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IFRS, Goodwill Deduction and Tax Planning

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2015 is full of new legislations to be applied by Brazilian companies, and investors should definitely wait for more changes in the tax arena, as the Brazilian Federal Government has had problems of deficit in public accounts.

One of the most important laws relates to regulation of IFRS effects for tax purposes. Basically, law no. 12,973/2014 is assuring the tax neutrality of IFRS adjustments while such adjustments correspond to unrealized results. However, in order to apply the neutrality, Brazilian companies had, in January 1st, 2015, to split the value of each account into two accounts – one, reflecting the tax cost of the item; the other, reflecting the IFRS adjustment. This is called "initial adoption". In addition, these "initial adoption" accounts must be registered in the regular accounting books of the company, and not only in its tax controls.

The amounts booked in the "initial adoption" accounts will be taken into consideration for tax purposes upon the actual realization. However, if, by any reason, the Brazilian company does not segregate its accounts as required for the initial adoption, the difference between the balance of the account and the tax cost will be considered taxable (if positive), or definitely nondeductible (if negative).

Such law establishes new regime for accounting recognition and taxation of Brazilian investments in controlled or related companies located abroad. Based on the law, the taxation of the corresponding foreign profits will continue to be immediate for controlled companies, or for related companies located in tax haven jurisdictions. In case of controlled companies with at least 80% of active income, there is the possibility of paying the Corporate Income Taxes ("IRPJ/CSLL") in installments – 08 years, 12.5% in the first year, cash basis in the following years, and the balance of tax due in the end of 08 years, with interest based on LIBOR rate.

On the M&A front, as of January 1st, 2015, the purchase of shares by one Brazilian company of another Brazilian company must observe the new rules related to goodwill recognition and documentation. Basically, it will be mandatory to apply the purchase price allocation ("PPA"), revealing firstly the fair value of tangible and intangible assets (whose appraisal report must be filed at the tax authorities' office or a public registry office), and then calculating the goodwill (which should be supported by an independent appraisal too). The deduction of goodwill for tax purposes is still permitted after a downstream or upstream merger in 5 years (1/60 per month). Please note that, for the purposes of making use of goodwill, it is key to demonstrate that the Brazilian entity that served as buyer was not only a "paper company", but rather an actual

company with substance (physical offices, employees, functions, etc.).

Tax Planning Front

In the last months, we have seen a number of Brazilian listed companies disclosing information about tax assessments with impressive figures – billionaires, or at least involving hundreds of millions, especially involving discussions related to tax planning, disputing the manner that such companies organized their businesses or completed certain transactions, such as reorganizations, mergers and acquisitions. These tax assessments demonstrate the improvement in tax inspectors´ training and a more aggressive approach taken by the tax authorities in relation to transactions that result in tax savings, which they consider to be "abusive tax planning". In most part of the cases, it is debated the substance of the transactions, as well as the purposes of the parties to perform them.

The analysis of substance over form and business purposes is commonly used by tax authorities of different countries throughout the world; thus, its use in Brazil is not surprising, except for the fact that there is no specific legislation about this subject. What is indeed surprising is the fact of Brazilian tax authorities, in various tax assessments, going beyond such an analysis, understanding that there is no good, reasonable or acceptable justification if the taxpayer did something that saved taxes and that the tax authorities themselves would not have done if they were in the management of the company.

The good news is that, for the time being, a significant part of the decisions of the Administrative Court of Tax Appeals ("CARF") has been much more reasonable, with the judges trying to understand the economic reasons other than tax saving that caused the taxpayer to adopt one manner or other of performing a certain transaction.

Anyway, it is essential for companies and individuals to consider that, any reduction of tax burden must be consequence of the intended transaction, and not its cause, in such a way that, in case of future challenges, it is possible to present to the tax authorities and judges the evidences of the real economic and business purposes that resulted in a legitimate tax saving.

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