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GLOBAL PRACTICE GUIDE

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# Tax Controversy

**Brazil: Law & Practice**

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# BRAZIL

## Law and Practice

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## 1. Tax Controversies

### 1.1 Tax Controversies in this Jurisdiction

The majority of tax controversies in Brazil arise from misinterpretation of, or resistance from public entities in complying with, the constitutional principles, most notably the principle of legality, which states that taxes can only be created (or increased) through laws enacted by the legislative branch.

Brazil's Constitution establishes the Brazilian tax system guidelines, which divide the power to levy taxes among the federal, state and, local governments based on certain triggering events that occur in the territories. The Brazilian Federal Constitution also states several principles to control and mitigate the power given to all the quoted public entities.

These guidelines are complemented by federal laws such as the National Tax Code and Supplementary, which are enforced throughout the entire Brazilian territory. Completing the tax legislation, the federal, state and municipal governments may also issue laws enacting tax obligations on activities carried out in their area.

The fact that Brazil has 27 states, more than 5,500 municipalities, and approximately 200 million inhabitants demonstrates the complexity of these systems.

Most commonly, tax controversies arise after a tax authority confirms inconsistencies during a tax audit proceeding, which can confirm the previous assessments presented by a taxpayer or even be initiated as a random check of the self-assessments and reassessments submitted by taxpayers.

Considering the volume of tax legislation, and the frequent taxpayer uncertainty about its interpretation, the other usual way that controversies arise is through lawsuits lodged by taxpayers to clarify and protect themselves in advance, ensuring the protection of taxpayers' constitutional rights.

### 1.2 Causes of Tax Controversies

According to the Brazilian Federal Revenue authorities and Federal Prosecutors' reports, the cause of most federal tax controversies, corresponding to a significant percentage of the approximately BRL2.2 trillion involved in tax-related litigation, are:

- corporate income taxes:
  - (a) corporate income tax (IRPJ);
  - (b) social contribution on net income (CSLL); and
  - (c) taxes on revenues;
- contribution for the social integration programme (PIS); and
- contribution for social security financing (COFINS).

The state tax that causes the most tax controversies is the value-added tax on sales and services (ICMS), which is of particular relevance in states where industrial and commercial development is more developed, such as São Paulo and Rio de Janeiro, where the value of judicial litigation alone is estimated at approximately BRL312 billion and BRL12 billion, respectively.

The most relevant municipal tax is the service tax (ISS), which is also responsible for a considerable amount of administrative and judicial litigation in regional courts.

Recently, there has been a focus on disputes between taxpayers and tax authorities regarding the compensation of credits aimed at reducing tax burdens in industrial, commercial and services operations. Tax authorities have already indicated their concern with this situation and are conducting specific tax audits to identify and assess these controversial credits.

Taxpayers' attention should be on the documentary evidence of their operations and taxable events. Bearing in mind that the most relevant tax issues tend to be analysed by the superior courts in taxpayer proceedings with binding effects, the evidence is the best way to support a specific case for a favourable judgment. Therefore, it is essential to review internal proceedings, documentation, invoices, and contracts to ensure that they are in line with the tax legislation.

### 1.3 Avoidance of Tax Controversies

The possibility of tax controversy is mitigated by compliance with the Brazilian tax system rules, which requires the assistance of a qualified accounting counsel and advice from a tax specialist to prevent liabilities.

However, the highly regulated and complex environment of the Brazilian tax system will probably expose companies to many factors that affect the tax risks. Such risks include the frequency of tax audits performed by federal, state and municipal authorities (eg, a company can be audited by the relevant authorities more than once during the statute of limitations), the high penalties and high interest charges in the case of non-compliance, and an enforcement process that is difficult to predict.

Another way to avoid further controversies regarding an administrative proceeding or following a tax audit, and to prevent the filing of a tax enforcement action with the respective seizure of assets, is to respond within 30 days of the final decision in the administrative proceeding.

### 1.4 Efforts to Combat Tax Avoidance

Brazil has not signed the Multilateral Convention to Implement Tax Treaty-Related Measures to Prevent Base Erosion and Profit Shifting (MLI) and has chosen to negotiate specific changes to

double tax Treaties bilaterally. In this context, the first treaty modified to incorporate limitation-of-benefits (LOB) and anti-avoidance clauses was the treaty signed with Argentina. The LOB and anti-avoidance terms were also included in recently signed double tax treaties with Singapore and Switzerland but have not yet been enforced.

