Tax Bulletin

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The Administrative Council of Tax Appeals

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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 75rt edition of our newsletter, we will comment on a decision in which the Administrative Council of Tax Appeals ("CARF") defined the concept of habitualness, for the purposes of the Social Security Contributions charged on portions considered as remuneration relative to salary bonuses resulting from Collective Labor Agreements.

We have also analyzed a decision in which the CARF found that earnings obtained from stock option plans constitute on which the Social Security Contributions are levied.

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

Social Security Contributions – Salary bonus - Habitualness

Social Security Contributions– "Stock Option" Plans– Remuneration

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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"SALARY. EXISTENCE OF BONUS LEGAL NATURE, BUT CONNECTION TO THE SALARY, WHICH PREVENTS THE ENJOYMENT OF THE EXEMPTION. ACCEPTANCE OF OPINION OF THE PGFN IN ACCORDANCE WITH THE PRINCIPLE OF EFFICIENCY. INAPPLICABILITY.
Bonuses are portions earned by workers due to an advance or substitution of adjustment. The portions denominated "bonus" that are not paid for such purposes do not have the legal nature of a bonus and may not enjoy the exemption in article 28, §9, letter "e", item 7 of Law 8,212/91. Existence of such characteristic . In addition, the law requires the disconnection of the salaries for the enjoyment of the exemption, which did not occur in this case, since the bonuses were referenced to the salary. Furthermore, considering the existence of Opinion PGFN 2.114/2011 combined with the effects of article 19 of Law 10,522/2002, we concluded that under principle of efficiency and in order to avoid the issue of an administrative act without purpose, that the inclusion of a single bonus provided for in a Collective Labor Agreement, not connected to the salary and paid without habitualness in the tax basis of the contribution, should not prevail. In the present case, when the connection to the salary is evidenced and there is a habitual payment, the application of the conclusions of the mentioned Opinion are unfeasible.
(...)
OCCASIONAL GAIN. DEFINITION. BONUS INAPPLICABILITY. APPLICABILITY CONCERNING THE SINGLE PAYMENT FOR THE RENEGOTIATION OF THE PETROS PLAN.
Occasional gain is the opposite of repetitive and habitual gain. Habitualness is the quality of what is frequent, repeated several time, which implies viewing as habitual that which is of may be repeated more than three time during the employment contract. Occasional gain is the gain that was of may be repeated at most three times during the employment contract term. The bonuses paid in the case at issue have habitualness characteristics, since they are paid annually. The single payment as compensation for the Petros Plan change is an occasional gain enjoying the exemption in article 28, §9, letter "e", item 7 of Law 8,212/91.
(...)"

The present decision originates from a tax assessment notice seeking the collection of the Social Security Contributions levied on portions viewed as remuneration related to the salary bonuses resulting from Collective Labor Agreement.

In 2011, the Tax Authorities assessed the Taxpayer for an alleged lack of collection of the Social Security Contributions charged on portions considered as remuneration. The reason for this is that they found that the salary bonuses paid by the Taxpayer did not enjoy the exemption provided for in article 28, § 9, letter "e", item 7 of Law no. 8.212/91[1] , since they failed to comply with the requirements provided for in article 214, §9, letter "j" of the Social Security Regulation ("RPS"), in the sense that the payments should be made without habitualness and disconnected from the salary.

[1] "Article 28. Contribution salary means:
[...]
§ 9 The following does not integrate the contribution salary for the purposes of this Law, exclusively:
[...]
e) amounts:
[...]
7. earned as occasional gain and bonuses expressly disconnected from the salary;"

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The Taxpayer was against this assessment, and filed an Opposition claiming that the assessment was invalid, since under Law no. 8,212/91, the social security contribution is not charged on a) indemnification sums; b) sums that do not correspond to the rendering of service; c) portions that cannot be substituted by any equivalent social security benefit; and d) occasional gains expressly disconnected from the salary. Thus, the bonuses would be exempt from Social Security Contributions, as they represent occasional gains expressly disconnected from the salary, which then justifies the non-collection of the contributions on the remuneration portion of the bonus.

The Opposition was deemed to be partly valid by the Federal Revenue Judgment Office ("DRJ"), for the recognition or not of the habitualness of the indemnification payments arising from the Renegotiation of the Social Security Plan and uphold the assessment as to the contributions allegedly levied on the other salary bonuses. According to the DRJ, the Taxpayer used to pay the bonuses on an annual basis, which should be considered as habitual, therefore ruling out the exemption event provided for in Law no. 8,212/91 and in the Temporary Service Receipt (RPS).

Dissatisfied, the Taxpayer then filed a Voluntary Appeal, repeating the claims contained in the Opposition. When hearing the Voluntary Appeal, the CARF dismissed it, in a casting vote.

