tax bulletin

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The Administrative Council of Tax Appeals

Specific tax report n° 102 • Year IX • September 2016

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 102nd issue of our note, we comment on a decision in which the Superior Chamber of Tax Appeals (Câmara Superior de Recursos Fiscais - CSRF) granted partial relied to a special appeal filed by the National Treasury, keeping an infraction notice issued to write off financial charges incurred by a company that had taken a loan for future capital increase in a related company, without having transferred the financial costs incurred with the loan.

We also analyze herein a decision in which the First Section of the Administrative Chamber of Tax Appeals (Conselho Administrativo de Recursos Fiscais - CARF) acknowledged the application of the statute of limitation in a proceeding in which the infraction notice had not mentioned the existence of willful conduct. In that case, the first-instance decision identified the existence of intent and, as consequence, did not apply section 150, § 4 of the National Taxation Code.

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

Loan for Future Capital Increase – Financial Charges – Non-deductible

Allegation of intent – The DRJ cannot claim there was willful conduct if the tax agent did not present such allegation

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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"CORPORATE INCOME TAX IRPJ. ADVANCE FOR FUTURE CAPITAL INCREASE. FINANCIAL CHARGES PAID. NON-DEDUCTIBLE.
Taxpayers cannot deduct financial charges incurred due to loans hired from a related company, used as advances for future capital increase of another related company, without the transfer of the same burden related to the period between the disbursement of such advances and the actual conversion into capital increase."

This decision deals with an Infraction Notice issued to write off the financial charges paid to obtain a loan signed with the purpose of advance for future capital increase of a related company. Such charges were deducted from the calculation basis of Corporate Income Tax (Imposto de Renda Pessoa Jurídica - "IRPJ"), Social Contribution on Net profit (Contribuição sobre o Lucro Líquido - "CSLL"), Contribution to the Program for Social Integration (Contribuição para a Programa de Integração Social - "PIS") and Contribution to Finance Social Security ("COFINS").

Tax Agents understood that the loan taken for advance for future capital increase is not a necessary expense, so the respective interest and IOF cannot be deducted from the taxable basis.

To strengthen their arguments, tax agents sustained that, in that case, the advance for future capital increase could not even be considered as necessary. The reason is that these amounts were credited to the invested company in April, 2002, but the actual capitalization only took place in January, 2003.

The taxpayer filed a Defense against the Infraction Notice sustaining, among others, that the loan taken has a legal nature different from the advance for future capital increase, and this precludes the possibility to transfer the related charges. In summary, this was a financial transaction to raise funds to make an investment, instead of a "loan taken for assignment of loan".

Under this perspective, the taxpayer sustains that the destination of the resources raised via loan does not matter; the deduction should always apply.

The first-instance decision in the administrative sphere granted partial relief to the Defense. An Ex Officio Appeal was filed and the taxpayer filed a Voluntary Appeal for the specific part relief had been denied.

After analyzing the appeals, CARF maintained the first-instance decision, which caused the National Treasury to file a Special Appeal, followed by the taxpayer's counterarguments.

The Superior Chamber, in turn, understood the taxpayer's arguments could not thrive. The decision noted that an advance for future capital increase is a revertible procedure and, in order for it to be undone, it should be characterized as a mere liability with third parties.

The Reporting Counselor confirmed his opinion mentioning CST Declaratory Act No. 9/1976, which states that, until the advance for future capital increase is actually capitalized, it should be excluded from net equity, as happens for any other liability.

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Then, he sustains that, since the advance for future capital increase is a procedure for the availability of resources to third parties, it is nothing more than an act of discretion, so the relevant financial charges are an unnecessary burden.

However, the Reporting Counselor also clarifies that his position should be counterbalanced by the time frame between the date the loan is taken and the actual conversion of the advance for future capital increase. The reason is that if a loan is taken to invest in an advance for future capital increase that is capitalized soon after, the financial costs incurred would be deductible.

Concerning this point, the Reporting Counselor explains that if the taxpayer did not have resources to carry out the advance for future capital increase in April, 2002, it should have waited until January, 2003 - date when the advance was converted into actual investment - to take the loan, since this would evidence the fulfillment of the requisite of necessity and avoid that resources booked as mere liability with third party remained in accounting records.

