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Tax Planning in Brazilian Administrative Courts

Planejamento Tributário nas Cortes Administrativas do Brasil

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Abstract
This article will discuss the treatment of tax planning by the Federal Administrative Tax Court (CARF) in Brazil, including its interpretation from an economic perspective and the concepts of tax fraud, sham transactions and substance over form. The study will also explore the comparison with other cases judged in the European Court of Justice (ECJ) to determine how to interpret cases of tax planning.
Keywords: Brazilian tax law, tax planning, tax avoidance, economic approach, sham transactions, fraud, substance over form.

Resumo
A intenção deste artigo é discutir o posicionamento do Conselho Administrativo de Recursos Fiscais (CARF) do Brasil em relação ao planejamento tributário, inclusive, sua interpretação através do viés econômico, e conceitos de fraude tributária, simulação e substância sobre a forma. Também será explorada neste estudo a comparação com outros casos julgados na Corte Europeia de Justiça para apurar como se interpretam os casos de planejamento tributário.
Palavras-chave: direito tributário brasileiro, planejamento tributário, evasão fiscal, análise econômica, simulação, fraude, substância sobre a forma.

1. Introduction

The subject of tax planning in Brazil underwent a historical change in the early XXI century due to the doctrinal influence of economic approach theory. Since then, administrative courts have dealt with this subject using an approach strongly influenced by what is called the jurisprudence of values. This doctrine was imported into Brazil with some distortions, which has contributed for the controversy regarding the freedom to organize businesses.

Since 2001, tax authorities have considered themselves authorized to disregard legal transactions performed by taxpayers that are intended to disguise or change the nature of a taxable event, based on article 116 of Brazilian Tax Code (CTN). The General Anti-avoidance Rule (GAAR) was included in the Tax Code in an inaccurate way, without proper regulation concerning the reclassification power of tax authorities during audits. This reasonable doubt can be seen beyond the administrative court rulings discussed below. Until the legislature establishes a framework for the Brazilian GAAR, taxpayers will have to live with legal uncertainty.

Living with legal uncertainty means: the Federal Administrative Tax Court (CARF) continues to uphold the tax assessments issued by tax auditors, even when the majority of the commentators argue that the GAAR is not self-enforcing. We expect there will be a new law that specifies what "disguises" means, but in practice the CARF applies article 116 of the CTN even though there is no legislation providing any GAAR or Specific Anti-avoidance Rule (SAAR) in the Brazilian tax system.

CARF rulings rejecting tax planning without a legal basis to reclassify transactions challenges scholars to study the cases and analyze the legal background beyond the decisions made by the administrative court. Accepting that the concept of tax planning has divergent meanings in the context of Brazilian tax legislation, starting with Supplementary Law (LC) 105, which introduced a controversial anti-abuse provision into the article 116 of the CTN, the question to be answered is how an administrative court can rule in this way without legal authorization.

The divergence regarding the tax planning practice and how the above-mentioned anti-avoidance rules can be interpreted has led to several discussions of the CARF analysis. CARF rulings consider tax planning transactions to be fraud or sham transactions, applying in practice the substance-over-form and business purpose doctrines. This approach could possibly be understood if CARF were applying civil law, rather than article 116 of the CTN, as the legal base to reclassify transactions.

As a practical consequence of this interpretation, companies have suffered successive defeats before the CARF. The administrative court combines the non-self-applicable GAAR with civil law code provisions to legitimate a localized economic approach doctrine. This interpretative model can be com-

pared to what was done in the early 1920s with German anti-avoidance doctrine.

This article will therefore describe the evolution of tax planning in Brazil, using the most paradigmatic cases ruled on by the CARF as examples of the behavior of the administrative court. From an international tax law perspective, this paper will also consider whether the Brazilian administrative court is aligned with other courts and jurisdictions and institutions like the OECD.

2. Economic approach

Even though Brazil is a civil law country, the economic perspective has been widely used by tax authorities to challenge the legitimacy of tax planning since 2001. The CARF has also developed a substance-over-form case law doctrine. We believe the CARF cannot re-characterize legal acts for tax avoidance purposes without a specific legal provision. Nevertheless, the CARF considers other elements besides formal aspects in tax planning disputes, importing the economic approach from European jurisdictions.

The economic approach doctrine has been established in Brazil by certain academics, who justified the substance-over-form GAAR. Under this doctrine, a taxpayer who actually achieves certain legal results different from the apparent result will be taxed in accordance with the actual legal result[1]. Those who follow this doctrine, including some CARF judges, believe that the economic approach, which is also endorsed by German and Italian practice, must be adopted in Brazil, regardless of the establishment of a specific law.

