Tax Bulletin of the Administrative Council of Tax Appeals

specific tax report

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Dear Readers,

In this 36th edition of our Tax Bulletin of the Administrative Council of Tax Appeals ("CARF"), we will comment on a decision wherein the Superior Chamber of Tax Appeals ("CSRF") ruled that the taxes having their enforceability suspended pursuant to article 151 of the National Tax Code ("CTN"), provisioned in the tax books, cannot be deducted from the tax basis of the Social Contribution on the Net Income ("CSLL").

We will also analyze a decision in which the CARF ruled that, for tax purposes, revenues arising from Profit Sharing Debentures ("DPL"), which have no provision from another remuneration other than the income ascertained by the issuer, are to be taxes as variable income transactions, and thus only the net gain in the transaction is to be taxed by the Contribution to the Social Security Funding ("COFINS"). The Council also ruled that this tax should not be levied on accounting adjustments which, pursuant to the DPL, do not represent effective revenues for the Taxpayer.

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Impossibility to deduct tax debits in the case at bar with suspended enforceability, as ascertainment expenses of the CSLL Basis

"CSLL. NON-DEDUCTIBLE PROVISIONS. TAXES WITH SUSPENDED ENFORCEABILITY. As this is a situation having an indefinite solution, which may result in favorable or unfavorable effects to the legal entity, taxes or contributions whose enforceability is suspended under article 151 of the National Tax Code, are not deductible for the purpose of determining the tax bases of the IRPJ and CSLL, as they translated as a clear provision nature. Thus, the deductibility of such will occur at the final judicial decision, unfavorable to the legal entity".

The synthesis of the Appellate Decision rendered by CARF's Superior Chamber of Tax Appeals, transcribed above, deals with an administrative proceeding arising from a Tax Assessment Notice requiring the CSLL relative to the calendar years of 1997, 1998 and 1999, as the Tax Authorities considered that

the Taxpayer had failed to add the value of the tax under judgment to its tax basis, whose enforceability was suspended.

Dissatisfied, the Taxpayer then opposed the Tax Assessment Notice, claiming that the taxes with suspended enforceability do not characterize accounting provisions, but rather effective expenses, for which reason they could be deducted from the CSLL tax basis.

The Federal Revenue Judgment Office ("DRJ") head the Opposition filed by the Taxpayer, but upheld the Assessment in relation to the value of the tax under judgment, with suspended enforceability, whose deduction was considered to be undue.

Against such decision, the Taxpayer then filed a Voluntary Appeal with the CARF based on the same arguments presented to the DRJ.

After granting the Appeal, the former First Chamber of the First Taxpayers' Council, by unanimous vote, dismissed the appeal, for which reason the Taxpayer then brought a Special Appeal, in which it sought to demonstrate, based on another CARF precedent ruling contrary to the rendered judgment, the Assessment's error.

In its fundaments, the Taxpayer claimed that such recorded amounts would be for accounts payable, and not provision, because although the enforceability tax was suspended, it would already be due, identifiable and measurable.

The Reporting Councilor repeated the position of the majority that was being applied by the CARF in relation to the deduction de taxes with suspended enforceability, meaning that such amounts correspond to provisions and that therefore are not effective "accounts payable".

That is, the Councilor claimed that the taxes whose enforceability would be suspended, pursuant to article 151 of the CTN, provisioned in the tax books, can only be considered deductible expenses at the effective payment of the tax subject matter of a judicial proceeding. The Councilor pointed out that this positions is not only valid for the ascertainment of the Corporate Income Tax ("IRPJ"), but also for the CSLL. He based his arguments on articles 41, § 1, of Law no. 8,981/95 and 13, item I, of Law no. 9.249/95.

To better expose the above reasoning, he transcribed the vote of the appealed Appellate Decision: "(...) *As this is a situation having an indefinite solution, the date of end of the calendar year to which it refers, which depends on future events that may or may not occur, is included in a contingency situation which may result in favorable or unfavorable effects to the legal entity, that is, at the time of the balance sheet, such gain or loss is only potential, and clearly does not represent an unconditional representation. (...)Hence the need to form a provision for the accounting record of the taxes having their enforceability suspended due to contingent liability in a future fiscal year, whose amounts, appropriated as expenses in the calendar year, should be added to the net income for purposes of ascertainment of the taxable income, and to determine the tax basis of the*

CSLL, by force of article 13, item I, of Law no. 9,249/95".

