Tax Bulletin

The Administrative Council of Tax Appeals

82

Specific tax report n° 82 • Year VII • January 2015

Dear Readers:

This publication **Tax Bulletin # The Administrative Council of Tax Appeals** is to inform our clients and interested parties on the main issues being discussed and decided in this court.

In this 82nd edition of our newsletter, we comment on the decision of the Tax Appeals Board (Câmara Superior de Recursos Fiscais, "CSRF") which settled the understanding that it is unnecessary to formalize Profit Sharing Plans ("PSP") before the beginning of the reference year; the company is only required to do so prior to payment of bonuses, in order to avoid the levy of social security contributions.

We also comment on a decision in which the CSRF established that when the Internal Revenue Service alleges the need to correct a formal error, it may not order the taxpayer to supply clarification statements or documents which might cause the tax matter at issue to be reexamined.

In order to access directly the text for each theme, click:

Profit Sharing Plans – Tax Immunity – Previous Agreement

Substitute Assessment – Requirements

Souza, Schneider, Pugliese e Sztokfisz Advogados law firm 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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"SUBJECT: SOCIAL SECURITY CONTRIBUTIONS
Calculation period: 12/01/2000 to 07/31/2006
PROFIT SHARING PLANS. TAX IMMUNITY. COMPLIANCE WITH APPLICABLE REGULATIONS. AGREEMENT BEFORE REFERENCE YEAR. UNNECESSARY.
Profit Sharing Plans PSP for the benefit of a company's employees, as a means of integration between capital and workforce, shall not be included in the assessment base for social security contributions, by virtue of the provision set forth on article 7, section XI of the Constitution, especially since these earnings are not characterized as wages, and they lack the requirements of repetitiveness and remuneration for work.
When the payment of bonuses titled as PSP do not meet the legal requirements set forth by specific regulations, significantly article 28, paragraph 9, subparagraph 'j' of Law no. 8.212/91, as well as Provisional Measure no. 794/94, as amended, in accordance with Law no. 10.101/2000, then social security contributions will be due, since the amount will then lose its PSP-related aspect.
The demand of other conditions, if not expressly or literally accounted for on the applicable regulations, such as the need to formalize an agreement before the beginning of the reference year, lies within the subjectivity of the enforcer/interpreter of the law. This exceeds the limits of specificity and threatens the very essence of the benefit, which, granted as a tax immunity, shall be interpreted extensively, not restrictively.
Special Appeal Dismissed."

The decision in question refers to a Tax Assessment issued by the Tax Authority for the collection of social security contributions levied on amounts paid as PSP bonuses by a company to its employees, during the fiscal years comprised between 2000 and 2006. The Tax Authority understood that the amount paid as PSP bonus failed to meet the legal requirements and should have been reported on the applicable social security contribution return form. To that effect, the Tax Authority issued the Tax Assessment for the collection of social security contributions levied in such amount.

The reasoning of the Fiscal Authority was based upon (i) the failure to prove there were previous negotiations between the company and its employees on the terms of the PSP; (ii) the fact that part of the agreements were signed after the beginning of the fiscal year of reference for the accounting of the profits which were distributed, which made clear that the employees were unaware of the rules for granting of bonuses under PSP for the first few months after the agreement entered into force; (iii) the lack of clear and objective rules that could be measured and regularly verified, for the benefit to be granted; and (iv) the absence of an agreement applicable to employees which occupied management positions in the company's headquarters.

By virtue of these facts, the amounts paid as PSP bonuses were found to be in violation of the legislation, and were not accounted for as benefits, but as regular wages, which are subject to social security contributions.

In response to the Tax Assessment submitted by the Brazilian Revenue Service ("RFB"), the company filed a Response claiming the lawfulness of the PSP bonuses. However, the Judgment Office of RFB (Delegacia da Receita Federal do Brasil de Julgamento, "DRJ"), when reviewing the company's allegations, chose to uphold the Tax Assessment as originally submitted by the Tax Authority.

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The taxpayer then submitted a Voluntary Appeal to the Administrative Council of Tax Appeals (Conselho Administrativo de Recursos Fiscais, the "CARF"), which canceled said Tax Assessment, by reasoning that the rules established for the characterization of PSP were clear and objective enough, and, additionally, that the payment of PSP bonuses, as well as the objectives sought after for granting this benefit, were ordinary procedures.