As to the need to disconnect the bonus from the remuneration salary, the Councilors view that in this case the bonuses are calculated based on the workers' remuneration.

With regard to the habitualness of the bonus payments, the Councilor Rapporteur sustains that the concept of habitualness must be analyzed through antagonism to the concept of an occasional nature, that is, for a systematic interpretation of the rule, the terms are to be compared.

Within this context, considering the heading of article 3 of the Consolidated Labor Laws ("CLT") and the many references to the term "occasional" presented in Law no. 8,212/91, the appellate decision adopts as habitual that which is frequent and repeated, and that happens more than three times throughout an employment contract.

Due to the adopted assumption, as the payments of the salary bonus are annual, they will certainly occur more than three times throughout the employment contract. Therefore, these bonuses are excluded from the exemption rule of article 28, §9 of Law no. 8,212/91.

"(...) SOCIAL SECURITY CONTRIBUTION. CONTRIBUTION SALARY. INTEGRATING PORTION. REMUNERATION. STOCK OPTIONS. INTEGRATION.
Contribution salary, for the individual taxpayer, is the remuneration earned in one or more companies or for the performance of his/her activities, for one's own account, during the month.
In this case, the granting of stock options to individual insured taxpayers working for the tax debtor is to integrate the contribution salary, since they were granted for the work of the insured, were integrated to the assets of the insured and may not be classified as deriving from a business activity, as there is no risk."

The decision under analysis is about a Tax Assessment Notice issued for the collection of Social Security Contributions levied on the difference between the values of shares issued due to stock purchase option

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plans, also known as "stock options", and the market value of the transferred shares. The reason is that stock options constitute a stock purchase option plan by executives and employees at previously set prices, which are to be lower than the market value at the time of purchase.

In this sense, the Tax Authorities found that this difference in values constitutes a deferred remuneration, to be earned at the time of resale of such stocks, and is therefore likely to be charged by the Social Security Contributions. As grounds for this decision, they used the provisions in Resolution of the Brazilian Securities and Exchange Commission ("CVM") n. 562/2008, which considers the gains under analysis as asset instruments composing remuneration.

Rejecting this decision, the Taxpayer then filed an Opposition, claiming that the purchase of stock represents a mere trade business, and that his future sale does not necessarily represent a financial benefit, taking into account the possibility of stock devaluation, composing a risk, which would rule out the remuneration nature of the transaction.

This Opposition was heard by the Federal Revenue Judgment Office ("DRJ"), which dismissed it, leading to the filing of Voluntary Appeal by the Taxpayer, who repeated the arguments so that they may be subjected to the CARF.

When the appeal was sent to the CARF, the casting vote in the decision found that the possibility of earning benefits through stock options by employees only exists as to employment relationships – since the possibility of option for stocks ceased at the end of the employment contract – and which grants asset increase to the worker, leading to an effective remuneration on which the Social Security Contributions should be levied.

In addition, the CARF found that the asset increase provided by the stock option plans, relative to the individual taxpayer, fits perfectly well into the concept of contribution salary contained in the provisions of articles 22 and 28 of Law n. 8.212/91, considering that this is a payment made for the performance of work and that its value is integrated to the taxpayer's assets.

The reason for this is that the mentioned Law provides for the irrelevance of the nature of the gains for the formation of the contribution salary, determining that all earnings arising from work will be remuneration for purposes of the contribution to the social security.

Moreover, the prevailing position among the Councilors was that there is no risk in the transaction, and that stock option plans constitute the offering of sporadic advantages, meaning there is no possibility of loss for the employee or the individual taxpayer – as they may opt for not purchasing of stocks if they are not advantageous to them, without assuming any loss, and are only faced with the option of an sporadic advantage.

In other words, according to the position adopted in the appellate decision, in stock option plans, the worker receives the option to purchase within a given period at previously determined prices, meaning that if, at the time of stock acquisition, the market value is superior to the preset price, the worker, when acquiring then, immediately increases his/her assets by the amount difference – and it is their responsibility to maintain the stocks and not resell them, making them shareholders subject to market variations.

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Otherwise, if at the time of acquisition the value of the stocks is lower than the one previously agreed to, the worker will obviously not acquire the stocks. Therefore, it was found that in the transaction there is no risk involved that can rule out the remuneration condition of this benefit.

In addition, in the explanation of the vote of one of the Councilors involved in the decision, the CVM's position was again pointed out, as to the nature of the advantage earned through the stock option transactions, in line with the position stated in the decision, as it recognized the mentioned advantage as a "flexible form of remuneration".

Thus, the Panel, in a casting vote, found that the Social Security Contributions are to be levied on the benefit earned by the workers through stock options.

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