Tax Bulletin

The Administrative Council of Tax Appeals

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Dear Sirs:

This publication **Tax Bulletin # The Administrative Council of Tax Appeals** aims to update our clients and others interested about the main subjects that are being discussed and judged in this body.

In this 68th edition of our newsletter, we will comment on a decision in which the CARF did not accept the deductibility of amortization expenses of what is known as an internal premium, the one formed by corporate transactions among companies of the same group.

We also examined a decision in which the CARF determined the cancelation of the joint liability of a company of the same economic group of the assessed company due to inexistence of a legal interest in the occurrence of the taxable event.

Click over the topics below to directly access each text:

Souza, Schneider, Pugliese e Sztokfisz Advogados law firm is available to its clients should they have any questions on the above matters.

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NULLITY. LIMITATION TO THE RIGHT OF DEFENSE NOT CLAIMED. EX-OFFICIO RECOGNITION. IRRELEVANCE. If the appellant understood the attribute made by the auditors and fully exercised her right of defense, mainly as no loss was claimed in any phase of the instituted proceeding, it is not up to the panel to recognize voluntarily the nullity of the assessment.
FREEDOM OF SELF-ORGANIZATION. LIMITS. The freedom of the taxpayer's self-organization before the Tax Authorities and the company is not absolute; it is subject to restrictions, such as the respect for free competition, good faith, and for the social role of the company, and is not in line with the practice of simulation, abuse of rights, or fraud against the law.
INTERNAL PREMIUM. AMORTIZATION. REJECTION. ABSOLUTE SIMULATION. The formal corporate restructuring documents file by the appellant do not represent effective business; they are merely apparent, lacking substance or real existence, characterizing simulation in its absolute position. Thus, even if formally regular, if they do not constitute an effective acquisition of equity interest, but mere simulation, solely seeking to reduce its tax burden, the rejection of the amounts amortized as premium by the Tax Authorities is correct.
PREMIUM. COMPLEMENTARY NATURE OF THE COMMERCIAL AND TAX LEGISLATIONS. EFFECTS. The taxable results of the legal entities ascertained based on the Taxable Income have as a starting point the net result computed in the commercial accounting, ruled by Law no. 6,404/1976, as established by Law Decree (DL) 1,598/1977. The premium is an economic fact, whose tax effects were regulated by the tax law, based on the generally accepted accounting standards. Therefore, the generally accepted accounting standards and the rules enacted by the inspection and regulatory bodies, such as the Federal Accounting Council and the Brazilian Securities and Exchange Commission, are pertinent and are to be observed in the ascertainment of the accounting and tax results.
INTERNAL PREMIUM. LACK OF PAYMENT. IMPOSSIBILITY OF ACCOUNTING RECOGNITION. The lack of an effective expenditure (equity sacrifice) by the investor for the equity interest subscribed in transactions with subsidiaries reveals the lack of economic substance of the transactions, which prevents its accounting record and recognition, since there is no effective change of the equity interest situation.
PUNITIVE FINE. INAPPLICABILITY. The non-recognition by the Tax Authorities of the term known as internal premium, with the consequent rejection of its amortization, does not lead, in itself, to the application of the punitive fine.
REJECTION OF EXPENSES WITH FREIGHTS, SERVICES AND PURCHASE OF GOODS. Failure to prove the expenses through proper documents for such requires the rejection of the amounts relative to the expenses deducted in the calculation of the net income.
SELIC INTEREST APPLIED ON EX-OFFICIO FINE. The tax credit derives from the principal tax obligation, which comprises the tax and the ex-officio (voluntary) fine. Therefore, on the total assessed tax credit, including the ex-officio fine, there should be late payment interest, calculated at the Selic rate.

This case deals with Tax Assessments concerning the Corporate Income Tax ("IRPJ") and the Social Contribution on the Net Income ("CSLL") of the ascertainment period of 2005.

The assessment arises from the rejection of expenses deducted by the Taxpayer in relation to the premium tax amortization, allegedly generated "intra-group" and that would therefore not be deductible.

The transaction that resulted in the premium may be summarized as follows:

The Taxpayer's partners formed company "A", whose capital was made up by the Taxpayer's shares (quotas) in the amount of R$ 1,000,000.00. Later, these shares were reappraised, and were then worth R$ 74,051,000.00.

After only one (1) day, company "A" paid in capital in company "B" with the Taxpayer's shares, which had already been reappraised.

Due to this corporate transaction, company "B" recorded in its assets a premium of R$ 64,340,498.56.

Six (6) months following the formation of company "A", the Taxpayer incorporates company "B", and then amortizes the mentioned premium.

According to the Tax Auditors, this premium would be nondeductible, considering that the Taxpayer had amortized a premium without investments, based on documents it had "fabricated".

After the due process through the 1st administrative court level, which dismissed the claim, the CARF partially granted the Voluntary Appeal filed in opposition, as it considered the premium in question to be nondeductible, having canceled, however, the punitive ex-officio fine.

Firstly, the judging panel analyzed the matter in relation to the self-organization freedom of the taxpayers. The CARF sees that although the taxpayers have broad freedom for their own self-organization, this freedom would not be absolute, but limited to certain aspects, such as free competition, good faith, the social role of the company, etc. Furthermore, in relation to tax aspects, the judging panel regards that it is essential to respect the principles of contribution capacity and of isonomy in the interpretation and application of tax laws.

Moreover, the appellate decision analyzed herein sees that for the premium to be amortized, it should have originated (i) from an investment acquisition among independent companies; and (ii) with the effective payment of the premium based on the expectation of future profitability.

As to item (ii), the judging panel clarifies that the effective payment does not happen only with the expenditure of an amount in kind, but also through other forms, such as payment in kind of assets or rights.

