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The Administrative Council of Tax Appeals

Specific tax report n° 107 • Year IX • February 2017

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 107th issue of our note, we comment a decision in which the Administrative Council of Tax Appeals (Conselho Administrativo de Recursos Fiscais - CARF) ruled that the lack of demonstration of the calculation made to assess the taxes due is a material defect, leading to the nullity of the infraction notice.

We also comment a decision in which CARF examined the imposition of the Contribution to Finance Social Security due by the Importer of Foreign Goods or of Services from Abroad ("Cofins-Import") and of the Contribution to the Program of Social Integration and of Formation of Public Workers' Wealth imposed on the Import of Foreign Goods or Services ("PIS-Import") on technology transfer and technical assistance contracts, purchase of software licenses and provision of services overseas.

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

Lack of Demonstration of Calculation on the Charge in the Infraction Notice – Material Defect - Nullity

Cofins-import and PIS-import – Technology Transfer, Technical Assistance, Purchase of Software Licenses and Provision of Services Overseas

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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"INDIVIDUAL INCOME TAX. REQUISITES OF THE INFRACTION NOTICE. DESCRIPTION OF FACTS. CALCULATION METHODOLOGY. INEXISTENCE. VIOLATION OF THE RIGHT OF DEFENSE. The infraction notice must indicate the facts that lead to tax consequences. The existence of a fault in relation to this element triggers a material defect, which leads to the cancellation of the charge."

The decision on point deals with an Infraction Notice issued to charge IRPF (Individual Income Tax – Imposto de Renda da Pessoa Física), assessed by Tax Agents on amounts earned by the taxpayer in 2001, due to a labor lawsuit that claimed labor fees related to 1988 to 1990.

In its Defense, the Taxpayer claimed to have filed a lawsuit against a City Hall, claiming amounts derived from a labor relation. The lawsuit was granted and the Taxpayer received payments related to replacement of position and overworked hours, with monetary adjustment and interest. In this scenario, the Taxpayer claimed the Charge should be cancelled, since the amounts received are characterized as indemnity, so they are exempt earnings, in accordance with section 39 of the Income Tax Rulings.

When examining the reasons presented in the Defense, the Judgment Office of the Internal Revenue Service granted partial relief to the Taxpayer's claims, excluding from the Infraction Notice amounts received as FGTS and prior termination notice.

Then, the Taxpayer filed a Voluntary Appeal to CARF, which cancelled the charge under the argument that one cannot identify the composition of the amount assessed as calculation basis of IRPF in the Infraction Notice. The Reporting Counselor stated that, in this case, "the Appellant's right of defense was violated, since it may only wonder what mathematical operations the tax agent performed to assess the tax object of the infraction notice".

Moreover, the decision indicated that the IRPF should have been calculated based on the rates related to the period of assessment of the earnings (1988 to 1990), not to the period in which the Taxpayer actually received these earnings (2001), mentioning this position is pacified in the Superior Court of Justice.

The National Treasury's Attorney's Office (Procuradoria Gerald a Fazenda Nacional – PGFN) filed a Motion for Clarification against this decision, requesting a clarification on whether the Infraction Notice was cancelled due to a formal or material defect. However, the Motion was rejected, since the Counselors understood there was no declaration of nullity in the trial of the Voluntary Appeal, and said declaration could never be assumed. Therefore, the Counselors that tried the Motion for Clarification understood that PGFN's claim concerned a matter that was not related to the appealed decision.

The PGFN then filed a Special Appeal, insisting on obtaining a declaration on the type of defect that led to the cancellation of the Infraction Notice, proposing the characterization of a formal defect. CSRF accepted the Treasury's appeal, but denied relief. Indeed, the arbitrors of the special court understood that the failure to clearly demonstrate the method to calculate the tax assessed means "the lack of indication of the taxable event of the tax obligation", concluding there was material defect, with violation of the assumptions of a tax charge provided by section 142 of the National Taxation Code (Código Tributário Nacional – CTN).

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"SUBJECT: CONTRIBUTION TO FINANCE SOCIAL SECURITY – COFINS
Calendar year: 2006
Summary: TECHNOLOGY TRANSFER AND TECHNICAL ASSISTANCE CONTRACT. REMUNERATION THROUGH ROYALTIES. NON-IMPOSITION OF COFINS.
The amount paid as royalties under a technology transfer contract is not subject to COFINS, since this is not a service (obligation to do something), but instead an obligation to give something. The hypothetical provision of technical assistance present in the agreement does not change this picture when the evidences present in the records indicate there was no payment for the provision of services, but instead for the transfer of technology (royalties). Alternatively, if there were proof of provision of services, tax agents would have to segregate the amount related to said service from the amount paid as royalties. Tax agents could never have assumed that the whole amount assessed was sent abroad due to an alleged service provided; otherwise, tax agents would not be taking on the burden to prove the fact that sustains its right (tax charge).
SOFTWARE LICENSE AGREEMENT. ALLEGED PROVISION OF TECHNICAL ASSISTANCE SERVICES. REMUNERATION. NON-IMPOSITION OF COFINS.
The amount paid as software license is not subject to COFINS, since this is not a service (obligation to do something), but instead an obligation to give something. The hypothetical provision of technical assistance present in the agreement does not change this picture when the evidences present in the records indicate there was no payment for the provision of services, but instead for the license to use software. Alternatively, if there were proof of provision of services, tax agents would have to segregate the amount related to said service from the amount paid for the license. Tax agents could never have assumed that the whole amount assessed was sent abroad due to an alleged service provided; otherwise, tax agents would not be taking on the burden to prove the fact that sustains its right (tax charge).
SERVICES AGREEMENT RELATED TO A SERVICE PERFORMED ABROAD BY A FOREIGN ENTITY WITH OUTCOME OCCURRING OUTSIDE BRAZIL. NON-IMPOSITION OF COFINS.
The provision of section 1, paragraph 1, II of Law 10,865/04 does not apply when the service hired by a national entity is provided outside Brazil by a foreigner and has is outcome assessed outside Brazilian boundaries, exactly as in this case, in which a national entity hired a foreign entity to provide services in the U.S.A. (certification of exported vehicles) so the vehicles exported to that country could move freely in American territory."