The Reporting Councilor thus ruled that the expenses with taxes whose enforceability is suspended has a provision nature, and not an accounts payable nature, for which reason they are nondeductible from the CSLL basis. Therefore he dismissed the Special Appeal of the Taxpayer, upholding the appealed decision.

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Taxation of DPL, by COFINS, as investment of variable income. Non-taxation of accounting adjustment not representing effective income.

"COFINS. DEBENTURES. VARIABLE INCOME. The investment in debentures which remuneration is the company's profit sharing, and that are not entitled to interest, monetary adjustment, premium, discounts, or any other typical remuneration of fixed income securities, represent variable income securities.

ACCOUNTING ADJUSTMENT. Accounting adjustments made with the sole purpose of, pursuant to the Law of Corporations, adapting the operational results ascertained through the cash basis method, according to IN SRF 84/79, to the accrual basis method, do not constitute taxable revenues for COFINS and PIS".

The decision synthesis in question deals with the Appellate Decision rendered by the CARF, under examination of an administrative proceeding arising from a Tax Assessment Notice issued for the collection of the COFINS relative to the ascertainment periods of June 2000 to August 2002.

The Treasury Authorities verified in a tax audit procedure that the Taxpayer had not subjected the revenues arising from Profit Sharing Debentures ("DPL") to the COFINS, nor the profits arising from the accounting adjustments made by the company that had issued such securities to the Taxpayer. Thus, due to the confirmation of the alleged lack of taxation, they issued a Tax Assessment Notice to demand such tax.

In disagreement with this Assessment, the Taxpayer opposed the Tax Assessment Notice that had been filed against it, claiming that the DPLs were variable income investments and, as such, there should be a reconciliation of the revenues earned from them with losses of equal nature, prior to being eventually subject to taxation. In this regard, as the result of its operation as a whole was *negative*, there would be no substantiality to be taxed, for which reason the Tax Assessment in this case would be groundless.

As to the accounting adjustments made by the issuer of the DPL[1], which had allegedly generated taxable income, the Taxpayer claimed that these revenues should not be recognized, as they derived from the mere adjustment of the issuer's financial statements, whereby they were adapted to the accrual basis method.

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[1] The DPL contained a provision stating that its remuneration would be calculated according to the result ascertained in accordance with the case basis method.

The Taxpayer also contended that the Inspection could not impose the obligation to recognize the revenues arising from the issuer by this method, when under the DPL, they would only be due when the issuer presented results based on the cash basis method, as provided for in Normative Rule of the Federal Revenue Office no. 84/1979 ("IN SRF no. 84/79").

The Federal Revenue Judgment Office ("DRJ"), in examining the filed Opposition, ruled that the reasons claimed by the Taxpayer are groundless, which led the latter to bring a Voluntary Appeal with the CARF, reiterating its arguments explained above.

In examining the Appeal, the Reporting Councilor fully granted it so as to rule out the tax collection, thus accepting the all the arguments brought by the Taxpayer.

In his own words, his position was in this sense "*With regard to the remuneration of the debentures which exclusive remuneration is profit sharing, one cannot fail to recognize that the results earned, directly related to this subscription performed by the appellant, are post-fixed financial revenues represented by a variable income security. (...). Therefore, in the case of variable income, the appellant is correct when affirming that the taxable basis is the net gain of the operation, which consists of the difference between the global amount of the obtained result and the invested capital, in accordance with the applicable legislation at the time of the facts, article 26 of Law no. 8,389/91; article 29 of Law no. 8,541/92; article 22, §3 of IN SRF 123/99 and article 23, §2 of IN SRF no. 25/2001*".

As to the possibility of recognizing the DPL results as cash, whose issuer is a legal entity which may, by express provision in IN SRF no. 84/79, tax its revenues based on the cash basis method, the Reporting Councilor explains that "*the corporate adjustment corresponds to the portion relative to the Results of Future Fiscal Years, appropriated to Operational Results, relative to construction works performed in the real estate units controlled by the mentioned Results of Future Fiscal Years account, whose credit rights were not received in the period. In other words, the amount of R$ 6,752,248.41 (...) corresponds to the results that were not ascertained in accordance with the rules provided for in IN SRF 79/84* (sic). *The portion of R$ 6,752,248.43 is to be excluded from the tax basis of such tax*".

Thus, based on such fundaments, the CARF granted the Taxpayer's Voluntary Appeal in order to rule out the collection of the COFINS on amounts that do not correspond to the taxable income.

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