

# Tax Planning in Brazil: Recent Developments

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# Tax Planning

- Concern for most countries
  - Discussions regarding the implementation of the General Anti-Avoidance Rules (“GAAR”)
    - Governments seek to avoid loss of revenue by means of transactions that imply on tax reduction
      - USA: Codification of Economic Substance
      - United Kingdom
      - India
      - Canada
      - Mexico

# “Traditional” view of the Doctrine

- Tax Planning is a right of the taxpayer
- The objectives sought are not important
- The legality of each act must be individually analyzed
- Rejects the economic consideration (or economic interpretation) on the tax planning analysis
- Analysis of the legal FORM adopted, and not the substance of the business carried
  - Principle of strict legality and “*tipicidade cerrada*”
    - “No one is obliged to do or not to do, except by virtue of law”
    - In tax law – art. 150, I – Union, States, Federal District and Municipalities can not demand or raise tax without law that establishes it

## “Traditional” view of the Doctrine

- Decision from the Taxpayer Council n. 101-124.462 (09/20/2001)
  - IRPJ-CSLL-SIMULATION-SWAP TRANSACTIONS- In order to characterize simulation it is necessary that the act practiced, which intends to conceal under the cloak of the act ostensibly committed, could not be made due to legal prohibition or any other reason. If the parties wanted and made the deal under the swap structure to indirectly achieve tax saving, it does not characterize misleading statement of will, essential on the simulation. (free translation)

# Amendment to the National Tax Code

- Complementary Law n. 104/2011 – Anti-avoidance rule
  - Article 116 – Occurrence of the taxable event and anti-avoidance rule
    - ADMINISTRATIVE authority can DISREGARD legal acts or transactions
      - Practiced to conceal the taxable event or the nature of the elements of the tax obligation
      - Relevant procedures must be established by ordinary law

# Amendment to the National Tax Code

- Complementary Law n. 104/2011 – Anti-avoidance rule

**Art. 116.** *With exception of law stating otherwise, the taxable event is considered occurred and its effects will subsist :*

*I – in case of fact situation, since the moment in which is verified the necessary material circumstances to produce the effects that usually it is subject to;*

*II – in case of legal situation, since the moment that is definitely constituted, as provided by the applicable law.*

***Sole paragraph. Administrative authorities can disregard legal acts or transactions practiced with the purpose to conceal the occurrence of the taxable event or the nature of the elements of the tax obligation, observed the procedures to be established by ordinary law.***

# Tax Planning

- Complementary Law n. 104/2011 – Anti-avoidance rule
  - Simulation – Article 167 of the Brazilian new civil code:
    - “Art. 167. A simulated juridical transaction is null, but what was disguised will subsist if it is valid in substance and in form.
      - § 1º There is simulation in juridical transactions when:
        - I – they appear to confer or transmit rights to persons other than those whom the rights really conferred or transmitted;
        - II – they contain statement, confession, condition or clause that is untrue;
        - III – private agreements are backdated or post-dated.
      - § 2º The rights of good faith third parties in relation to the contracting parties to a simulated juridical transaction are safeguarded.”

# Analysis of the substance over form

- Adopted on several countries of the world to attribute the tax effects to the acts and transaction practiced
- It does not matter the legal form adopted
  - Economic result matters
  - “starting point” x “arriving point”
- There is no specific Brazilian legislation on the subject
  - Sole paragraph of art. 116 of the National Tax Code it is not regulated yet
    - Administrative authorities can disregard legal acts or transactions practiced with the purpose to conceal the occurrence of the taxable event or the nature of the elements of the tax obligation, observed the procedures to be established by ordinary law.



# Analysis of the substance over form

- There is no specific Brazilian legislation on the subject
  - Tax authorities is applying the concept of “simulation”
  - Concept of simulation – Civil Code
    - appears to provide or transmit rights to persons other than those which actually provide or transmit
    - private agreements are backdated or post-dated
    - contain not genuine statement, confession, condition or clause
  - Imposition of qualified penalty – 150%

# Analysis of the business purpose

- Is tax saving business purpose?
  - Yes it is, but it CAN NOT be the only reason to implement a certain transaction
    - Tax saving must be CONSEQUENCE, and not CAUSE

