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# tax bulletin

The Administrative Council of Tax Appeals

Specific tax report n° 99 • Year IX • June 2016

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 99th edition of our newsletter, we will comment on a decision in which the Administrative Council of Tax Appeals ("CARF") viewed that the tax incentive granted by the State of Ceará in connection with the Industrial Development Incentive Plan has an investment aid nature, and therefore does not integrate the tax bases of the IRPJ and the CSLL.

We have also analyzed an appellate decision in which the CARF confirmed a lower administrative court ruling that cancelled the Assessment Notices for the requirement of credits related to the Contribution to the PIS and Cofins ascertained in operations between companies of the same economic group, under the opinion that there was simulation in the separation of activities.

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



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“IRPJ. TAX BENEFIT. INVESTMENT INCENTIVES: LOAN TRANSACTIONS. FUNDING OF PART OF THE DUE ICMS. REDUCTION OF THE DEBT AMOUNT. CHARACTERIZATION.
The concession of incentives for the implementation of industries considered to be fundamental for the development of the State of Ceará, among them the execution of loan transactions in favorable conditions, namely when the following is present: (i) the intention of the Legal Entity of Public Law to transfer capital to the private initiative and the (ii) increase of the stock of capital in the granted legal entity, through the incorporation of funds in its equity, characterizes the granting of an investment incentive. Investment incentives are to be directly recorded into a capital reserve account, and are to not go through a result account.
SOCIAL CONTRIBUTION ON THE NET INCOME –CSLL- INDIRECT TAXATION.
The decision related to the main tax assessment notice is to be equally applied in the trial of the consequent or indirect assessment notice, since both assessments, main and indirect, are supported by the same elements of certainty.”

This is a decision rendered by the Superior Chamber of Tax Appeals (“CSRF”) concerning Tax Assessment Notices issued for the collection of the Corporate Income Tax (“IRPJ”) and the Social Contribution on the Net Income (“CSLL”).

The assessment was caused due to the Tax Authorities’ not regarding the benefits received as tax incentive by the taxpayer from the Government of the State of Ceará as an investment incentive, in connection with the Industrial Development Incentive Plan (“Provin”).

To effect the incentive, the taxpayer received funds from the Industrial Development Fund of Ceará (“FDI”), as well as “granted credits of ICMS” from that State. According to the Tax Authorities, the benefits enjoyed by the taxpayer would characterize a funding aid, for which reason they should invariably compose the taxable income and the tax basis of the CSLL.

Upon the filing of an Objection to the Tax Assessment by the taxpayer, the matter was brought to the Federal Revenue Judgment Office in Fortaleza/CE (“DRJ”), which developed its arguments stating that the amounts transferred to the taxpayer have the nature of an investment aid, but obeyed the duty to follow the rules issued by the Federal Revenue Office of Brazil (“SRFB”), dealing specifically with Interpretative Declaratory Act (“ADI”) no. 22/2003, which concluded otherwise.

Therefore, the appellate decision of the DRJ expressly affirmed that although the transaction is considered as an investment aid, the DRJ was required to maintain the assessment, because the ADI binds it and considers the transaction as a funding aid (subject to the IRPJ and to the CSLL).

When the case was taken to the Administrative Council of Tax Appeals (“CARF”), it was decided that the tax incentive in question in fact consisted of an investment aid, canceling the assessment.

Dissatisfied, the National Treasury then filed a Special Appeal with the CSRF, defending that the purpose of investment incentives should be to cover specific expenses of the taxpayer, for the expansion of economic ventures, and not for the investment in commerce and production, which would characterize support for general expenses, viewed by the National Treasury as a funding aid. It also viewed that there would be no evidence in the case records that the incentives were utilized for economic venture purposes.

The Superior Chamber – reproducing the position rendered by the CARF – understood that the require ments to characterize an investment aid had been met: (i) the transfer of funds from the Government to the taxpayer; (ii) the purpose of encouraging the implementation or expansion of an economic venture; and (iii) the record of a transfer into a capital reserve account, to be utilized only in order to absorb losses or to be incorporated into the company's capital.

Lastly, the Chamber highlighted, citing CARF's appellate decision that granted the Voluntary Appeal, that "The specific destination of the funds in the acquisition of certain assets and rights is therefore not relevant", upholding the cancelation of the assessment.

"SIMULATION. INEXISTENCE. To simulate is the act of deceiving, concealing, hiding the reality, disguising the purpose of a legal transaction with another, as the intended purpose would be reached by a different transaction, hence the reason for article 167 of the Brazilian Civil Code establishing that the simulated legal transaction will be null. The breaking down of activities by companies of the same economic group, seeking to rationalize the operations and reduce the tax burden is not simulation. Voluntary Appeal Dismissed."

The decision in question deals with Tax Assessment Notices issued for the rejection of credits of the Contribution for the Employee Profit Distribution Program ("PIS") and of the Contribution to the Social Security Funding ("Cofins"), ascertained in the acquisition of timber utilized as input, as well as in expenses with storage and freights in sale transactions related to such products.

In sum, the Tax Authorities based their position on the fact that the purchase and sale transactions that led to the ascertainment of the credits in question were simulated, under the argument that there was corporate unity between the companies purchasing and selling the input, both belonging to the same economic group.

As a result of the alleged occurrence of simulation, the Tax Authorities then imposed a punitive fine of 150% on the tax credit amount and also issued joint liability statements in order to hold officers and managers liable for the assessed company.

The assessed company then filed an Administrative Defense against the Assessment Notices, claiming the lack of simulation, taking into account the independence of the companies and the effective existence of the transactions on a real, accounting, and tax level. In addition, it claims it was impossible to hold its officers accountable, given the lack of ultra vires acts or violation of any law or bylaws.

In a lower administrative court, the Federal Revenue Judgment Office ("DRJ") accepted the Objection. However, considering that the lower court ruling set the tax credit to a higher amount than the authorized limit, the National Treasury filed a voluntary appeal with the CARF.

When examining the matter, CARF fully confirmed the decision of the lower administrative court, which had cancelled the assessments in question.

In his vote, the Rapporteur Councilor noted that the purchase and sale transactions had not been simulated, since, in the year in which they occurred, the assessed company was no longer the owner of tree farms. In fact, the rural owners had been transferred to the company that sells input in the year prior to that of the transactions, through paid-up capital determined in debt restructuring proceedings.

In this regard, the Rapporteur stated that it is perfectly acceptable for the taxpayer to resort to legal means in order to save/reduce taxes. To characterize simulation, the Tax Authorities would have to invalidate the presumption of legitimacy of the acts, proving that they conceal a legal nature that is different from the intended one, which is not verified in this specific case, since the capital pay up was approved by judicial order and duly filed with the relevant bodies. Moreover, the Rapporteur stated that the involved companies had their own and different head offices, as well as their own accounting department and employees, which would rule out any indication of simulation.

Lastly, the Rapporteur concluded that "it is imperative to point out that the mere creation of a company with the purpose of reducing the tax burden in itself does not characterize tax violation, nor is it sufficient to disregard legally supported acts and transactions”.

Therefore, CARF dismissed the Voluntary Appeal, upholding the decision of the lower administrative court, which had fully cancelled the assessments.

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