Therefore, the decision on point considered that the deductibility of charges derived from loans taken to serve as advance for future capital increase is not strictly connected with the destination of such resources, but to the criterion of necessity of the business transaction. In other words, if the invested company had capitalized right after the advance for future capital increase received, the financial expenses incurred by the investor could be deducted.

Finally, the decision states that the advances for future capital increase performed at the expense of indebtedness, considering the amounts involved in the transactions and the timeframe between the disbursement of such advance and its actual conversion into capital increase, may turn a valid transaction into a fraudulent one or trigger the occurrence of bankruptcy acts.

Based on the aforementioned, the CSRF granted relief to the National Treasury's Special Appeal, keeping the infraction notice issued to write off financial charges incurred with a loan taken for the advance for future capital increase of a related company.

"SUBJECT: TAX ADMINISTRATION RULES. Year: 1998. STATUTE OF LIMITATION. INTENT. LACK OF DEMONSTRATION. The existence of willful conduct must be demonstrated by the tax agent for the application of the term of statute of limitation provided by section 173, I of the CTN. This demonstration cannot be met by an analysis made by the first-instance decision. STATUTE OF LIMITATION. ASSESSMENT BY HOMOLOGATION. INITIAL DATE. LACK OF INTENT. For taxes subject to assessment by homologation, the statute of limitation when there are payments and there is no demonstration of intent of fraud is counted from the triggering event, as provided by section 150, §4 of the National Taxation Code."

The decision in point analyzed infraction notices issued to charge IRPJ, CSLL, PIS and Cofins under the argument that the Taxpayer had failed to prove the conditions necessary to regularly deduct its expenses and had also omitted incomes. Based on these allegations, the Tax Agent applied an ex officio fine corresponding to 75% of the amount of taxes not paid.

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The Taxpayer filed a Defense against the infraction notice, presenting the evidences it understood were sufficient to demonstrate the inexistence of omission of incomes and proved that the expenses that affected its Real Profit and CSLL calculation basis were regular. Besides, it claimed the statute of limitation had occurred, since the term provided by section 150, §4 of the National Taxation Code had expired – according to such rule, the statute of limitation would indeed apply.

When judging the Taxpayer's Defense, the first-instance judgment organ converted the trial into a diligence to better analyze the documents presented and request additional evidences. After the diligence ended and the records returned to that organ, it understood that the Taxpayer had acted with intent in the computation of its taxes, which would avert the application of section 150, §4 of the National Taxation Code and trigger the application of section 173, I, which provides for a longer term of statute of limitation when there is intent.

Therefore, although the Tax Agent that issued the infraction notices did not claim the existence of intent, the first-instance judgment organ envisage a malicious conduct and denied the application of section 150, §4 of the National Taxation Code, confirming the infraction notice.

The Taxpayer then filed a Voluntary Appeal against such decision, claiming that the appealed decision should be reversed, under the argument that the Tax Agent had not proven the existence of intent – and had not even mentioned it-, so the first-instance decision could not have affirmed the infraction notice under the claim of existence of malicious or fraudulent action.

When trying the Taxpayer's Voluntary Appeal, CARF understood firstly that the Tax Agent had not proven the existence of intent, which is confirmed by the fact that it had charged ex officio fines at the ordinary rate of 75%, instead of at the qualified rate of 150%, valid for malicious and fraudulent conducts.

Therefore, considering that the first-instance judgment organ could not have given a new motivation to the assessment, CARF unanimously reversed the appealed Decision, acknowledging the application of section 150, §4 of the National Taxation Code.

Furthermore, the first-instance decision had cancelled a significant part of the charge, acknowledging the regularity of the expenses incurred. CARF understood that this position demonstrated a contradictory behavior: acknowledging the deductibility of part of the expenses, and at the same time averting the application of the statute of limitation concerning the other expenses whose deductibility had not been proven based on the allegation of malicious conduct.

Therefore, based on these two arguments – inexistence of claim of intent by the Tax Agent, which impairs such claim by the first-instance judges and contradiction of the decision -, CARF reversed the decision, fully cancelling the charge.

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