Other scholars reject this economic approach, reasoning that because no law authorizes the tax authorities to reverse what was done according to the formality provided for by law, the approach is not admissible (Alberto Xavier)[2]. The formal approach maintains that no constitutional provision allows limitation on the law, particularly on tax planning activities. According to this doctrine, a tax planning structure is legitime so long as no law forbids the conduct in question. The problem inherent in the formal approach lies precisely in its presumption of absolute liberty to avoid taxation. This radical assumption triggered the economic approach doctrine in Germany in the early 1920s. The German Tax Code reform of the GAAR assumed that the right to organize a business in not absolute, which scholars there accept[3].

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1 GRECO, Marco Aurélio. *Planejamento tributário*. São Paulo: Dialética, 2004, p. 325. GRECO, Marco Aurélio. Crise do formalismo no direito tributário brasileiro. *Revista da PGFN* n. 1 (2011), p. 9/18.

2 XAVIER, Alberto. *Tipicidade da tributação, simulação e norma antielisiva*. São Paulo: Dialética, 2001, p. 103.

3 TIPKE, Klaus and LANG, Joachim. *Steuerrecht*. Colônia: Dr. Otto Schmidt, 2010 – § 1, 39; § 4,

The economic approach started with the MITROPA case in Germany, in which the Finance Reich Court accepted a restructuring transaction, assuming that the tax law had no mechanism to forbid elusive business[4]. After this case, the German government hired Enno Becker to write the German Tax Code. The academic Becker established a new way of thinking about taxation, with more independence from civil law and authorization for the use of analogy in interpretation[5].

Thus, if the taxpayer's intent is to reduce the tax burden by using tax avoidance instruments revealed in a tax planning concept, the CARF will likely consider this tax planning improper and re-characterize it from an economic approach perspective. In similar cases, the court has interpreted the evidences as abuse of form to disqualify taxpayer acts[6].

The Anglo-Saxon business purpose doctrine is also used to examine the tax purpose of tax planning to question the effects of the transaction performed when there is no economic reason other than the intention to reduce the tax burden. Although this doctrine is subjective in nature, it also seeks to determine the purpose and the function of the act or legal transaction[7].

The economic approach described in these CARF precedents can be seen in the arguments used in the rulings mentioned above. The court has rejected companies' reorganizations conducted for the sole purpose of reducing the tax burden. These paradigmatic cases demonstrate how the CARF considers business efficiency as tax avoidance from an economic approach perspective.

3. Tax fraud and sham transactions

Considering the lack of a legal basis for applying this European doctrine, the CARF economic approach has been heavily criticized by the Brazilian tax law community. To avoid criticism related to re-characterization of legal acts for tax avoidance purposes without a specific legal provision, the administrative court has realigned its judgments to justify the re-characterization with civil law concepts of fraud or sham transactions. Therefore, the CARF's approach, through a set of judgments, has created subjective requirements to legitimate its line of reasoning, such as:

177; § 5, 96; § 21, 16.

4 MACHADO, Brandão. *Prefácio* do livro *Interpretação da lei tributária*: conteúdo e limites do critério econômico, de HARTZ, Wilhelm. São Paulo: Resenha Tributária, 1993, p. 7.

5 BECKER, Enno. *Von der Selbständigkeit des Steuerrechts. Klare Entwicklung seiner Grundgedanken als Lebensbedingungen des Steuerrechts. Zur wirtschaftlichen Betrachtungsweise, in StuW 1937* (481/552).

6 Molicar Case n. 101-95552-2006.

7 Martins Case n. 107-07596.

– *Time of transaction*: the time period is a key aspect to determine a sham transaction. The CARF reporting judge mentioned that one of the most important aspects to characterize a transaction as a sham was that a few days after the investor joined the partnership, the old partner withdrew from it[8];
– *Displacement of the taxable base*: change of the tax base to another legal entity that is in a comparatively more advantageous and beneficial tax regime. As an example, the Eucatex Case held that the structuring of a company group in as many entities as necessary to perform their different operations was not characterized as a sham transaction even if this practice reduces the tax burden on the group operations[9];
– *Business substance*: is a concept that expresses the relationship of the adequacy of the structure of the company to the functions that constitute its corporate substance. In the HSBC Corretora case, the taxpayer appeal was upheld since clear avoidance is legally necessary to consider the operation illegal and subsequently characterize it as a sham transaction, even though the transaction had reduced the tax burden on the business conducted[10];
– *Misleading statement of intent*: the CARF considered the act done a sham transaction when it sought to conceal the intent under the cloak of the act ostensibly committed, which could not be done due to a legal prohibition or for any other reason. If the parties wanted to deal by using a swap structure and indirectly save taxes, the tax authority cannot disregard this transaction because there is no misleading statement of intent (no. 101-124.462);
– *Business purpose*: any legal transaction must pursue an economic purpose, having as its main objective to optimize the business of the company. In the Martins case[11], the upside-down merger was approved by the CARF since there is no legal prohibition to avoid the use of tax credits or tax losses to improve the economic efficiency of the business of the operational entities of the same group. The CARF ruled that the tax authorities are not authorized by law to disregard legitimate business transactions. The court held that the evidence was sufficient to show a business purpose, even if tax planning was also a motive in the case[12].