# Substance over form, business purpose, IFRS and RTT

- Accounting in accordance with the IFRS is based on economic substance and business purpose
  - Can it generate tax effects?
    - RTT: made to cancel the effects of the IFRS on the INCOME accounts of the exercise
      - Additions and exclusions
  - Affects the analysis of the tax authorities regarding the operations
    - E.g. operation of debt recorded in equity or vice-versa

# Substance over form, business purpose, IFRS and RTT

- Accounting in accordance with the IFRS is based on economic substance and business purpose
  - Can it generate tax effects?
    - It can affect the form of taxation
      - E.g. transfer of the fixed asset to the short-term or long-term assets to be sold
        - Exemption of PIS/COFINS only on the sale of fixed assets
        - There is no exemption for the sale of current assets or long-term assets
        - Exemption rule – literal interpretation

# Summary

- Form over substance

- Traditional view of the Brazilian Doctrine
- Does not matter
  - Objectives
  - Effective result obtained
- Rejects the economic consideration (or economic interpretation) on the analysis of tax planning
- Important to verify if the legal form is valid
- Tax effect in accordance with the legal form adopted

- Substance over form

- Adopted on many countries
- Analysis of the objectives and results effectively obtained
- Independent of the legal form adopted
- Taxation based on the effective result

# Substance over form

- Form over substance

IRPF – Ex(s): FROM 1990. IRPF – CAPITAL GAINS – SIMULATION – In order to characterize simulation in legal acts, it is necessary that the acts practiced could not be performed, by legal prohibition or any other reason. **If there was no obstacle to make the capital increase, the effectiveness of the merger and decisions, such as carried out and each one of the practiced acts has not a different nature of the one that actually seems, i.e., if in fact and law it did not occur different acts from the ones performed, it is not possible to qualify the operation as simulated.** The pursued objectives with the practice of the acts does not interfere on the qualification of the practiced acts, therefore, if the practiced acts were legitimate, the possible consequences contrary to the tax authorities must be qualified as cases of tax avoidance and not illegal evasion. (...) Appeal approved. (106-09.343, Decision 09/18/97, DOU 04/28/98)

- Substance over form

SIMULATION. Once characterized simulation, the acts practiced with the objective of artificially reduce taxes are not enforceable against the tax authorities, which might disregard them. GOODWILL TRANSACTION – SUBSCRIPTION OF SHARES WITH GOODWILL AND SUBSEQUENT MERGER – REAL SALE OF EQUITY. If the acts formally practiced, analyzed as a whole, demonstrate that the parties had the sole purpose of avoiding taxation, and its substrates are unrelated to the institutes used or does not correspond to a real experience of the risks involved on the operation chosen, such acts are not enforceable against tax authorities, deserving the tax treatment that the real concealed act produces. **Subscription of shares with goodwill, followed by a merger and delivery of the monetary amount of the goodwill, it refers to a real sale of equity.** (...) Appeal not approved. (101-95.537 – Decision 05/24/2006)

# Business purpose

- Analysis adopted by most of the countries
- Operations that has the only purpose of tax saving
  - It is not accepted by tax authorities
- To the tax saving created by certain operation be accepted
  - There must be other objectives other than the tax saving
  - Business purpose / legitimate and demonstrable business

# Business purpose

## No business purpose

"IRPJ – "REVERSE MERGER" – MATTER OF PROOF – TAX LOSS OFFSET. The legal definition of taxable event is interpreted apart from the legal validity of the acts actually committed. If the documents gathered clearly evidence that the will statement on the merger agreements was deceitful to produce other effects than the one stated, tax authorities are not bounded to the effects that such acts would produce, but to the real economic repercussion of the underlying facts." (First Chamber Superior Council of Tax Appeals – CSRF – Decision CSRF/01-02.107)

## With business purpose

IRPJ – REVERSE MERGER – TAX LOSS DISALLOWANCE – DISMISSAL - The so-called "reverse merger", not prohibited by law, held between operating companies and that always been under common control, can not be typified as a sham operation or abusive, especially when, apart of the undeniable intention to not lose the accumulated tax losses, had the scope to search for a better efficiency of operations between both practiced. Special Appeal denied. By majority of votes, deny approval to the appeal. (First Chamber Superior Council of Tax Appeals – CSRF – Decision CSRF/01-05.413 in 03.20.2006)



