

TAX DEVELOPMENTS

November and December 2009

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Our team of lawyers is available to answer any questions and provide additional information. Please contact us at: bkgb@bkgb.com.br.

1. COUNCIL ALLOWS USE OF PREMIUMS TO REDUCE *IRPJ* AND *CSLL*

The members of the Administrative Council of Tax Appeals (*Conselho Administrativo de Recursos Fiscais - CARF*) decided favorably, establishing a new precedent in relation to the use of premiums, generated as a result of company mergers, in situations where the company absorbed its investor company, taking advantage of the premium generated in the previous acquisition to reduce the payment of taxes.

This decision is unique insofar as the members admitted the use of the premium, represented by the amount paid as a result of the company's future profitability, for the reduction of the amounts due in the way of Corporate Income Tax (*IRPJ*) and Social Contribution on Net Profit (*CSLL*), in the event of the merger of a company by third parties. The tax authority adopts the position in the sense that the deduction benefit set forth in article 386 of the current Income Tax Regulation (*RIR/99*) can only be used by whoever paid for the Premium in the acquisition transaction and, therefore, has been issuing statutory notices of tax deficiency to taxpayers that were absorbing investor companies benefitting from the premium recorded in the previous acquisition.

It is worth noting that, when the matter refers to the use of the premium in merger operations and other forms of corporate reorganization, tax deficiency notices have proliferated. On the one hand because the tax authority carries out a meticulous verification in the sense of determining whether there was a case of mere simulation through operations without major economic objectives beyond that of paying fewer taxes. On the other hand, by reason of the restrictive line of interpretation of the prevailing tax legislation with respect to the rules for the use of the premium, but that in this case has been counter-argued in administrative appeals lodged by the taxpayers and that are still awaiting judgment by the CARF members.

2. *STJ* DECIDES THAT FACTORING COMPANIES SHALL PAY *COFINS*

The Federal Court of Appeals (*Superior Tribunal de Justiça – STJ*) ruled that the levy of *COFINS* (Contribution for Funding of Social Welfare Programs) on the income derived from factoring is valid. The discussion began with a Rio de Janeiro factoring company

that filed a writ of mandamus (*mandado de segurança*) in 1999, seeking acknowledgement of its clear legal right of not being subject to the levy of *COFINS* on the difference between the face value and purchase price of acquired credit rights, bearing in mind the provision in *COSIT* Declaratory (Normative) Act 31/97.

In the opinion of the reporting justice of the appeal, Luiz Fux, a factoring company performs an atypical mixed commercial activity, which involves the offering of services, including the purchase of credit rights, gaining financial benefits resulting from the transactions effected, wherefore the dissociation of said business activities for the purpose of determining gross taxable income does not seem coherent.

3. STJ EXEMPTS AMOUNTS RECEIVED FROM EXPROPRIATION FROM THE PAYMENT OF CAPITAL GAIN

The Federal Court of Appeals (*STJ*) judged in the sense that Income Tax is not levied on the indemnity obtained with the expropriation of real property. The judgment was handed down following the sequence of the Law of Repetitive Appeals (*Lei dos Recursos Repetitivos*), which prevents the judgment of other identical appeals.

In the case in question, the payment of Income tax on the sum of money paid as compensation by the federal government on the expropriation of real property was called into question. The Tax Administration understands that, in this case, there is a capital gain and charges a 15% Income Tax. The *STJ*, however, understood that there is no increase in wealth in cases of expropriation, there being thus no taxable capital gain.

4. COUNCIL APPROVES PRECEDENTS CONCERNING BANK SECRECY AND THE OMISSION OF INCOME

The Full Council of the Superior Chamber of Tax Appeals - *Câmara Superior de Recursos Fiscais* (*CARF*) approved a precedent that permits the use of taxpayer information relating to the period when the *CPMF* (Temporary Contribution on Financial Transfers) was in force, which would characterize the retroactive application of the law.

The possibility of breaking taxpayer bank secrecy is presently pending judgment by the Supreme Court of Brazil (*Supremo Tribunal Federal* - *STF*), given that Law 9311/96, which

instituted the *CPMF*, expressly determined that the information would not be used for the inspection of any taxes, other than the *CPMF*. Nevertheless, subsequently, Law 10174/01 permitted that the information obtained through the *CPMF* was used by the Tax Administration for the collection of taxes, through the comparison of the data, which gave rise to all the controversy.

CARF also recently approved a precedent concerning the omission of income – amounts the origin of which has not been duly evidenced by the taxpayer – in which the Tax Administration eliminated the need of evidencing the subsequent allocation of resources for the purposes of the statutory notice of tax deficiency. This means that the Tax Administration can now officially notify any omissions of income, without the necessity of evidencing the allocation of such income within the assets and liabilities of the taxpayer.

5. DCTF SHOULD BE DELIVERED MONTHLY

Through Normative Instruction 974/09 the Brazilian IRS (*Receita Federal do Brasil - RFB*) established new rules concerning the submission of the Declaration of Federal Tax Debts and Credits (*Declaração de Débitos e Créditos Tributários Federais - DCTF*), including the fact that as of 1 January 2010 companies (including those taxed through the presumed profit method) are required to submit said declaration monthly. In addition, the time limit for the delivery of the *DCTF* is now the 15th business day of the 2nd month subsequent to the month in which the taxable events occurred.

6. JUDICIARY SEIZES INCOME TAX REBATES TO SECURE THE PAYMENT OF AMOUNTS DUE BY TAXPAYERS

The Judiciary began to adopt the attachment of amounts corresponding to Income Tax rebates as a way of securing the payment of amounts due by taxpayers, quite some time ago. Through this kind of attachment, the judge sends an official letter directly to the Brazilian IRS, to determine that the Income Tax rebate amount to which the taxpayer is possibly entitled is not made available in the tax rebate rounds, in order to thereby secure the payment of the taxpayer's debts.