Against the decision of the CARF, the National Treasury filed a Special Appeal, arguing specifically about the absence of PSP agreement before the beginning of the reference year for its calculation, which consequently caused the lack of previously established rules. The company submitted a counterstatement.

When judging the appeal, the CSRF postulated that the provisions of Law no. 10.101/2000 are not to be considered mandatory; instead, they offer suggestions for the creation of PSP between employers and employees. This is due to the expression "may be considered," which is present on article 2, paragraph 1 of the aforementioned law. In other words, the mere absence of a previous agreement is not enough to change the legal essence of PSP bonus payments.

Moreover, the CSRF went on to clarify that, as a tax immunity, the payment of PSP bonuses is not subject to the regulations of article 111, section II, and article 176 of the National Tax Code (Código Tributário Nacional, "CTN"), which entail the restrictive interpretation of exemption rules. In fact, the immunity, as declared by the Reporting Board Member, ought to be interpreted comprehensively, earning the status of a fully enforceable constitutional norm.

To that effect, the Reporting Board Member concludes: "Therefore, the compulsory request of a previous agreement is derived from a subjective interpretation by the IRS official in charge of the Notice of Infringement, especially when it intends to enforce the requirements set forth by article 2, paragraph 1, subparagraphs I and II of Law no. 10.101/2000, which are not mandatory requirements. As previously settled, the matter of exemption/immunity does not allow for subjectivity," whereby the decision by the CARF that overruled the Tax Assessment was upheld.

"Subject: Social Security Contributions.
Calculation period: 05/01/1985 to 05/31/1995 and 11/01/1995 to 11/30/1995.
SOCIAL SECURITY CONTRIBUTIONS. EXPIRATION. ASSESSMENT DECLARED VOID. SUBSTITUTE ASSESSMENT OR NEW ASSESSMENT.
In the present case, the first tax assessment was declared void due to the lack of a perfect description of the taxable event. Since it was not possible to characterize the transfer of workforce rights, the assessment was in violation of article 142 of the CTN. This decision is not analyzing the essence of the error pointed out at the time the tax assessment was canceled, but rather the applicability of the new assessment's legal scope within the frame of the original one. Under the pretext of correcting a formal error, the IRS may not order the taxpayer to supply clarification statements or documents which might cause the tax matter at issue to be reexamined. If such measures are in fact necessary for the issuance of a new assessment, the tax obligation was not clearly defined before, which means the correct procedure is not the issuance of a substitute assessment, but the creation of a new assessment. Ergo, at the time it was assessed, the tax credit had been extinguished by virtue of expiration. Special Appeal Dismissed."

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The decision in question is in reference to a Notice of Tax Credit Assessment (Notificação Fiscal de Lançamento de Débito, "NFLD"), issued to a service receiver in the field of construction, bound by joint liability, which replaced a previously canceled NFLD, for the collection of Social Security Contributions due on wages paid to the employees of the contractor.

When analyzing the case, the CARF accepted the Voluntary Appeal, acknowledging the caducity of the assessed tax credit, seen as the lack of characterization of the taxable event constitutes material error. This entails the inapplicability of article 173, section II of the CTN, which allows for the restoration of the deadline for the Treasury to assess a tax credit that was previously canceled in light of formal error.

Against this decision, the office of the National Treasury General Attorney (Procuradoria-Geral da Fazenda Nacional, "PGFN") filed an appeal with the CSRF, claiming that the errors detected on the decision in dispute were formal, not material, whereby the caducity of the debts was not to be upheld.

When analyzing this appeal, the Reporting Board Member understood that the assessment in question was entirely new, and not merely a correction of the errors contained in the original assessment, given the lack of material identity between both assessments, caused by the new elements added to the records by means of demanding documents from the taxpayer such as ledgers, contracts, receipts, invoices and other documents pertaining services carried out by the contractors.

Dismissing the validity of the procedure adopted by the Tax Authorities, the Reporting Board Member affirmed that, under the pretext of correcting a formal error, the IRS may not order the taxpayer to supply clarification statements or documents which might cause the tax matter at issue to be reexamined, which in turn means the substitute assessment does not allow any material innovation. The deadline set forth by article 173, section II of the CTN is intended to allow for the substitution of an assessment that contained a valid substance that could be used again.

Therefore, the CSRF was unanimous to deny the Special Appeal filed by the PGFN, declaring the Tax Assessment void and ordering its full cancelation, seen as the tax credit at issue had already been extinguished by virtue of expiration when the taxpayer was summoned for the new assessment.

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