From an international perspective, it is worth mentioning that Brazilian transfer pricing rules were adopted in Brazil in 1996. The conciliation of Brazilian transfer pricing rules with internationally accepted transfer pricing methods became one of the biggest challenges faced by multinational enterprises in Brazil. The difficulties relate mainly to the deviation of the Brazilian rules from the OECD's Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations. Regarding such variations, it should be noted that there is no leeway for advance pricing agreements (APAs) under the Brazilian transfer pricing legislation, and that Brazilian law has adopted fixed margins for the various methods, regardless of the nature of the taxpayer's business, industry or role in the transaction (ie, there is no functional analysis). The law provides that the Minister of Finance may establish other statutory margins for each industry to determine the parameter-price in controlled transactions.

Cross-border transactions carried out by legal entities incorporated in Brazil are subject to transfer pricing controls when they are entered into with related parties, or with parties located in low-tax jurisdictions or jurisdictions with underdeveloped tax regimes, irrespective of whether such parties qualify as associated enterprises. Brazilian transfer pricing rules do not apply to cross-border payments of trademark or patent royalties, or fees payable as compensation for the transfer of technology, or the rendering of technical, administrative or scientific assistance services with a transfer of technology or know-how. Relevant agreements must be registered with the Brazilian Intellectual Property Agency and the Central Bank of Brazil.

The Brazilian tax system has a general anti-avoidance rule under Article 116, sole paragraph, of the Brazilian Tax Code (CTN), which authorises tax authorities to disregard the formal aspects of a transaction and analyse only its economic substance for taxation purposes (substance over form). This rule lacks further regulation and, therefore, could, in theory, be unenforceable.

However, Brazilian Tax Authorities have been using Article 116 to assess taxpayers, using the substance over form concept and also the "abuse of law" and "sham" concepts contained within the Civil Code. This issue has been discussed at Brazilian administrative tax court, on a case-by-case basis, and those transactions considered to lack "business purpose" are generally punished by the tax authorities with a tax assessment and notice

of infraction demanding the payment of applicable taxes plus a higher fine of 150% (instead of the general penalty of 75%).

## 1.5 Additional Tax Assessments

Brazilian additional tax assessment occurs when a tax self-assessment is partially paid, or when it does not reflect the entire tax obligation. When tax authorities confirm such a situation, an additional tax assessment is issued in the form of an infraction notice.

If a taxpayer does not recognise such an additional assessment, it is possible to file a defence to that infraction notice, stating the reasons why the notice should be cancelled and then officially commencing litigation in a tax administrative court.

This administrative proceeding does not require any payment or guarantee. However, if the taxpayer chooses to litigate in a judicial court, a judge may require a guarantee to discuss such a matter in court and stop any further execution by the tax administration.

Tax authorities may also file additional tax claims involving taxes that were not declared or were declared and not paid by a taxpayer. Such lawsuits may also impose aggravated penalties when a tax authority deems a taxpayer's conduct to be fraudulent. These situations usually lead to a criminal investigation.

## 1.6 Possible Impact of COVID-19 on Tax Controversies

The first impact of COVID-19 on all pending controversies, not only on tax litigation, was the suspension of all procedural terms by the National Council of Justice (CNJ). Most of the state-level courts followed the CNJ directive and also suspended their procedural terms.

To establish general standards of conduct to contain the spread of COVID-19, persons and entities that may face, or are already facing, disputes (including those that will inevitably result from the current scenario) keep track of the resolutions that have been issued by the courts and administrative courts.

Another significant impact was the increasing use of virtual judgment session. As an example, the Supreme Court is judging important matters virtually, respecting the social distancing and the health of the judges without the full interruption of all judicial activity.

Most of the state courts are also adopting virtual judgment procedures and virtual hearings.

It is possible to observe solutions more favourable to the state to matters argued as a response to the COVID-19 pandemic,

such as tax deferrals not established in the current legislation. This kind of claim was used based on the reduction of commercial activity to maintain job positions. Still, the judiciary is ruling in favour of the state and national government, due to the increased public expenditure caused by the COVID-19 pandemic.

