Tax Bulletin of the Administrative Council of Tax Appeals

specific tax report

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Dear Readers:

In this 62nd 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 deductibility of expenses incurred as Profit Sharing, even if certain formal requirements have not been met.

We also examined a decision in which the CARF ruled that for purposes of ascertainment of PIS and COFINS' credits, input means any goods or services employed directly or indirectly in the manufacture of goods or the service rendering, without which the production/service rendering activities are impossible or their quality is affected.

Enjoy your reading.

IRPJ – PLR Payments – Lack of formal requirements – Deductibility

"MATTER: CORPORATE INCOME TAX - IRPJ
Calendar year:2004

EMPLOYEE PROFIT AND RESULT SHARING. DEDUCTIBILITY OF EXPENSES. LACK OF UNION REPRESENTATION IN NEGOTIATION. CONSEQUENCES.
In the event of a formal agreement between the employer and employees setting the rules for the payment of remuneration, the lack of union representation in the negotiation is not sufficient to prevent the deductibility of the expense, for purposes of ascertainment of the taxable income."

The origin of this decision is the assessment of the Corporate Income Tax (IRPJ) due to the reduction of amounts deducted by a legal entity merged by the Taxpayer, in the ascertainment of the taxable income of calendar year of 2004, relative to profit sharing ("PLR") payments to its employees.

The reason is that the Tax Authorities viewed that the lack of participation of the competent union entity in the agreement that would authorize those payments would violate article 2 of Law no. 10,101/2000, prohibiting the deduction of this expense. Therefore,

they reduced it, redid the tax basis of the IRPJ, and levied the tax.

Against this assessment, the Taxpayer then filed an Objection claiming the non-conformity of the payments to Law no. 10.101/2000, since, although the union entity failed to attend the negotiation of the agreement that implemented the PRL plan, it was informed and invited for negotiations – which would be sufficient to comply with article 2, of Law no. 10,101/2000.

This Objection was found to have no grounds by the Federal Revenue Judgment Office ("DRJ") under the claim that the presence of a union representative is a legal requirement aimed at guaranteeing a fair and balanced negotiation between employees and employers.

Furthermore, according to the DRJ, there is no legal provision authorizing the exemption of a union representative in the negotiations. Thus, in case a union is not present in the negotiations, the expenses would not be deductible, due to the violation of Law no. 10,101/2000.

The DRJ also claims that the non-performance of the provisions in Law no. 10,101/2000 does not transform the payments initially made on the basis of PLR into bonuses, expenses which are deductible under the legislation. Therefore, the payments made in an alleged non-compliance with Law no. 10.101/2000 could not be deducted as PLR, nor under any other grounds, as bonuses.

Dissatisfied, the Taxpayer then filed a Voluntary Appeal defending the regularity of the deductions. For such, he claims that the negotiations of the PLR plan were conducted by a committee of representatives of his employees and that the union entity of the class had been invited to participate in this committee. Despite the fact that the union had failed to send a representative to the negotiation, the agreement on the PLR plan was sent to the union for their records and information, pursuant to article 2, §2, of Law no. 10,101/2000.

In addition, according to the Taxpayer, the presence of the union representative would be a mere formality, according to the position of the doctrine and case laws, and the delay of the union in attending the negotiations would cause losses to the employees only.

In this regard, he attached CARF decisions that are against the rejection of participations of this sort, and questions the positions of the DRJ as to fact that the purpose of the presence of the union representative is to balance the relation between the parties in the agreement, since the law would only require the debate and negotiation between employees and employers, a condition that would have been met by works of the committee of employee representatives – even if the union representative were absent.

As to the agreement itself, he claims that the criteria specified therein are objective and easy to understand, meeting the legal requirements. Moreover, it would have superior parameters (i.e, more beneficial to

employees) to those of the Collective Labor Agreement, which had the effective participation of the union entity.

Lastly, as a secondary argument, the Taxpayer claims that even if the provisions of Law no. 10,101/2001 had not been observed, the payments made are deductible, as they are *bonuses*. In fact, after the repeal of article 22 of Law no. 8,218/1997, these bonuses would not be subject to deductibility, pursuant to administrative case laws.