The Federal Court of Appeals (*Superior Tribunal de Justiça – STJ*) has already accepted this kind of attachment, both in a debt collection suit lodged by a bank against its customer, and in labor collection suits.

7. PROVISIONAL MEASURE IMPOSES INTEREST DEDUCTION THRESHOLDS

Provisional Measure (*Medida Provisória*) 472, published on 15 December 2009 (“PM 472/09”), limited the deductibility of the interest paid as a result of loans made between companies resident and domiciled in Brazil and nonresident natural persons and legal entities.

In summary, with the advent of the Provisional Measure, the deductibility of interest expense paid and/or credited by a source based in Brazil to a nonresident related natural person or legal entity, for the purposes of the determination of Taxable Profit and the Social Contribution on Net Profit tax base, is now subject to the cumulative satisfaction of the requirements pertaining to the proof of necessity for the company’s operating activities, delimited by hereafter applicable maximum indebtedness thresholds, calculated in relation to the equity interest amount held by a related foreign company or companies in the net equity of a legal entity in Brazil.

In accordance with PM 472/09, two requirements must be satisfied for the interest expense to be deductible: (i) the loan amount may not exceed twice the sum of the equity interests in the Brazilian company, and (ii) the sum of the loans may not exceed twice the sum of the equity interests of all related entities in the Brazilian company.

Moreover, if the creditor is resident or domiciled in a country with favored taxation or a privileged tax regime (tax haven country or jurisdiction), the new conditions imposed are even more restrictive: the indebtedness (individual and joint) with a legal entity or entities established in such countries may not exceed 30% of the net equity of the Brazilian company, on pain of non-deductibility and the adjustment of surplus expenses in the determination of the tax bases for the calculation of Corporate Income Tax (Taxable Income) and Social Contribution on Net Profits.

Further information on this subject may be obtained in our BKBG Special Tax Release published in January /2010, or directly with the professionals from the BKBG Tax Consulting team.

8. NEW TRANSFER PRICING RULES

Provisional Measure 478/09 (“PM 478/09”) established new transfer pricing rules, among other procedures. Transfer pricing rules were established in Brazilian legislation as a means of controlling the prices practiced between companies and their nonresident related companies. The objective of this legislation, therefore, is to determine these prices in order that they are as close as possible to the prices practiced in the market, as regards the importation of goods, services and rights conducted between related parties.

PM 478/09 modified aspects relating to the methods set forth for the determination of the arm’s length price in import operations, which should be compared to the prices effectively practiced by companies, so that any distortions and respective tax effects may be ascertained for the purposes of the determination of Corporate Income Tax (*IRPJ*) and Social Contribution on Net Profit (*CSLL*). The changes introduced into the system in force include, especially, the elimination of the *Preço de Revenda menos Lucro – PRL* (Resale Price less Profit) method, which was replaced by the *Preço de Venda menos Lucro – PVL* (Sales Price Less Profit) method, defined as the weighted arithmetic average of the sales prices in the Country of the goods, rights or services imported and calculated using the appropriate methodology defined in PM 478/09.

PM 478/09 also made generic alterations relating to the transfer pricing discipline, applicable both to imports and exports. Thus, among other measures, it was determined that the Minister of State for the Treasury may establish different profit margins by sector or field of economic activity, for the purposes of the calculation of the arm’s length prices.

Further information on this subject may be obtained in our BKBG Special Tax Release published in January/2010, or directly with the professionals from the BKBG Tax Consulting team.

9. COMPLEMENTARY LAW 133/09 REDUCES THE TAX BURDEN IMPOSED ON ARTISTS

As of the publication of Complementary Law 133/09, “*cinematographic, audiovisual, artistic and cultural productions, their exhibition or presentation, including in the case of music, literature, scenic arts, and visual, cinematographic and audiovisual arts*” have started to be taxed, in the *Simplex Nacional* (Special Unified Regime for the Collection of Taxes and Contributions due by Very Small and Small-sized Companies), at the rates of Annex III (and no longer Annex V) of Complementary law 123/06 (“CL 123/06”).

This means that companies from the artistic sector that opt for the tax system established by the *Simplex Nacional*, in accordance with CL 123/06, may benefit from a significant reduction of their tax burdens. The reason being that such companies, which were previously subject to rates that ranged from 17.5% to 22.9%, depending on the total sum of annual Gross Revenues, may now benefit from rates of between 6% and 17.42%, applicable also in accordance with the total Gross Revenue amount.

10. DECREE 7052/09 AUTHORIZES THE DEDUCTION OF MATERNITY LEAVE

Decree 7052/09, which was published on 24 December 2009, instituted the Company Citizen Program (*Programa Empresa Cidadã*), with the aim of extending, for 60 days, the duration of maternity leave and corresponding period for the maternity allowance. Maternity leave is a social right of urban or rural workers, established in the Federal Constitution of 1988, and has the originally determined duration of 120 days.

As a means of encouraging adhesion to the Company Citizen Program, the granting of a tax benefit was established whereby the total compensation of a female employee paid during the extension period of her leave may be deducted from the tax due by legal entities taxed on the basis of Taxable Profit. The simultaneous deduction of such total compensation as operating expense is, however, prohibited.

Female employees of legal entities that have adhered to the Program may be benefitted by the Company Citizen Program. To adhere to the Program, companies should send an application addressed to the Brazilian IRS, provided that the request for the extension of the maternity allowance is made by the employee by the end of the 1st month after the birth. Employees who adopt or obtain legal custody for the purposes of the adoption of children may also be benefitted.

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