Brazil has not adopted measures to relieve payments of tax obligations based on the existence of litigation. The rules adopted by Brazil are focused on the economic impact of the COVID-19 pandemic, such as:

- import tariffs for medical goods set at 0% until the end of December 2020;
- the tax on industrial products (IPI) lowered to 0% for medical goods and hospital supplies;
- deferral of the taxation system for small taxpayers (SIMPLES) for three months;
- deferral of the employer's contribution to the unemployment severance fund (FGTS) due by legal entities for three months;
- the Brazilian Federal Revenue issuing new rules to simplify and expedite the customs clearance of imported goods related to Covid-19 treatment;
- certain tax liabilities and other charges being postponed, particularly for small businesses;
- deadline extension for the payment of some federal taxes from March and April to July and September 2020 (such as contributions for pensions and social assistance and social insurance);
- deadline extension from April to June for personal income tax declarations, with the payment postponed;
- deadline extension for the procedural acts with the Federal Revenue Service of Brazil; and
- extension, for 60 or 90 days, of the payment of state taxes.

In the authors' opinion, it is unlikely that COVID-19 will impact on the results of pending cases. Still, the number of new judicial matters, presented by taxpayers arguing COVID-19 as a cause for tax reduction or exemption without specific legislation, may increase considerably. This situation will pressure the courts to rule in a position of increasing public expenditure, so it will probably impact the outcome of decisions.

The tax audits shouldn't change, because the Brazilian Congress recently approved a bill to punish abuses of public servants, which gave a negative incentive to harsh tax audits.

In the authors' opinion, the new ADR rule authorising the tax transactions may be a powerful solution during and after the pandemic. It represents a more effective and short term solution for tax litigation.

## 2. Tax Audits

### 2.1 Main Rules Determining Tax Audits

All Brazilian taxpayers are subject to tax audits by any public entity within its correspondent jurisdiction (federal, state and municipal revenue services), but the criteria used to select which taxpayers will be investigated are not publicly known. Brazilian companies must maintain proper records of taxes paid for a minimum of six years, in case of a tax audit.

It is common for the tax authorities to audit companies or business sectors with relatively high income and net worth. In this context, tax authorities organise themselves into specialised groups considering specific industries or tax collection regimes that, in most cases, indicate high net worth companies and individuals.

In the federal area, for example, eight specialised Federal Revenue Services are focused on specific groups, such as financial market companies and the international trade market, as the biggest taxpayers.

This specialisation is typical of states with a predominant industry, such as in Rio de Janeiro, where there is a special state revenue service group dedicated to specific industries, such as oil and gas and supermarkets.

### 2.2 Initiation and Duration of a Tax Audit

Generally, a tax audit can be initiated at any time, and does not have to be completed within a predetermined time.

The statute of limitations in Brazil for tax purposes is generally five years, beginning on the first day of the calendar year following the year when the tax could have first been assessed (in practice, up to six years). A longer statute of limitation period applies for the severance pay indemnity fund (FGTS) (up to 30 years). During the statute of limitations, a company can be inspected by federal, state and municipal tax authorities even though an audit of a given tax or fiscal period might have already occurred.

The statute of limitations cannot prevent a tax audit from being initiated, which may take place after the limitation period is due, considering that a tax authority is not subject to any binding statute on this matter (ie, the statute cannot prevent a tax audit, but it can affect an eventual future tax claim).

Even though a certain tax period may have already been submitted to inspection, a taxpayer can still be inspected and assessed by the tax authorities.

## 2.3 Location and Procedure of Tax Audits

In Brazil, tax audits occur in the taxpayers' premises if they concern taxes over products or goods, but they can also occur in a tax authority's headquarters based on the information and assessments submitted by a taxpayer, which can be submitted in print or electronically.

Due to ancillary obligations, tax authorities already have access to most of the relevant tax information in digital form, which improves the efficiency of the system for reviewing taxpayer procedures.

## 2.4 Areas of Special Attention in Tax Audits

As stated in 2.1 **Main Rules Determining Tax Audits**, the tax administration tends to give special attention to the biggest taxpayers, which can be high net worth companies or individuals. In the authors' opinion, tax audits will focus primarily on the volume of transactions made by a taxpayer, and on any contradictions of information presented to the revenue services.