In examining the Voluntary Appeal, the CARF, by unanimous vote, deemed it to be valid according to the decision of a similar case heard by the DRJ of Rio de Janeiro, to which a company belonging to the same group as the Taxpayer is a party.

In this decision, the DRJ stated that "*even if the payment of the amounts on the basis of PLR had failed to precisely observe the provisions in Law no. 10,101/2000, its cause it the prior agreement between the company and its employees. Therefore, when reaching certain production goals or intended profits, the company is required to pay the previously agreed to amounts to its employees, since the agreement has the force of law between the parties and must be performed for legal certainty and social peace purposes. As a matter of fact, as the Romans would say,* pacta sunt servanda *(= the contract must be performed), a principle that prevails until today.*

Along this line of thought, the remuneration paid to employees, as profit sharing, even if the provisions in Law no. 10,101/2000 is not complied with, integrates its remuneration, maintaining bonus characteristics agreed to on the basis of a premium for productivity increase, which eventually leads to the company's profit increase".

In this regard, the Rapporteur Councilor viewed that, if there is no other alleged defect, other than the one claimed by the Tax Authorities, the payments have a remuneration nature, since there is no other indication of forbearance, meaning they are therefore deductible.

SOUZA, SCHNEIDER, PUGLIESE AND SZTOKFISZ ADVOGADOS law firm is available to its clients should they have any questions on the above decision.

Concept of "input" for PIS/COFINS credits

"CREDIT. CONCEPT OF INPUT. All goods or services employed directly or indirectly in the manufacture of the goods or service rendering, whose subtraction leads to the impossibility of rendering the service or production is to be considered input, that is, whose subtraction is an obstacle for the company's activities, or which implies substantial loss of quality of the service or service resulting therefrom."

The present case deals with Tax Assessment Notices referring to the non-cumulative contribution to the Employee Profit Sharing Program ("PIS") and to the Contribution to the Social Security Funding ("COFINS") of the ascertainment periods between May

and December of 2004 and between February and July of 2005.

Within this administrative case, the Tax Authorities challenged the accrual of PIS/COFINS credits over expenses with the representation of milk with suppliers and amounts paid as commission to business representatives; the inclusion of depreciation charges relative to fixed assets not used in the production of goods or provision of services, and those related to assets acquired before May 1, 2004, in an alleged non-compliance with the legislation.

The Tax Assessment Notices were objected by the Taxpayer, who claimed, in sum, that all the acquisitions of intermediary products, representation of milk, payment of commissions to business representatives, and fixed assets in relation to the general rule always generate PIS and COFINS' credits.

He grounded his argument on the non-cumulativeness of the contributions in question in relation to Constitutional Amendment 42/2003 and the differences of the non-cumulativeness of the IPI and ICMS and the non-cumulativeness to PIS and COFINS supported by the Constitution.

The DRJ found the Objection to lack grounds, since, according to its position, only the costs and expenses listed in the items of article 30 of Law no. 10.637/2002 generate PIS and COFINS' credits, through the non- cumulativeness system.

The Taxpayer, due to the DRJ's rejection in recognizing the validity of the arguments of the Objection, filed a Voluntary Appeal with the CARF, repeating the arguments presented previously.

In her opinion, the Rapporteur Councilor, seeks to shed some light to the definition of "input" for purposes of PIS and COFINS' credit ascertainment, citing the opinion of Justice Mário Campbell Marques, in Special Appeal no.246.317/MG, as the basis for her position.

In this regard, she affirms that the definition of "input" for these contributions is not based on the legislation that defines the concept of "input" for purposes of the Tax on Manufactured Products ("IPI"), taking into account that it is extremely restrictive; nor it is by the legislation that defines the concept of "costs and operational expenses" for Income Tax ("IR"), considering the wide scope of this definition.

The Rapporteur Councilor then states as credit input of the PIS and COFINS all the goods and services directly or indirectly used in the manufacture of goods and rendering of services whose subtraction leads to the impossibility of rendering services or production, that is, whose subtraction is an obstacle for the company's activities, or which implies substantial loss of quality of the service or service resulting therefrom.

Therefore, in her position, the Taxpayers' arguments were dismissed, as this definition of "input" does not comprise the goods or services of administration nature or relative to

business and marketing representation, as in the case in question.

Therefore, the Taxpayers' appeal was dismissed.

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