Tax Bulletin

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The Administrative Council of Tax Appeals

Specific tax report n° 69 • Year VI • December 2013

Dear Sirs:

This publication **Tax Bulletin # The Administrative Council of Tax Appeals** aims to update our clients and others interested about the main subjects that are being discussed and judged in this body.

In this 69th edition of our newsletter, we will comment on a decision in which the Superior Chamber of Tax Appeals (CSRF) recognized that the taxation on income earned abroad could not reach profits computed prior to the enactment of Law no. 9,249, of December 26, 1995.

We also examined a decision in which the CSRF found that matters already turned into precedent are to be heard in ex officio proceedings, and may be argued in any phase of administrative proceedings.

Click over the topics below to directly access each text:

Souza, Schneider, Pugliese e Sztokfisz Advogados law firm is available to its clients should they have any questions on the above matters.

Enjoy your reading!

SOUZA, SCHNEIDER, PUGLIESE e SZTOKFISZ ADVOGADOS

"MATTER: CORPORATE INCOME TAX - IRPJ
Calendar year: 1996, 1997
PROFITS EARNED ABROAD PRIOR TO WORLDWIDE TAXATION. Taxation on worldwide income only came into existence with Law no. 9,249/95, and it was not possible to tax profits earned prior to the enactment of this law, even if they were made available after that.
SPECIAL APPEAL OF THE NATIONAL TREASURY. If the counter entry of the investment assessment through the equity method still did not have an impact on the taxable income, due to the provisions in article 25, § 6, of Law no. 9,249/95, the ownership interest revenue could only be recognized by the cash basis method, at the time of its availability, therefore, article 2 of Normative Rule (IN) of the Federal Revenue Office (SRF) 38/96 was in line with the law".

The decision in question deals with a Tax Assessment Notice issued for the collection of the Corporate Income Tax ("IRPJ"), under the claim that the Taxpayer should have added the profits earned abroad (Portugal) to its net income of calendar years 1996 and 1997 through a subsidiary – pursuant to article 25 of Law no. 9,249/95, to Normative Rule of the Federal Revenue Office of Brazil ("IN") no. 38/96, and to Declaratory Act of the Federal Revenue Office of Brazil ("ADE") no. 06/97. The mentioned profits were earned by the Brazilian Taxpayer (the sole partner of the subsidiary abroad), in the form of dividends, in December 1996 and February and March 1997.

In an Objection, the Taxpayer claimed (i) violation of article 43 of the National Tax Code (CTN), created by article 25 of Law no. 9,249/95; (ii) illegality of IN no. 38/96; (iii) the need to rule out ADE no. 06/97, which sought the taxation on dividends based on the mentioned IN; and (iv) the need to apply the Treaty for the Avoidance of Double Taxation executed between Brazil and Portugal.

The Assessment Notice was objected, and the Objection was held invalid after it was heard by the Federal Revenue Judgment Office ("DRJ"). Thus, due to the DRJ's rejection, the Taxpayer then filed a Voluntary Appeal with the Taxpayers' Council, which partially granted the Taxpayer's appeal.

In its decision, the Taxpayers' Council found that, while Law no. 9.249/95 was in force, the date on which the profits of the branches, subsidiaries, and associate companies abroad were recorded in their respective balance sheets of Dec. 31 should be considered as the taxable event, and not the date they were effectively available to the Brazilian parent company (reception of dividends). Therefore, the Council found that IN no. 38/96 is illegal, due to the fact that this non-statutory rule, when determining that the taxable event would be the effective availability of the profits, altered the timely aspect of the levy event, since it "created a new tax collection".

Based on this position, the Council partially granted the Taxpayer's claim, to cancel the assessment related to the calendar year of 1997 – which had considered as taxable event the date the dividends paid by the company situated in Portugal were received – given the error in identifying the taxable event. As to the calendar year of 1996, because the assessment considered the taxable event on Dec. 31, 1996, the Taxpayers' Council decided to uphold the requirement in relation to the mentioned year.

The Attorney General Office of the National Treasury and the Taxpayer then filed a Special Appeal against this decision with the Superior Chamber of Tax Appeals: the Taxpayer seeking the ruling out of the remaining requirement – the assessment relative to the calendar year of 1996 – and National Treasury seeking the

cancelation of the Taxpayers' Council's decision with regard to the calendar year of 1997.