The decision on point deals with the imposition of Cofins-import and PIS-import in three cases:

(i) on payments object of international technology transfer and technical assistance agreements, as services capable of triggering the imposition of Cofins-import and PIS-import;

(ii) the imposition of these contributions on the purchase of software licenses with additional services; and

(iii) the charge of Cofins-import and PIS-import on services provided abroad, related to tests made abroad with products exported by the Taxpayer.

The Taxpayer had entered into a Technology Transfer and Technical Assistance Agreement with a legal entity situated abroad, by means of which it had to transfer know-how to the former, and, if requested, send employees to Brazil for the provision of technical assistance. The parties agreed the Taxpayer would pay a percentage of its net revenue earned with certain products as compensation for the technology transfer and technical assistance (situation "i").

Besides this contract, the Taxpayer had purchased software licenses from a foreign entity, whose invoice indicated that the price paid referred to the software itself, besides documentation, updates and support (situation "ii").

Finally, the taxpayer also executed a Services Agreement with an entity situated abroad for the analysis of products it exported, to be performed outside Brazil (situation "iii").

When analyzing this set of agreements, Tax Agents issued an infraction notice against the Taxpayer based on section 1, paragraph 1 and section 3, II of Law No. 10,865/2004, which provides that these contributions are imposed on "the payment, credit, delivery, use or remittance of amounts to entities situated abroad as compensation for services provided", for services originated from abroad provided by residents of other countries, performed in Brazil or overseas, if the outcome is verified in Brazil.

Tax Agents understood that the elements involved in the Technology Transfer and Technical Assistance Agreement had the nature of services, which triggered the imposition of Cofins-import and PIS-import (situation "i"). Moreover, in relation to the purchase of software licenses, Tax Agents charged taxes under the argument that the Taxpayer had hired connected services (situation "ii"). Finally, they also understood the services rendered abroad had their outcome verified in Brazil, which justified the taxation (situation "iii").

The Infraction Notices were duly refuted by the Taxpayer, but the DRJ affirmed them under their own grounds. The Taxpayer filed a Voluntary Appeal, which was judged by CARF after the trial was converted into diligence for the production of additional evidence. In its defense, the Taxpayer claimed, concerning each respective situation, that:

(i) the Technology Transfer and Technical Assistance Agreement had as object the transfer of a right, not the provision of a service, since the technical assistance services were free of charge and there was only the possibility of them being rendered. Even if one considers technical services were provided upon charge, Tax Agents made a mistake in the quantification of the taxes due, since it considered the total amount remunerated, instead of segregating the amount that actually referred to technical assistance;

(ii) the activities considered connected were not services, but non-remunerated mean-activities; the Taxpayer's goal was to purchase software licenses; and

(iii) the tests were made by a non-resident, with products that were not in Brazilian territory. Therefore, the outcome was not verified in Brazil.

Regarding situation "i", CARF's analysis was based on the classic division of obligations to do something and to give something, which classifies services as typical obligations to do something, assuming the existence of an activity performed by someone. CARF based this assumption on the Civil Code, on section 110 of the National Taxation Code and on precedents issued by the Supreme Court concerning the imposition of ISS on the rental of immovable property, object of Binding Precedent 31. In summary, the Council understood that Tax Law is a Law of superposition, which cannot change Private Law definitions.

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After establishing this assumption, CARF analyzed the Agreement and, based on the documents analyzed, it concluded it concerned a technology transfer agreement, which had as compensation the payment of royalties. Most Counselors understood the agreement had as object an obligation to give something (a transfer of right), instead of the provision of services by a non-resident, which averts the imposition of Cofins-import and PIS-import.

Besides the contractual provisions, CARF considered the following additional elements to characterize the transfer of rights – compensated by royalties – and refute the characterization of this obligation as a service: (i) registration of the agreement with the National Organization for Industrial Property ("INPI") as technology transfer contract; and (ii) for the payments abroad, the exchange operations were registered under the specific code for transactions involving technology transfer, as provided by the Ruling of Exchange Market and International Capital (Regulamento do Mercado de Câmbio e Capitais Internacionais - RMCCI).

When analyzing the Taxpayer's alternative argument – of mistake in the identification of the calculation basis -, the Council accepted the appellant's arguments, understanding that Tax Agents could not have charged the contributions on the total remuneration paid: they should have segregated the total remuneration and allocated only the portion related to technical assistance.

Regarding situation "ii", CARF also accepted the Taxpayer's claims, since it verified there were no connected services. Besides, the same defect in the computation of the taxable basis was presentin this case, since Tax Agents did not segregate the amounts paid to the non-resident based on the respective nature.

Finally, concerning situation "iii", CARF cancelled the charge based on the argument that the services were provided abroad and produced results overseas. The reason is that the products were tested abroad, after being exported, so one could not claim results were produced in Brazil.

Therefore, CARF granted relief to the Taxpayer's claim presented in its Voluntary Appeal and cancelled the tax credit.

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