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 106th issue of our note, we comment on a decision in which the Superior Chamber of Tax Appeals (Câmara Superior de Recursos Fiscais - CSRF) confirmed the imposition of PIS and Cofins on discounts granted to taxpayers by suppliers of products for resale and disallowed credits of such contributions under the non-cumulative regime on the ICMS-ST applied on the purchase of such products and on the freight for circulation of products between different branches of the same taxpayer.

We also comment a decision in which the CSRF affirmed IRPJ and CSLL charges concerning profits earned by an affiliate situated overseas, based on the position that the transfer of shares held by the Brazilian Affiliate implied the use of the amount in its favor, triggering the taxation in Brazil.

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

PIS and Cofins – Discounts and Bonus, Credits on Freight between Branches and ICMS- ST – Calculation Basis of the Contributions

IRPJ and CSLL – Profits Earned Abroad – Availability – Use of Amount

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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"CALCULATION BASIS. FORMATION. DISCOUNTS OBTAINED.
Discounts obtained on the prices adopted by the supplier are included in gross revenue. It does not matter to the purchaser whether they were granted conditionally or not."

The decision on point deals with infraction notices issued to charge Contribution to the Social Integration Program and Contribution to Finance Social Security ("PIS" and "Cofins") of years 2008 and 2009, added with ex officio fine and interest. The taxpayer is a retailer and wholesaler, member of a supermarket chain.

The taxpayer failed to include in the calculation basis of the contributions on point the amounts related to discounts received from its suppliers. However, Tax Agents understood said discounts should be included in the calculation basis of the Contributions on point, because they are part of the taxpayer's operational gross revenue.

Moreover, Tax Agents disallowed PIS and Cofins credits registered by the taxpayer under the non-cumulative regime, assessed on expenses with freight for the transportation of products between the taxpayer's branches; and on the amount of Tax on the Circulation of Merchandise and Provision of Services paid under the Tax Substitution regime ("ICMS-ST") imposed on the purchase of products for resale.

The taxpayer filed a defense sustaining that the discounts granted by its suppliers cannot be included in its gross revenue, and, as consequence, taxed by PIS and Cofins. Instead, they correspond to cost reduction for the products purchased, since there is no condition for their concession. Concerning credits disallowed by Tax Agents, the taxpayer argued they are both under the principle of non-cumulativeness established by section 195, paragraphs 12 and 13 of the Federal Constitution of 1988. The taxpayer also claimed that interest could not be imposed on the ex officio fine.

In the first-instance administrative trial, the Office of Judgment of the Revenue Service (Delegacia da Receita de Julgamento - "DRJ") affirmed the charge. The taxpayer then filed a Voluntary Appeal repeating the arguments presented in the Defense.

CARF then affirmed DRJ's decision, stating that according to the evidence present in the records, the discounts granted by the taxpayer's suppliers, as provided by the relevant supply agreements, were subject to a kind of compensation by the taxpayer – hence, this was not an unconditional discount subject to non-imposition, as set forth by section 1, § 3, item V, "a", of Laws No. 10,637/02 and No. 10,833/03.

That Administrative Court also affirmed the disallowance of credits assessed on ICMS-ST, under the argument that this tax is not included in the purchase cost of the products acquired by the taxpayer for resale. The reporting counselor stated that "the basic rule of non-cumulativeness is that only what was paid can be credited", and that ICMS-ST was not part of the calculation basis of PIS and Cofins payable by the supplier that sold the products to the taxpayer.

Furthermore, the Court affirmed the disallowance of credits related to freight for the transportation of products between branches, stating that there is no express legal provision authorizing such procedure, contrarily to the freight related to direct sale transactions. On the other hand, it decided to cancel the imposition of late-payment interest on the ex officio fine, due to the lack of legal provision.

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The National Treasury and the taxpayer then filed Special Appeals.

The winning vote issued at the Superior Chamber of Tax Appeals (Câmara Superior de Recursos Fiscais - "CSRF"), which diverged from the vote rendered by the Reporting Counselor, considered that discounts are taxable to the taxpayer that receives them in any case. Therefore, by majority of votes, that court understood that the legal provision that excludes "unconditional discounts granted" from the calculation basis of PIS and Cofins should be interpreted as referring to the revenue of the one that granted the discount, not of the one that received it. Hence, the charge was affirmed concerning this matter.

Regarding ICMS-ST and freight for the transportation of products from one branch to another, the court also disallowed these credits by majority of votes, affirming the decision issued by CARF, agreeing that these credits are not allowed under any circumstance.

Finally, concerning the imposition of interest on ex officio fine – which had been cancelled by CARF due to the lack of specific legal provision -, the CSRF decided that, based on the provisions of sections 161, 139 and 113, § 1 of the National Taxation Code (Código Tributário Nacional - "CTN"), the fine not paid until the due date becomes part of the main tax obligation, which corresponds to the tax credit, and this amount is subject to interest.

Therefore, for the reasons presented above, CSRF granted relief to the Special Appeal filed by the National Treasury and denied relief to the Special Appeal filed by the taxpayer.