8 Case n. 1302-001.330.
9 Case n. 3302-003.138.
10 Case n. 101-93.616.
11 Case n. 1401-00155.
12 Case n. 1402-001.472.

It must be pointed out that the requirements mentioned above were phased out from decisions that follow a restrictive interpretation. However, there is still uncertainty regarding this subject since the decisions issued by the CARF are not always in keeping with the international doctrine, which generates a lack of consistency in the criteria employed. This is sufficient for it to have been said that the "CARF is likely to resurrect its former legality approach with no further clarifications with respect to distinguishing between a specific case and others that would seemingly call for economic substance considerations"[13].

Notwithstanding, the precedents above show the civil law approach in CARF rulings. In those cases, the substance-over-form doctrine is combined with civil law concepts of fraud and sham transactions. Thus, in the more recent CARF approach, the evidence can be seen as crucial for the taxpayer.

4. Substance-over-form – evidence

The main purpose of tax planning is the identification of a legal opportunity to reduce the tax burden on an investment, an operation or a transaction. This is a legal right of every taxpayer. Moreover, there is no law providing that the taxpayer must always pay the maximum tax possible on its business. The taxpayer needs to prove the substance and the form in tax planning, as we can see in analyzing paradigmatic rulings.

In the Marcopolo Case, the taxpayer demonstrated that the sale was made by its controlled subsidiary (trading company) and the payments made by foreign consumers would not be related to the Brazilian company. The key evidence in this case was the demonstration of the business substance of the entire transaction[14].

In the Center Automoveis Case, the CARF ruled against the possibility of raising goodwill internally within the same group, justifying its decision on the lack of proof related to the business substance for the transaction. Moreover, the ruling stated that the fulfillment of formal requirements does not strengthen tax planning; it was considered an abuse of law by the court[15].

In the Tinto Case, the CARF held it was a sham transaction to incorporate a fund for the sole purpose of avoiding capital gain income tax in an M&A transaction. The taxpayer failed to present sufficient business purpose evidence to reject the tax authority's allegation of a sham corporate restructuring plan during a company purchase transaction[16].

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[13] SCHOUERI, Luís Eduardo and BARBOSA, Mateus Calicchio. *GAARs* – a key element of tax systems in the post-BEPS tax world. Amsterdam: IBDF, 2016 (188/238).

[14] Case n. 105-17.083.

[15] Case n. 1103-000.501.

[16] Case n. 1201-001.640.

In the Magius Case, the taxpayer was not able to present sufficient evidence to prove internal goodwill generation before the company's sale. The goodwill generated in internal business operations with the main purpose of justifying the excessive price in an M&A transaction was held to be a sham transaction by the CARF[17].

The cases described above are illustrative of the importance of the evidence before the CARF, especially regarding tax planning. The taxpayer needs to prove the substance and form in organizing business to avoid taxes in a legal way. Since a general Brazilian anti-abuse tax rule is not enforced yet, the civil law reclassification approach in the CARF rulings applies the substance-over-form rule imported from Anglo-Saxon doctrine. In this regard, the taxpayer's evidence is crucial to reject the tax assessments.

5. Reclassification in practice

The new tax planning models that meet all the above-mentioned requirements will not face many difficulties before the CARF if companies succeed in producing timely evidence in the administrative proceeding. However, there are still companies that do not take proper care and attempt to act contrary to the current jurisprudence of the administrative court.

As a consequence of these fraud attempts, the CARF tends to cancel part of the transactions, in an attempt to bring them as close to reality as possible. An example of this kind of ruling is the HStern Case, which dealt with the effects of tax reclassification, reconsidering the proof of the legal act of issuance of debentures and a divergent legal transaction. It was decided that the evidence reported diverged from the legal event, denying the legal transaction previously presented (issuance of debentures) and, as a consequence, they limited the beneficial effects of reclassification[18].

This matter is not settled in the jurisprudence. However, many decisions provide attribution regarding the same taxpayer or when there is confusion between the subjects or their tax effect. In the economic approach cases analyzed above, if a taxpayer actually achieves certain legal results different from the apparent result, it will be taxed in accordance with the actual legal results. Therefore, in practice, the rulings regarding tax fraud or sham transactions can be also considered a reclassification.

6. Penalty

By examining decisions of the Administrative Council, we can conclude that there was a uniform position that (i) if the offense was well described in a

[17] Case n. 10980.728833.

[18] Case n. 107-09.587 / n. 107-09.601.

tax assessment, (ii) if the conduct met the definition (triangular transactions, false statements), and (iii) was accompanied with a robust set of evidence, then the penalty for fraud should be applied.

