Tax Bulletin

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The Administrative Council of Tax Appeals

Specific tax report n° 66 • Year VI • September 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 66th edition of our Tax Bulletin of the Administrative Council of Tax Appeals ("CARF"), we will comment on a decision in which the CARF accepted the impossibility of recognizing a "de facto" company formed by different companies when there is no evidence of indistinctness of their corporate purposes and assets.

We also examined a decision in which the Superior Chamber of Tax Appeals ("CSRF") ruled that preclusions, within administrative proceedings, only occur if there is no opposition as to the taxation itself or violation. It therefore does not encompass its arguments, which may be presented any time throughout the administrative proceeding.

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Souza, Schneider, Pugliese e Sztokfisz Advogados

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"DE FACTO COMPANY. EVIDENCE. In order for the tax auditors to consider that four companies are in fact only one, it is necessary to demonstrate that the corporate purposes and assets are indistinct. Therefore, it is necessary to prove that the companies: lacked authority to decide; and/or lacked a specific physical space, maintained at their expense; and/or lacked their own or rented machinery; and/or did not acquire their own input, raw materials, or goods; and/or were not the ones to hire its employees; and/or did not perform their sales; and/or were not accountable for their contracts, products, loans, and acts; etc."

This case deals with Tax Assessment Notices relative to the Corporate Income Tax ("IRPJ") and to the Social Contribution to the Net Income ("CSLL") of the ascertainment periods from 2007 to 2009. The assessment derives from the incorrect computation of taxes as it was "verified that in the period under audit, there were four companies which, in practice, operated as a single one".

The four companies, created from the split of another company, according to the Tax Authorities' view, in sum, (i) shared the same physical space of operation; (ii) performed identical activities; (iii) used the same trademark; (iv) had common direction, majority partners, and employees; (v) carried out internal transactions with one another; (vi) had the same accountant and a similar accounting structure; (vii) shared consumption accounts and, lastly, (viii) shared financial and accounting information.

In an Opposition, the taxpayer denied all the claims presented by the Tax Authorities, and also attached to the opposition documentation that attested the independence of the companies with regard to resources, machinery, employees and corporate purposes.

When hearing the Opposition, the Federal Revenue Judgment Office (DRJ), in addition to not recognizing any claims of the taxpayer, innovated by analyzing the reason presented for corporate restructuring. According to the DRJ, the split of the company for the formation of distinct companies only occurred for tax economy reasons, and for the validity of the tax planning, there should be non-tax reasons, which were not present in the case in question.

Against this decision, the taxpayer then filed a Voluntary Appeal, repeating the arguments presented in the Opposition and arguing that the DRJ should not have modified the assessment. Due to this, it collected new documents in order to corroborate the business purpose of the corporate restructuring performed.

In analyzing the case, the CARF rendered a favorable decision to the taxpayer, not recognizing the existence of the de facto company. The Reporting Councilor examined all the claimed raised by the auditors to provide grounds for the existence of a single company and ruled them out one by one. He found that the four companies were independent and that the complementary nature of the activities derived from the activities within an economic group.

As to the argument used by the DRJ that the corporate restructuring had been the product of tax planning aimed at reducing taxes, the Councilor first mentioned the lack of jurisdiction of the DRJ to add arguments not present in the assessment.

The Reporting Councilor affirmed that only if "*the tax planning were prohibited would it be possible to state that the acts and business motivated by tax economy were cases of abuse of right or fraud against the law. However, this assumption is not true, since the legal system does not prohibit tax planning*".

Moreover, he affirmed that the thesis stating that tax planning should be disregarded when lacking a business purpose and only aimed at tax economy unduly extends the powers of the Tax Authorities inherent to the assessment.

According to the Reporting Councilor, this thesis would only be feasible if the tax planning were forbidden and, consequently, the reason to reduce the tax burden would make the business defective. However, he believes that there is no law that prohibits tax economy, therefore, there would be no unlawful reason able to attract the application of article 166 of the Brazilian Civil Code (which provides for the nullity of the legal transactions, whose determining reason, common to both parties, is legal).

Therefore, by unanimous voting, the CARF granted the Taxpayer's appeal, recognizing the legitimacy, for tax purposes, of the corporate restructuring subject matter of the Tax Assessment Notice.

