the requirement is canceled."

The decision in question deals with the Tax Assessment Notice issued for the collection of the Corporate Income Tax ("IRPJ") and of the Social Contribution on Net Income ("CSLL"), which would be due by the alleged failure to subject the profits from a subsidiary based in Hungary to taxation.

According to the Tax Authorities' position, founded upon the provisions in article 74 of Provisional Measure no. 2.158-35/01, the result obtained by the Hungarian company, in the calendar year of 2010, should have been added to the tax basis of the IRPJ and CSLL of its Brazilian parent company, in the proportion of its ownership interest.

In a Motion of Opposition, the assessed company claimed that the profits earned abroad had not effectively been made available thereto and that, for this reason, it would not be obliged to add them to the tax basis of the IRPJ and the CSLL. In addition, it clarified that, due to the existence of an agreement for the avoidance of double taxation entered into between Brazil and Hungary ("TDT Brazil – Hungary"), it would be exempted from subjecting the profits earned by its Hungarian subsidiary to taxation.

Furthermore, the taxpayer demonstrated that, in 2008, the Hungarian company accumulated losses, which exceeded the profits earned in 2009 and 2010, and these were offset against the negative result of 2008.

The Federal Revenue Judgment Office ("DRJ") fully granted the Objection, cancelling the Tax Assessment Notice. Despite the exemption of the tax credit, the DRJ filed an ex-officio appeal with the CARF for the necessary review.

In its trial, the CARF observed that, in fact, the documents submitted proved that the negative results of 2008 exceeded the positive results ascertained in 2009 and 2010.

Thus, the Rapporteur Councilor, based on provisions of article 4 of Normative Rule RFB no. 213/02, which establishes that the "losses ascertained by a subsidiary or associated company abroad may only be offset against the profits of this same subsidiary or associated company", agreed with the appealed decision, viewing that the procedure of the Brazilian company, which offset the profits of the fiscal years of 2009 and 2010 against the losses of 2008, was correct. Therefore, the decision of the DRJ was upheld, and the Tax Assessment Notice remained fully cancelled.

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"MOTIONS. CONTRADICTION RESULTING FROM OMISSION IN THE VOTE OF THE REPORTING JUDGE RELATED TO THE DECISION. Upon the verification of omission in the vote of the reporting judge regarding the decision on the change of position of the Rapporteur Councilor, expressed in the trial session and evidenced in the trial outcome, the motions are examined and granted in order to complete it, and to complement the decision with the corresponding summaries.
REDUCTIONS AND UNCONDITIONAL DISCOUNTS NOT VERIFIED. Except for the portions that the taxpayer proved to be bonuses, examined jointly with the correlated matter also addressed in the assessment, the rejection portion explained as a reversal is canceled.
UNRECORDED ADDITIONS IN THE ASCERTAINMENT OF THE TAXABLE INCOME. UNCONDITIONAL DISCOUNTS. BONUSES. The bonus is a common practice in commerce and characterizes a benefit given the amount of sales contracted with a customer, whose final result is identical to the discounts, and may not be characterized, in theory, with liberality, without previous challenge of the contracts from which said commercial practice resulted."

The proceeding in question addresses the tax treatment given to bonuses in kind, and the Tax Authorities issued tax assessment notices in order to require IRPJ, CSLL, PIS and COFINS credits from the Taxpayer for, among other accusations, its failure to add the bonuses in kind granted to its customers to its net income or for unduly deducting them from its gross revenue.

The discounts were granted by the Taxpayer as a benefit to its main customers and a way to leverage its sales and brand. As a procedure, the Taxpayer would issue an invoice for the shipment of the goods supplied as bonuses. In other words, a specific invoice was issued for the goods that circulated as such, and there were no discounts identified in the sales invoices.

The bonuses were considered "unconditional discounts" by the Taxpayer, which turned them into deductible expenses for purposes of ascertainment of the IRPJ and CSLL, and allowed their exclusion from the tax basis of the PIS and COFINS.

However, due to this practice, the Assessing Authority viewed that the bonuses in question constituted a mere act of liberality and that the fact that a specific sale invoice was issued for the shipment of the goods as bonuses removed its unconditional discount nature, since it would not be possible to accept that the entire invoice value was represented by a discount.

Therefore, based on the Tax Authorities' argument that the bonuses in kind may not be regarded as "unconditional discounts", but a mere liberality, the tax assessment notices whose discussion reached the CARF were then issued.

When examining the Taxpayer's Voluntary Appeal, the CARF developed a line of thought stating that the benefits to customers may be granted by the seller in two ways: as unconditional discounts and as bonuses. However, the Council claimed that the tax effect of both forms is the same, since: (i) for the seller, the discount reduces the sale price and, consequently, the profit; and (ii) for the buyer, there is a reduction of the purchase price and higher profits.

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In addition to the tax effect equivalence, the Councilors added to their argument the usualness of the concession of bonuses within the market logic, which started to be demanded by retail chain stores for the access to certain benefits – such as the exposure of goods in more prestigious spots. The Council also viewed that the fact that the Taxpayer utilized a single invoice to ship the goods with bonuses would not change their nature, since it is not always possible to state the bonus amount in each sale invoice.

Based on this position, the Taxpayer's Voluntary Appeal was granted, overturning the Decision of the DRJ in order to cancel the assessments related to the bonuses in kind.

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