tax bulletin

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The Administrative Council of Tax Appeals

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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 108th issue of our note, we comment a decision in which the Administrative Council of Tax Appeals (Conselho Administrativo de Recursos Fiscais - CARF) analyzed the Contribution for Labor Accident Insurance (Contribuição para o Seguro de Acidente do Trabalho - SAT) due because of the risk level of the main activity.

We also comment a decision in which CARF examined the need of substantial economic activity for a pure holding company.

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

SAT Rate – Main Activity – One CNPJ

Pure Holding Company – Substantial Economic Activity

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.

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"SAT RATE. MAIN ACTIVITY. ONE CNPJ.
The rate of the contribution for Labor Accident Insurance (SAT) is assessed based on the risk level of the company's main activity, when there is only one registration on CNPJ.
The main activity is the one that, in each assessment period, contemplates the higher number of secured employees, temporary workers and resident physicians".

This decision was rendered in a Voluntary Appeal concerning an infraction notice issued to charge Contribution for Labor Accident Insurance (SAT) paid by the employer and imposed on the payroll. In accordance with section 22, II of Law No. 8,212/91, the rate of said Contribution is calculated based on the risk level of the work environment, ranging from 1% to 3%, depending on the risk (low, medium, high) related to the main activity developed at the establishment.

The appellant had collected SAT at a 1% rate, since it understood its main activity was education, so the risk level of its work environment was low. However, according to tax agents, the rate is "determined by the Taxpayer's main activity, contemplated in the List of Main Activities and respective Risk Levels", present in Exhibit V of Decree No. 3,048/99. Based on this reasoning, considering the CNAE code indicated in the company's CNPJ, the applicable rate was 2%.

In its Defense, the company claimed that most of its professionals work in the educational sector, so it could not be framed as a medium-risk company, applied to administrative activities. Notwithstanding this argument, the Judgment Office of the Internal Revenue Service denied relief to the Defense.

In its Voluntary Appeal, the company repeated the arguments presented in its Defense.

After receiving the records, CARF requested a diligence for the IRS unit of origin to evaluate the quantity of branches of that company and the main activity performed by each of them. In this context, the Tax Agents requested the taxpayer to present a list of employees and their respective professional categories. Then, the Tax Agent concluded that the main activity had administrative nature, not educational.

Confirming the position presented by DRJ, CARF stated that the SAT contribution rate shall be assessed based on the risk level of each CNPJ, individually, or by the level risk of the main activity, when there is only one registration. Said Court also mentioned Binding Precedent No. 351 of the STJ.

For a company with only one CNPJ, without individual branches with different CNPJs, CARF understood that the definition of the main activity should consider the activity that occupies the higher number of secured employees.

In the case on point, the demonstrative chart of the total number of employees per CNAE demonstrated that the activity with more employees was not education itself. Therefore, said court ruled that the appellant failed to prove that the "educational activity was the main one", so the classification of the risk level as medium was correct. For this reason, the infraction notice was affirmed.

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"SUBJECT: CORPORATE INCOME TAX CIT
Calendar year:2009, 2010, 2011, 2012
SUB CAPITALIZATION RULE. INAPPLICABLE TO THIS CASE.
Even for a pure holding company, its is incorrect to state it does not perform a substantial economic activity only because its object is participation in other entities' capital, with the purpose of obtaining revenues derived from the distribution of profit and capital gain.
A holding company develops substantial economic activity when it has, in the jurisdiction of its residence, operational capacity compatible with the management of the economic group, especially to make decisions related to the administration of its assets and corporate shares. The operational capacity is measured by the existence of physical space and number of qualified employees to manage the group at a level compatible with the complexity of the activities performed."

The decision on point concerns a dispute involving the application of sub capitalization rules provided by Law No. 12,249/2010 to operations between an entity situated in Brazil - the Taxpayer - and its mother company situated in Denmark, which is a pure holding company, that is, a holding company that has as sole object holding shares in other companies of the same economic group.

Section 25 of Law No. 12,249/2010 establishes that one of the criteria for the application of sub capitalization rules is the performance of transactions with an entity situated abroad with a privileged tax regime. Especially for holding companies situated in Denmark, section 2, II of IRS Ruling No. 1,037/2010 characterizes as privileged tax regime the one to which holdings that "do not perform substantial economic activity" are subject.

Based on these provisions, Tax Agents revised the computation of CIT and CSLL made by the Taxpayer, for understanding the holding did not have substantial economic capacity; as consequence, sub capitalization rules applied to the transactions between said company and its daughter company in Brazil – the Taxpayer.

The infraction notice was grounded on the interpretation that pure holding companies will never have substantial economic capacity. In other words, Tax Agents understood that only service providers, industrial or commercial entities could hold the status of entities that "perform substantial economic activity". Under said perspective, the mere property of assets – shares and quotas – could never imply a substantial economic activity. As consequence, all transactions performed with pure holding companies should be subject to sub capitalization rules.

The Taxpayer refuted the charges claiming, in summary, that three criteria apply for the application of section 25 of Law No. 12,249/2010: ***(i)*** the non-resident must be situated in Denmark; ***(ii)*** the resident must be a holding company, and ***(iii)*** the holding company cannot perform any substantial economic activity. Only criteria ***"i"*** and ***"ii"*** are present in this case, as sustained by the Taxpayer, because the holding company performed a substantial economic activity, since it managed the shares held in the economic group. Moreover, Tax Agents failed to prove the inexistence of substantial economic activity; they only assumed that no holding companies bear said feature.

The DRJ denied relief to the Defense, and the Taxpayer filed a Voluntary Appeal. CARF examined the Taxpayer's arguments and, because of the absence of legal provisions concerning the definition of substantial economic activity, it used the presentation of motives of the bill of Ruling submitted to Public Consultation No. 007/2016. The Council gave particular relevance to the following excerpt, which then motivated the draft of IRS Ruling No. 1,658/2016:

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> *"6. Therefore, a holding that develops substantial economic activity is the one that has, in the jurisdiction where it resides, operational capacity compatible with the management of the economic group; especially to make decisions related to the administration of its assets and corporate shares. Finally, it is relevant to notice that the operational capacity is measured by the existence of physical space and number of qualified employees to manage the group at a level compatible with the complexity of the activities performed."*

Based on this excerpt, CARF understood that the interpretation given by the Bill of Ruling to the definition of substantial economic activity was reasonable and could be applied to the actual case. When examining the facts, said court understood that the charge was mistaken for having assumed that pure holding companies were not capable of performing a substantial economic activity. This interpretation justified the cancellation of the infraction notices, due to the lack of demonstration, by Tax Agents, of the lack of capacity of the holding company to perform its end activities.

In other words, in CARF's interpretation, pure holding companies may or may not have substantial economic activity; this depends on the existence of operational capacity and adequate installations.

Therefore, CARF granted relief to the Voluntary Appeal and overruled DRJ's Decision, averting the application of sub capitalization rules based on the allegation of the existence of transactions with a holding company without substantial economic activity and cancelling the charge.

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