# Measures against tax planning

- 1. Intensification of the inspection
  - Better preparation of the auditors
  - Creation of task force to analyze tax planning
- 2. Better control of the transactions held by the taxpayers, with data crossing
  - Several filings/returns/statements + SPED
- 3. More tax assessments with penalty for tax evasion
  - 150%
  - Criminal representation to the Ministry of Public Prosecution

# Measures against tax planning

- 4. Better preparation of the tax authorities representatives before the judging bodies
  - Prosecutors
  - CARF judges
- 5. Creation of anti-avoidance rule
  - In discussion on the Internal Revenues Service with many parties
- 6. Analysis of the business transactions
  - Not only the accounting / tax records

# Biggest taxpayers

- Monitoring services of biggest taxpayers (“SEMAC”)
  - Responsible to manage the identification activities and different monitoring of the taxpayers with bigger tax potential, to elaborate a preview, monitoring and analysis of the revenues and propose goals to the units of the respective fiscal region
- Monitoring of biggest taxpayers divisions – Dimac (SRRF of the 7th and 8th Fiscal Regions)
  - Responsible to manage the identification activities and different monitoring of the taxpayers with bigger tax potential, to elaborate a preview, monitoring and analysis of the revenues and propose goals to the units of the respective fiscal region

# Biggest taxpayers

## Special stations of biggest taxpayers – “Demac”

- Main functions:
  - Develop monitoring activities, monitoring and inspection of the tax planning
  - Develop activities of inspection of:
    - Operations of transfer pricing between related parties
    - Taxation on universal basis
    - Customs valuation
    - Moving of funds abroad
    - Operations related to international transfer due to exchange operations and international transfer in local currency
    - Other transactions abroad with tax impacts
- São Paulo, Rio de Janeiro and Belo Horizonte

# Biggest taxpayers

## Special stations of biggest taxpayers – “Demac”

- *It's a milestone of the inspection, because the RFB will act in a gray area of tax planning which is the space that the taxpayer has to organize themselves in order to pay less taxes," summarized the secretary of the agency, Otacilio Cartaxo.*
- *In São Paulo it will be under the magnifying glass of DEMAC over 5,000 taxpayers, selected by criteria that take into account the revenue (R\$ 80 million to R\$ 370 million), debts declared (from R\$ 8 million) and value of the payroll (R\$ 11 million to \$ 45 million). Throughout Brazil, this list is composed by 10,000 companies that are responsible for 75% of the total revenue.*
- *42% of large taxpayers ascertained tax losses in the last five years. And there is a stock of goodwill of R\$ 110 million, from mergers and acquisitions."*

Source: "Fisco mira novo tipo de sonegador", Diário do Comércio, 11/30/2010

## Inspection

“RFB collects R\$ 40 bi in debts”

Source: Jornal da Tarde, August 5, 2011

At the time the government announces more incentives to the domestic industry, the RFB has issued yesterday a report on the inspection showing that the sector was the one that most committed crimes against tax order or against Social Security.

The assessments issued in the first half of this year for legal entities focused on the industrial sector and resulted in a recovery of taxes in the amount of R\$ 10.8 billion, 102.2% more than the same period in 2010.

In total, the RFB collected R\$ 38.03 billion from January to June 2011, representing an increase of 23.4% over the same period last year, even with a reduction of 2.3% in the number of companies audited. In the case of individuals, the recovery of credit totalized R\$ 2.24 billion, the same amount of the first half of 2010, despite a 25% drop in taxpayers assessed.

The Tax Authorities expects to achieve revenue of R\$ 100 billion in tax credits recovered this year. The tax collection was higher, in nominal terms, in the industrial sector, but higher percentages, points out the growth of 498.1% (R\$ 2.29 billion) in the communications, energy and water industry and of 194.2% (R\$ 6.57 billion) in the financial services industry.

**RFB found several abusive tax planning operations made by companies to reduce the calculation basis for the payment of Corporate Income Tax (IRPJ) and Social Contribution on Net Profit (CSSL).**

The sub secretary of the Treasury, Caio Marcos Cândido, informed that was collected R\$ 8.9 billion in taxes in 63 operations. This represents almost 10% of all credit recovered last year by the RFB.