"PROFITS ABROAD. LAW 9,532/1997. TRIGGERING EVENT. ASPECTS. According to scholars' lessons, the triggering event has several aspects and the union of said aspects gives its integrity. An analysis of section 1 of Law No. 9,532/1997 and paragraphs allows one to conclude that said rule, under a subjective aspect, is addressed to the legal entity situated in Brazil which holds shares of an affiliate or subsidiary situated abroad. Under the material aspect, it provides that profits earned overseas by invested entities shall be added to net profit, upon occurrence of the cases provided law, among which, for a daughter entity or an affiliate situated overseas, the availability of the profit to the entity in Brazil on the date of payment (temporal aspect). The profit is deemed paid when the amount is used in favor of the beneficiary in any place (territorial aspect), including for capital increase of the daughter company or affiliate situated abroad.
PAYMENT OF PROFIT. ACTS PERFORMED BY THE INVESTED ENTITY AND BY THE INVERSTOR. The cases for payment of profit comprise acts taken by initiative of either the invested entity or the investor. The credit of the amount on a bank account, in favor of the mother entity or affiliate in Brazil, the delivery, at any title, to a representative of the beneficiary, and the remittance, in favor of the beneficiary, to Brazil or anywhere else, result from acts performed by the invested entity. In turn, the use of the amount corresponds to an act performed by the investor, which holds the shares of the invested entity and may, at any time, dispose of its shares at its discretion, for instance, through a sale, transference, grant to pay in other entities' capital, among others.
USE OF AMOUNT. CONDITION FOR THE CONFIRMATION OF THE TEMPORAL ASPECT. The use of the amount consolidates the increase of value of the investment, which is reflected in the investor's balance sheet though equity equivalence method. It is not taxable until the profits are available, because the profit is already taxed in the invested entity. From the moment the investor decides to dispose of the shares held in the invested entity and benefits from the increase of value of the investment – generated by the profits earned by the affiliate, reflected in the investment through equity equivalence -, the use of such amount is clear and, as consequence, the payment of profit – temporal aspect – occurred."

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The decision on point deals with infraction notices issued to charge Corporate Income Tax (Imposto sobre a Renda da Pessoa Jurídica - "IRPJ") and Social Contribution on Net Profit (Contribuição Social sobre o Lucro Líquido - "CSLL") concerning profits earned through an affiliate situated overseas.

In summary, Tax Agents stated that the disposal of shares of an affiliate situated abroad is a case of availability of profits in favor of the affiliate in Brazil, capable of triggering the imposition of IRPJ and CSLL on said profits. According to Tax Agents, the charge results from the provisions of section 1, §2, "b", "4" of Law No. 9,532/1997, which, at the time of the events, provided that profits earned abroad through branches, subsidiaries, daughter entities or affiliates were considered available to the Brazilian entity in case of "use of the amount, in favor of the beneficiary in any place, including for capital increase of the daughter company or affiliate situated abroad".

When judging the Defense filed by the taxpayer, the Office of Judgment of the Revenue Service (Delegacia da Receita Federal do Brasil de Julgamento - "DRJ") partially affirmed the infraction notices, maintaining the charges in what concerns this matter. When judging the Voluntary Appeal, CARF affirmed said decision, which led the taxpayer to file a Special Appeal.

In its Special Appeal, the Taxpayer argued that the disposal of shares does not correspond to the use of the amount in favor of the Brazilian entity, because the profits remained in the affiliate after the operation and were not used for capital increase. The taxpayer also claimed that one could not admit that the expression "use of the amount" could be characterized as a conduct adopted by the taxpayer with the sale of shares, since the conducts described in the remaining items of letter "b" of paragraph 2 of section 1 of Law No. 9,532/1997 ("credit" and "delivery" and remittance") refer to acts performed by daughter entities or affiliates situated overseas, not by the Brazilian entity.

In his vote, the Reporting Counselor highlighted that the expression "use of amount" comprises any act taken by the invested entity or by the investor, which, as holder of shares of the invested entity, could dispose of its shares or quotas at its discretion. Therefore, the Reporting Counselor stated that "since the investment was transferred to another entity, the legislator understood this would be a case in which the profit, which had not been made available by the invested entity yet, would become available, because it served to increase the value of shares".

The Reporting Counselor also noticed that the fact that Ruling No. 38/1996 brings an express provision on the availability of profits upon the disposal of shares of daughter entities or affiliates, which was not established by Law No. 9,532/1997, enacted after this Ruling, does not allow the conclusion that the disposal of shares does not fall within the scope of the legal definition of use of amount.

One of the Counselors that agreed with the Reporting Counselor wrote a declaration of vote reinforcing that it was impossible to assume that the use of the verb "use" excludes the availability of profits by an act performed by the Brazilian entity. Moreover, such Counselor highlighted that the legislative history does not suffice to exclude the taxation of profits in this case.

On the other hand, one of the Counselors that disagreed with the Reporting Counselor issued a declaration of vote stating that, if there is no direct distribution of profits to the Brazilian entity, the legislator conditioned the taxation of profits abroad to the existence of one main element and one accessory element: the main element, under responsibility of the foreign entity, consists of a deliberation on the availability of profits and the ancillary element is under responsibility of the Brazilian entity, with the

purpose of crediting, delivering or using the profits.

Therefore, in accordance with the Counselor, in the case on point, there was no prior availability of profits by the foreign entity in favor of the Brazilian entity, so these profits could not be taxed in Brazil because of the lack of the main element presented above. Therefore, he emphasized that "the transfer of shares was performed exclusively by the Brazilian shareholder, and did not demand any act performed by the foreign entity related to the credit, delivery or use of said profits whose distribution was deliberated".

That Counselor also understood that the fact that Law No. 9,532/1997 did not provide for the disposal of shares as a case of availability of profits in Brazil demonstrates, on one hand, that the disposal of shares does not correspond to the use, delivery or credit of profits earned by the daughter entity or affiliate; and, on the other hand, that with the enactment of said Law, the legislator confirmed the decision of not providing for the disposal of shares of daughter entities or affiliates situated abroad as a case in which these profits would be taxable in Brazil.

In summary, the Panel denied relief to the taxpayer's Special Appeal, affirming the charge in what concerns the matter on point, by casting vote.

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