In its Special Appeal, the Taxpayer, with the purpose of having the requirement relative to the calendar year of 1996 ruled out, claimed that during this period, pursuant to article 7 of the Treaty for the Avoidance of Double Taxation entered into between Brazil and Portugal, it was Portugal the one to tax the profits earned by the companies situated therein.

With regard to the above argument, the Superior Chamber found that, in this case, there is no taxation on the profits earned by the company located in Portugal, but on the dividends arising from the Brazilian investing company's profit share in its subsidiary in the Portuguese territory.

As to the Special Appeal filed by the National Treasury, the Superior Chamber decided to rule out the illegality of IN no. 38/96 stated by the Taxpayers' Council. According to the CSRF, this Normative Rule is an integration rule that effects and legitimizes the interpretation of article 25 of Law no. 9,249/95, pursuant to the Federal Constitution.

In addition, the Superior Chamber applied in its decision the position that prior to Law no. 9,249/95, which established the worldwide taxation on income, there was the principle of territoriality, which did not authorize the taxation on profits earned outside the national territory. For this reason, the CSRF cancelled the assessment related to the profits effectively computed up to Dec. 31, 1995, even if such profits have been effectively distributed on a subsequent date.

Therefore, in line with the foregoing, the CSRF granted the Special Appeal of the National Treasury, in order to maintain the assessment related to the calendar year of 1997, and partially granted the Taxpayer's Special Appeal, in order to rule out only the portion of the tax assessment that reached the profits recorded in balance sheet prepared prior to the enactment of Law no. 9,249/95.

"EX OFFICIO FINE. TAX CREDIT SUSPENDED BY INJUNCTION. PRECEDENT OF THE MATTER OF PUBLIC ORDER. PRINCIPLE OF REASONABLENESS.
It is the duty of the Taxpayers' Council to control the legality of the assessment, removing from it any acts lacking legal grounds, with clear errors, and to hear matters of public order, mainly when relating to matters already turned into precedents."

The decision in question relates to the Tax Assessment Notice on the Corporate Income Tax ("IRPJ"), from 1994 to 1996. The assessment derives from allegedly undue exclusions of amounts from the tax basis.

In an Objection, the Taxpayer affirmed that he had filed a judicial action seeking the deduction of the portion related to the adjustment of the financial statements of January 1989 from the net income, as of Dec. 31, 94, using a 70.28% index. He further informed that his request had been partially granted.

When hearing the Objection, the DRJ cancelled the requirements related to June to August of 1996, due to the tax agent's error in relation to the period in which the irregularities were allegedly made.

Due to this decision, the Taxpayer then filed a Voluntary Appeal in which, among other claims, he argued that the ex officio fine imposed in order to prevent the statute of limitations on the tax credit, whose enforceability was suspended, was not enforceable – said argument not presented in the Objection.

In analyzing the case, the First Taxpayers' Council did not hear part of the appeal due to the conjunction of administrative and judicial discussions on the same matter, which implies the waiver of the case in administrative courts, pursuant to Precedent no. 1 of the mentioned administrative body. As to the unenforceability of the ex officio fine, the Council found that the new argument could not be heard in this procedural phase, due to claim preclusion, as set forth in article 17 do Decree no. 70.235/72.

Due to such, the Taxpayer then filed a Special Appeal, as to the part of the appellate decision that failed to hear the arguments claimed against the ex officio fine. In this Appeal, the Taxpayer demonstrated the divergence as to the adequacy of the moment of argument of the illegality of the imposition of the ex officio fine, given the violation of the principle of legality.

In turn, the National Treasury claimed that the Code of Civil Procedure, a supporting set of rules to tax administrative proceedings, determines that the judge is to decide on disputes within the limits imposed thereon, being forbidden to hear issues not raised in the claim, which the law requires that they be made by the parties. It concluded that the judge or any other administrative authority should focus only on the plaintiff's pleading, and any decision made beyond such limits would be extra petita.

In analyzing the case, the CSRF affirmed that the rule contained in article 17 of Decree no. 70,235/72 –stating that matters that have not been expressly objected to by the objectant will be considered to not have been opposed to – is limited not only by decisions of matter of public order, but also by the principles of reasonableness, of strict tax legality, and of procedural economy.

Due to such, the Superior Chamber found that the imposition of the mentioned fine was in fact undue, and that the matter had also turned into a precedent (CARF precedent no.17), and thus lacked legal grounds.

Therefore, the CSRF, by majority vote, ruled out the application of the preclusion rule provided for in article 17 of Decree no. 70,235/72, granting the Special Appeal and cancelling the ex officio fine, based on the provisions of CARF precedent no. 17.

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