**There are still ongoing operations in which 87 more were identified with evidence of abusive tax planning, as in reverse mergers (merger of a profitable company with a deficit one) and operations “*casa e separa*” (made to disguise capital gains on sale of equity).**

# Inspection

## "RFB collects R\$ 40 bi in debts"(cont.)

Source: Jornal da Tarde, August 5, 2011

### Losses

Cândido also informed that the Brazilian Internal Revenue (RFB) is reviewing the high values recorded as losses in receipt of loans by financial institutions. These statements have lowered the IRPJ calculation basis of these banks and, consequently, the tax paid to the RFB.

In this first stage, are being analyzed the statements of 34 financial institutions headquartered outside Sao Paulo, since the state has a station specialized in financial institutions.

Of selected, on 16 there is strong evidence of irregularities. RFB estimates that it is undue R\$ 1.7 billion out of R\$ 15 billion recorded as losses between 2007 and 2009.

The sub secretary said that only one bank, after notified, immediately rectified the declaration of 2009, withdrawing R\$ 50 million of losses declared by increasing the payment of IRPJ on R\$ 6 million.

"The inspection has to keep the risk perspective. The function of the RFB, in addition to applying the tax law is to give the feeling of risk, but the spontaneous declaration falls greatly", said the sub secretary.

He said it will be soon created a new regime for corporate fine mesh, which increases the risk for companies that make abusive tax planning or tax evasion. "We will increase the fiscal presence and the risk will increase with the new system", he said.

## Carrefour Group

- Carrefour Group, by means of its Brazilian holding company (“Brepa”), bought the company Rainha Dallas Continente. As Carrefour Group intended to use the goodwill registered in such acquisition, however without merging Rainha with Brepa or vice-versa, Brepa, a new company (“Newco”) was created to receive Rainha shares and immediately after be merged into Rainha.
- Tax authorities disregarded the deduction of goodwill, stating that the creation of an intermediary company, followed by the merger, was nothing else than a simulation to supposedly trigger the right to use the goodwill
- The Administrative Court has already decided in favor of tax authorities, and no judicial decision has been issued yet



# Telemar

- The shareholders of “Telemar” created a sub-holding company to transfer the goodwill and, subsequently, merged it into the operational one to trigger the use of goodwill
- Tax authorities understood that in fact, the creation of such a company and the merger would have to be disregarded for tax purposes, once the original holding and the original invested company remained as two independent and separate companies
- Before the Administrative Court Telemar was granted with a favorable decision (not final). The transaction was not considered as an abusive tax planning, since the goodwill amortization was part of the benefits provided for Brazilian tax law in order to attract the taxpayers to the privatization auctions

# Santander Banespa

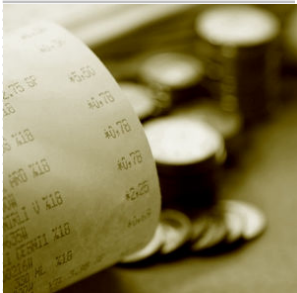
- Santander Spain purchased the shares from Banespa on a privatization auction and then, created a holding in Brazil to hold these shares. Banespa merged the holding and considered the goodwill amortization tax deductible
- Tax authorities challenged the goodwill amount and its deduction
- The administrative court decided in favor of the taxpayer, considering that all conditions for the goodwill recognition were met. The accusation of sham was denied, since there was an effective transfer of values on the operation to third parties.
- The decision also considered that the Tax Authorities failed to prove the illegality of the transaction
- Decision is subject to appeal to Superior Chamber of Tax Appeals

## DASA

- Diagnósticos da América S/A (Dasa) amortized for tax purposes R\$ 58.8 million in goodwill related to acquisitions of shares occurred in the past
- Tax authorities challenged the of the goodwill, considering that companies were created solely for the purchase of investor shares, and the sale was closed for more than 20 times that the property, via "indirect business representative of company practices"
- Tax authorities also stated that the amounts paid over the acquisition of the company could not refer to future profitability, due to lack of documentary proof of the estimate
- The Administrative Court issued a favorable decision (not final) to the taxpayer

# Tax avoidance x Tax evasion

- Conclusions
  - Evaluate the operations that result on tax saving based on the analysis of the substance and business purpose is a increasing trend from the tax authorities and courts
    - Not only in Brazil, but in many countries of the world
  - The chances of success of the purely “tax” operations are lower
  - New tax planning must consider such aspects
    - Combination of business opportunities with tax opportunities



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