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"ADMINISTRATIVE TAX PROCEEDING. PRECLUSION. CHALLENGED MATTER. The preclusion dealt with in article 17 of Decree no. 70.235/72 is to be applied only in cases in which the taxpayer fails to object to its own taxation (that is, infraction) in an opposition and seeks to do so only through an ordinary appeal ordinary appeal (voluntary). 'An unchallenged matter means, in other words, 'collection/infraction that is not objected to': and this is precisely the flaw that fails to have an administrative litigation started. In the contrary sense, once a collection has been objected to, the administrative proceeding then commences, in which all the defense arguments presented by the taxpayer on any court level are to be examined, even if not originally brought forth in the opposition. The preclusion in question does not include the 'defense grounds' submitted by the taxpayer on any court level, even if not originally brought forth in the opposition. The preclusion in question does not include the 'defense grounds', but instead the 'defense' against a given requirement or infraction to the tax legislation, in case it was not filed with a first–tier administrative court. This is the case of application of the principles of instrumentalism of the forms and the moderate formalism that provide grounds to the administrative tax proceeding."

The Appellate Decision under analysis deals with a Special Appeal that was filed based on a case law divergence on the application of preclusion provided for in article 17 of Decree no. 70.235/72.

The administrative proceeding which led to the Special Appeal started with the opposition of Tax Assessment Notices issued for the collection of IRPJ, CSLL and related fines. The Taxpayer was assessed by allegedly having failed to comply with the 30% net income limit for the offsetting of tax losses and CSLL negative tax basis.

In its Opposition, the Taxpayer challenged the collection of taxes and fines based on: (i) the unconstitutionality of the limit, since it would imply the taxation on assets and not on income; (ii) the existence of vested rights for the full offsetting with regard to tax losses and negative tax bases formed prior to the enactment of the law that introduced lei this limit; (iii) the inexistence of equity increase in the assessed calendar year; and (iv) that the limit would constitute the unconstitutional and illegal creation of a compulsory loan.

The DRJ found the Opposition to lack grounds as it viewed the offsetting limit was legal and that the analysis of the constitutionality of the rule would not be under its jurisdiction.

As to the Voluntary Appeal, the Taxpayer renewed its arguments when claiming that: (i) the profit of December of the assessed calendar year is fictitious, in other words, it does not exist; and (ii) due to the takeover process, the total tax losses and CSL negative basis could be offset without being subject to the limitation.

The former Taxpayers' Council rejected the Voluntary Appeal and it viewed that the mentioned limit would having its principal place of business legal basis and that the constitutionality of the rule could not be examined. With regard to the new arguments claimed in the Voluntary Appeal, the Council did not examine them, as they considered that the matter was not pre-challenged by the Taxpayer throughout the proceeding – which would violate the principle of second hearing of the case.

Due to such, the Taxpayer then filed a Special Appeal demonstrating the divergence as to the scope and application of the preclusion rule provided for in article 17 of Decree no. 70.232/72

After the Special Appeal was granted by the Taxpayers' Council, the CSRF partially heard it, so as to analyze the issue relative to the preclusion.

The CSRF affirmed that the rules that govern administrative tax proceedings are to be construed less strictly, taking into account the principles of instrumentalism of the forms and of the moderate formalism. In addition, according to Rapporteur, the adequate control of the legality of administrative acts would be of the interest of the public administration.

Based on such elements, the CSRF found that the preclusion rule provided for in article 17 of Decree no. 70.235/72 would only be applicable in cased in which the taxpayer fails to object to the taxation. The reason is that the unchallenged matter subject to preclusion is not related to the argument content used by the Taxpayer, but instead to the lack of opposition to the collection of taxes or fines.

After a collection is objected to, whether at the time of the Opposition or in the Voluntary Appeal, they are to be examined.

Citing Reporting Councilor: "*once a collection has been objected to, the administrative proceeding then commences, in which all the defense arguments presented by the taxpayer on any court level are to be examined, even if not originally brought forth in the opposition. The preclusion in question does not include the 'defense grounds' submitted by the taxpayer on any court level, even if not originally brought forth in the opposition. The preclusion in question does not include the 'defense grounds', but instead the 'defense' against a given requirement or infraction to the tax legislation, in case it was not filed with a first–tier administrative court*.".

Therefore, the CSRF partly examined the Special Appeal and in this regard, by majority vote, granted it, determining the case be remanded to the Court of origin so that the arguments that were not examined could be so based on preclusion.

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