## 2.5 Impact of Rules Concerning Cross-Border Exchanges of Information and Mutual Assistance Between Tax Authorities on Tax Audits

The Brazilian tax administration will pursue tax audits based on cross-border exchanges of information and mutual assistance between tax authorities, particularly where inconsistencies based on the database crosscheck are shown.

Brazil is a crucial participant in the global exchange of tax information, having adopted most of the OECD's Global Forum standards, such as:

- the US Foreign Account Compliance Act (FACTA);
- the Multilateral Convention on Mutual Administrative Assistance in Tax Matters (MCMAA);
- the Multilateral Competent Authorities Agreement for the Common Reporting Standard (MCAA CRS);
- country-by-country Reporting (CbCR);
- exchange of information regarding tax rulings; and
- mandatory beneficial ownership reports for Brazilian individuals who are defined as the legal or factual controller of a legal entity.

Mutual assistance for tax audits is still not a reality in Brazil since most dispositions of such treaties, together with the model proposed by the OECD, are still under study by the Federal Revenue Service.

## 2.6 Strategic Points for Consideration During Tax Audits

The most important strategy, in the author's view, is to anticipate possible liabilities with the aid of an accounting professional and a tax expert lawyer, in order to prevent future audits.

There have been substantial improvements in the efficiency and effectiveness of the Brazilian tax administration following reforms taken over the past two decades, most notably the implementation of the Public System of Digital Bookkeeping programme (SPED). This implementation started in the middle of the past decade and comprised a broad framework of tax, commercial and operating data, organised in standard formats, which taxpayers must prepare and submit electronically to tax authorities.

SPED submissions are mandatory, irrespective of any related tax inspection. Depending on the file, an electronic filing must be made monthly, annually or even instantly, on a transaction-by-transaction basis (which is the case of the electronic tax invoice (*nota fiscal eletrônica* – NF-e)).

In the course of a tax inspection, the Federal Revenue has unrestricted access to a taxpayer's tax documents and bank details. Concerning this, there has been a discussion in case law about the legality of tax authorities obtaining bank data directly, which implied a breach of confidentiality. However, the Supreme Court has recently decided that the tax administration can collect this data directly, by asking the relevant financial institutions.

## 3. Administrative Litigation

### 3.1 Administrative Claim Phase

Tax disputes in Brazil may take place in the administrative or judicial area, but taxpayers are not required to pay a disputed tax before the start of administrative proceedings.

Litigating in the administrative courts is optional and not binding on taxpayers, meaning that taxpayers may choose to sue directly in the judicial courts, and an unfavourable final decision in the administrative court can still be challenged in a judicial court. However, if taxpayers choose to bring a tax dispute directly before a judicial court, bypassing the administrative courts, this is legally deemed as a waiver of the right to an administrative debate.

It is an important decision for a taxpayer, because litigation in an administrative court is usually more straightforward, quicker and less burdensome, as the proceeding is less complicated than judicial litigation. Most importantly perhaps, it is not necessary to give a guarantee during the procedure.

## **Administrative Procedure**

Administrative proceedings commence after an audit made by the Brazilian tax authorities if any evidence of a flaw in the taxpayer's obligations is found; this finding will be stated in a tax infraction notice seeking to collect the corresponding debt (comprising the principal, interest and any penalties).

After an infraction notice is sent to a taxpayer, there are three options:

- pay the debt within 30 days, usually with a discount on the penalty;
- file a defence to the infraction notice, stating the reasons why the notice should be cancelled and then officially commencing the litigation in a tax administrative court; or
- take the dispute directly to judicial court by filing an ordinary claim or a writ of mandamus.

Instead of paying the debt (in a lump sum, in instalments, or under a tax relief scheme), a taxpayer can challenge the tax infraction notice before administrative judgment authorities at the federal, state or municipal level; these authorities are composed of technical and expert administrative judgment panels and are knowledgeable and skilled in the specific tax issues under dispute – this is another aspect to consider when choosing between the administrative or judicial sphere.