According to the appellate decision, it is necessary for there to be an "*effective equity sacrifice" by the acquirer. As stated in the concurring opinion, "the lack of an effective expenditure (equity sacrifice) by the investor for the equity interest subscribed in transactions with subsidiaries reveals the lack of economic substance of the transactions, which prevents its accounting record and recognition, since there is no effective change of the equity interest situation*."

With regard to the existence or not of simulated acts in the corporate transactions carried out by the Taxpayer, the CARF disagreed with the position of the auditors and with that of the 1st level, since it had already affirmed the inexistence of any simulated acts by the Taxpayer, stating there were, in fact, acts practiced with the sole purpose of resorting to a situation provided for in the law that would lead to a tax economy.

Lastly, the Authorities, according to the Reporting Councilor, failed to prove their claim that the pension plan did not extend to all the workers. As a matter of fact, the exclusion of any employee as a beneficiary of the plan was not proven. As to those hired or terminated during the year, the respective payment was made proportionally, according to the rules set in the plan.

Therefore, through a casting vote, the CARF ruled that the intergroup premium was nondeductible. However, by majority vote, the judging panel decided to cancel the punitive ex-officio fine, affirming there was no simulated act on the part of the Taxpayer.

"JOINT TAX DEBT. COMMON INTEREST NOT DEMONSTRATED. LACK OF GROUNDS. The characterization of the mandatory joint liability provided for in article 124, item I, of the National Tax Code (CTN), does not require the demonstration of the common interest of legal and not only economic nature, meaning that which lies on the performance of the fact that is able to generate taxation."

The present case deals with Tax Assessment Notices issued for the collection of the IRPJ, CSLL, Contribution to the Employee Profit Sharing Plan ("PIS"), Contribution to the Social Security Funding ("COFINS") and the Withholding Tax ("WHT" [IR/Fonte]), referring to the calendar year of 2003.

According to the Tax Auditors, the following violations were verified: **(i)** omission of revenue arising from the payments of expenses made with funds not recorded in the accounting; **(ii)** omission of revenue relative to unverified liabilities; **(iii)** unverified costs and expenses; **(iv)** exclusions and offsetting not authorized by the legislation; **(v)** lack of addition determined by law; and **(vi)** lack of collection of IRPJ estimates.

In addition, another legal entity was included as debtor in the tax liability, being Jointly Liable therefor, pursuant to article 124, item I, of the CTN[1], on the following grounds: **(i)** same share control at the time the taxable events occurred; **(ii)** rotation of the same people in the management of the companies of the Group, including the Jointly Liable Entity; **(iii)** the fact that the Jointly Liable Entity "is enrolled with the Corporate Taxpayers' Registry (CNPJ) as a 'holding' company and therefore does not have its own revenues"; and **(iv)** the definition as a facto company between the Jointly Liable Entity and the Taxpayer, given the financial dependence of the former.

The Taxpayer and Jointly Liable Entity filed an Opposition, claiming, in sum, that article 124, item I, of the CTN, would not apply to the case, since the "common interest" would only be verified in case there was a direct connection of the jointly liable taxpayer with the taxable event of the tax liability. So, as the Jointly Liable Entity did not participate in the facts described in the assessment, nor did it earn the taxed income, its joint liability would be illegal.

[1] "Article 124. The following hold joint liability:
I – persons having a common interest in the situation constituting the taxable event of the principle liability;"

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Furthermore, it was also claimed that the indirect control of the holding company on other companies does not constitute a “common interest”, as this does not presuppose administrative subordination. To conclude the argument, the Opposition pointed out the fact that the Taxpayer and the Jointly Liable Entity have different corporate purposes and develop their business autonomously and independently, sharing none of the earned results, and Tax Auditors’ conclusion that all of them constitute a single company would go against the principle of the entity.

The Federal Revenue Judgment Office (DRJ), when hearing the case, upheld the joint liability. The Jointly Liable Entity then filed Voluntary Appeal against this decision, repeating the arguments of Opposition and adding that there is a judicial decision, rendered under article 141 of Law no. 11,101/05 (Law of Court Lei Judicial Debt Restructuring Procedures and Bankruptcies), which protects it against the accountability for liabilities of third parties (in this case, the Taxpayer).

In the trial of the Appeal, the Rapporteur Councilor, immediately pointed out that the judicial decision upheld by the Jointly Liable Entity would already be sufficient for the cancellation of the obligation connected thereto.

Nevertheless, he added that even that were not so, the joint liability would also not prevail, since it is not a mechanism to choose the responsible taxpayer, that is, “*it does not have the power to include a third party to the tax liability as a debtor, but only to classify the liability of those already included therein*”.

The Rapporteur also stated that there can only be a joint liability under article 124, item I, of the CTN, if all the debtors have an interest focused on the situation constituting the taxable event of the tax liability and provided that this interest is not simply economic, but also a legal one, meaning “one derived from a legal relationship of which the holder of the right is an integral part and which interferes in his rights and obligations and legitimizes him to claim in court the defense of his interests”.

The Rapporteur then concluded saying that the legal interest “*does not exist among companies that maintain their independence and distinction, even if bound to a common economic purpose. In order for two companies to have a common legal interest capable of ascribing the joint liability, it would be necessary for both to have performed the taxable event together as, for instance, if both were owners of the same property, or if they had rendered services together or disposed of a product in the consumer market as partners*”.

Therefore, as the Tax Auditors failed to point out any circumstance establishing a connection between the Jointly Liable Entity and the occurrence of the taxable event, the Rapporteur Councilor voted for the cancelation of the joint liability, and was followed by all other members of the Judging panel.

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