On the other hand, it can be observed that the requirement for the non-application of the classification was the absence of one of the items above. That is, for the non-application of the fine, the judges found either (i) willful misconduct was not sufficiently shown; or, (ii) there was no evidence concerning the willful misconduct of the taxpayer; or (iii) the conduct indicated as intentional was not actually described in articles 71, 72, or 73 of Law 4,502/64.

We can highlight the CBEMI Case, in which the judge stated that the application of the penalty for fraud requires the presence of specific intent. The specific intent must be proven by showing that the taxpayer has engaged in conduct with the intention of reaching the specific result to disguise the occurrence of a taxable event[19].

Furthermore, in the Benedini Case, the judge held that the penalty for fraud can only be imposed after proving the occurrence of fraud without any doubt, and not just in theory. Therefore, if fraud is not proven, the penalty cannot be imposed[20].

7. International approach – reclassification

The vast majority of the discussions in Federal Administrative Tax Court (CARF) described in this paper are similar to the ones originated in rulings of the Court of Justice of the European Union (ECJ), which interpreted local and economic bloc (European Union) legislation to reclassify business acts considered abusive.

In Apple's case, the international corporate structure was established aiming to reduce the effective tax burden through mismatches between the laws of Ireland and the Netherlands. Basically, the transaction, called *Double Irish*, was a tax planning device used by US corporations in Ireland to shield non-US income from the US worldwide 35% tax system (prior to the Tax Cuts and Jobs Act of 2017 (TCJA)), and almost all Irish taxes.

Through similar tax planning, Google developed the so called *Dutch Sandwich*, which involves the establishment of Irish, Dutch and Bermudian companies aiming to increase tax-deductible expenses as royalty payments related to intellectual property in order to drastically reduce the international group's tax burden.

Even these tax planning devices were designed within the law, they suffered great popular opposition, being considered at least immoral and caus-

[19] Case n. 1103-001.177.

[20] Case n. 04-00.236.

ing the loss of about one trillion euros in revenue, accordingly to the former President of the European Council, Van Rompuy[21]. The political approach is similar to what was observed in some CARF rulings.

The popular public pressure caused preliminary investigations under the statement that "'We are not saying your company is doing something wrong, but just tell us what you are paying.' They simply protest against the company until it answers the question on what it effectively pays in taxes and in which country."[22]

In the end, Apple was ordered to pay € 13 billion in taxes, plus interest, to Ireland after the European Union investigation determined that the company had received illegal tax benefits for 11 years due to abusive tax planning. The abusive tax planning concept came from economic results, not from ilegal acts or sham operation to justify the reclassification.

Meanwhile, Google agreed with British tax authorities to pay £130 million in back taxes and bear a greater tax burden in the future. The deal covered a decade of underpayment of United Kingdom taxes by the company, which has been criticized in the past for its tax avoidance policies. The adjustment made by Google reflected the fear of a ruling that can be used as a precedent in future decisions.

In these cases, under the justification that the arrangement does not have any commercial substance and the only purpose of the transaction was to achieve the tax benefit, Apple and Google suffered reclassification as a result of the application of the European GAAR.

8. Conclusion

In this way, even with those serious semantic errors and the lack of effectiveness of a nonexistent Brazilian general anti-avoidance rule, tax authorities have attempted in recent years to apply it in a disguised form, appealing to the concept of a sham transaction in civil law, i.e., falsehoods in the performance of legal transactions with the intent to circumvent taxes.

These assessments ultimately become cases to be ruled on by the CARF, which, as we have seen, tends to decide increasingly against the taxpayer. Therefore, additional care should be taken by companies when practicing tax planning in order to maintain substance and purpose in the transactions they conduct.

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[21] HURK, Hans van den. *Bulletin for International Taxation*, January 2014. IBFD. "Starbucks versus the People", p. 27. Euronews, Van Rompuy urges action on tax (Apr. 2013). Available at: <www.euronews.com/2013/04/12/van-rompuy-urges-action-on-tax/>.

[22] HURK, Hans van den. *Bulletin for International Taxation*, January 2014. IBFD. "Starbucks versus the People" – *2. Who are the key players in this discourse*, p. 27.

After all the attempted rulings against the tax planning practice analyzed in this study, it seems that the Administrative Court also practices what we could call upside-down tax planning, where tax authorities aim to find any particular breach in the tax law to pursue and annul the tax planning done in Brazil.

From a comparative law perspective, we can assume that CARF aplies GAAR in a similar way ECJ is also ruling. In other words, both courts reclassify tax planning operations based in case law and use the substance over form doctrine. The main diference between the rulings observed stays in the fact Brazilian tax sistem do not authorize CARF to use GAAR. This fact generates a great uncertainty for the taxpayer to conduct business in Brazil.

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