### *Levels of appeal*

At the federal level, a taxpayer has 30 days from service of an infraction notice to present its defence (opposition). This opposition and its case records are sent over to the Federal Revenue Judgment Unit (DRJ), which is in charge of deliberating on the case and issuing a first instance decision, generally upholding the infraction notice (except when there is any material breach that would render the notice void).

Taxpayers may then appeal (voluntary appeal) to the Administrative Tax Appeals Board (CARF). Each CARF judgment chamber is made up of members nominated by both taxpayers and tax authorities. A tie is construed in favour of the tax authorities.

A third administrative level – the Higher Tax Appeals Chamber (CSRF) – is only called upon to arbitrate if the taxpayer or the tax authority, as applicable, shows that the same or distinct CARF judgment chambers rendered conflicting decisions on the same subject.

Therefore, if a taxpayer is defeated but finds a different CARF decision on the same subject, he or she may lodge a special appeal at CSRF. The contrary also holds: the defeated tax authorities can also file a special appeal at CSRF under those same

circumstances. Also, at CSRF level, a tie is construed in favour of the tax authorities.

As of the writing of this chapter, there is a Federal Provisional Measure (MP) No 899/2019 approved by the Brazilian Congress and pending Presidential sanction to change the tie rule, construing them in favour of the taxpayers.

A similar three-tier structure is replicated at a state level, and even some municipalities (eg, the City of São Paulo) have administrative tax courts to review infraction notices issued by the tax authorities. However, small municipalities usually lack human or financial resources to put this complex dispute resolution structure in place and, for this reason, disputes over a local infraction notice are generally much less formal.

On average, it takes two to four years for a final ruling on tax disputes in an administrative court. The Central Bank of Brazil's SELIC benchmark interest rate accrues on the overall tax debt throughout the litigation period. No bond needs to be posted.

## **Recourse to Judicial Litigation**

If the final administrative decision is favourable to the taxpayer, the tax authorities cannot take the case to the judiciary, except under exceptional circumstances. By contrast, a final administrative decision that is unfavourable to the taxpayer can be disputed in court under the same or a different line of reasoning.

### **3.2 Deadline for Administrative Claims**

The Brazilian tax authorities do not have a deadline within which to decide an administrative claim that has been lodged by a taxpayer, and no hierarchical appeal or judicial request is possible if the tax authorities do not reply within a specific timeframe.

In 2018, however, a federal justice issued an order in a writ of mandamus requiring the CARF to judge a claim that was waiting for the definition of a reporting judge for more than five years. The judge considered that this timeframe was unreasonable, and determined the immediate appointment of a reporting judge, but this was the first case of this kind.

## **4. Judicial Litigation: First Instance**

### **4.1 Initiation of Judicial Tax Litigation**

Judicial tax litigation in Brazil can be initiated by the tax authorities through enforcement lawsuits, or by the taxpayer through anti-enforcement lawsuits and proactive claims (eg, ordinary claims or writ of mandamus), which may be presented to the federal or state courts, depending on the specific tax matter.



## **Enforcement Suits**

Enforcement claims are lodged by the tax authorities to fulfil a tax obligation that was not fulfilled spontaneously by a taxpayer at the moment established in the legislation or during/after the administrative proceedings. This situation is stated on an overdue liabilities certificate (CDA). This claim is known as a tax execution proceeding and, according to Law 6.830 of 1980, various instruments can be used to fulfil the payment, such as seizure of properties, assets or goods, and even the confiscation of funds found in the taxpayer's bank accounts and investments.

## **Anti-enforcement Suits**

Anti-enforcement claims are divided into two groups, depending on whether a tax execution proceeding exists.

If a tax execution proceeding was already lodged, a taxpayer usually has a motion for a stay of the tax execution proceeding to expose his or her arguments to cancel the overdue liabilities certificate, or a motion for advance dismissal of enforcement.

A motion for a stay of the tax execution proceeding can be lodged within 30 days of the presentation of a guarantee. The distinctive quality of this motion is the necessity of presenting a guarantee for the debt stated on the CDA, which means that the taxpayer must first post a bond in benefit of the court and then defend itself; these claims have a discovery phase. However, judicial precedents have lessened this requirement so that a taxpayer can file such lawsuit without a guarantee, though he or she will not obtain a suspension for the debt's enforceability. In some specific cases, a suspension of the enforceability can be granted by a court upon the presentation of other types of guarantees or, exceptionally, without any warranty.

The motion for advance dismissal of enforcement is lodged on a tax execution proceeding as a simple petition and can terminate the proceeding before any further seizure. However, this motion does not provide for a discovery phase, so that the evidence presented with the motion must be able to prove the arguments. It is not necessary for the taxpayer to post a bond for court costs to defend itself.

## **Proactive Claims**

Proactive claims lodged by taxpayers generally seek to avoid the taxation imposed by legislation on the grounds that it does not comply with constitutional principles or the interpretation of the law, and its constitutionality may be subject to different interpretations.

If the final administrative decision is unfavourable to the taxpayer (or if the latter has waived its right to challenge the tax infraction notice in the administrative sphere), the taxpayer may take this issue to the judiciary (via ordinary action or a

motion for writ of mandamus) or else wait until enforcement occurs and then bring a motion to stay enforcement.

## **4.2 Procedure of Judicial Tax Litigation**

In Brazilian tax litigation the plaintiffs must prove the facts substantiating the right claimed in the lawsuit, while the defendant must prove facts that modify, extinguish or prevent the right claimed by the plaintiff. Facts that enjoy legal presumption, such as the CDA mentioned in **4.1 Initiation of Judicial Tax Litigation**, do not require proof of existence or veracity.

After the defendant has responded to the plaintiff's claim within the allotted time, the discovery phase takes place, after which a court decision will be delivered in writing, containing a brief description of the parties' arguments, the issues under dispute and the legal resolution of the conflict.

The Brazilian judiciary operates based on written civil procedure and is divided into specialised and ordinary courts; the ordinary courts are then further divided into federal and state matters. In a tax litigation context, federal courts judge claims regarding federal taxes, while state courts judge matters related to state and municipal taxes.

Both federal and state courts have two levels:

- trial, where cases are filed and ruled on by a single judge; and
- appellate, where appeals are analysed by panels usually comprised of up to three justices.

## **4.3 Relevance of Evidence in Judicial Tax Litigation**

Civil tax litigation generally admits documentary evidence, and the moment for the discovery of such proofs varies according to the type of claim.

As mentioned above, most tax litigation concerns the interpretation of the law. In most cases, it is necessary to prove that a determined fact has occurred, so the applicable legislation is that noted by the plaintiff.

In this context, documentary evidence is essential to prove the facts that a plaintiff or defendant argues to make its case.

## **4.4 Burden of Proof in Judicial Tax Litigation**

In civil law, the burden of proof is on the party making the relevant allegation. Therefore, a taxpayer that files a lawsuit challenging a specific obligation must both demonstrate the existence of an obligation and provide the judge with all evidence showing that a given tax is illegal or unconstitutional.

In the case of tax execution proceedings filed by the government against taxpayers, the tax is presumed to be due and to affect the taxpayer's assets (for the satisfaction of the tax obligation). Therefore, if the taxpayer intends to challenge a requirement under a tax execution order, as stated in **4.1 Initiation of Judicial Tax Litigation**, it must first post a bond for court costs and then defend itself. The burden of proof is also on the taxpayer in these cases.

Under Brazilian criminal law, the burden of proof is on the prosecution, which submits the case before the court. In the event of doubt following the criminal investigation, the defendant must be acquitted.

## 4.5 Strategic Options in Judicial Tax Litigation

As stated in **1.1 Tax Controversies in this Jurisdiction**, most judicial tax claims regard the interpretation and application of the laws and principles of the Brazilian tax system, and, as stated in **4.1 Initiation of Judicial Tax Litigation**, enforcement and anti-enforcement lawsuits characterise the judicial litigation. Furthermore, settlements are not allowed in the Brazilian tax system.

In this context, taxpayers must always be clear about the strength of their arguments before entering into any litigation. The first thing that a taxpayer should do when facing a tax assessment notice or tax infraction notice is assess the convenience of complying with any payment requirements.

From a strategic point of view, taxpayers must always consult a specialised attorney and a trusted accountant before making this decision.

If a taxpayer chooses to lodge a judicial claim, it is necessary to present all evidence at the time of the first allegations. Depending on the procedure chosen, it is possible for the judge to provide the opportunity to produce other evidence during the process, such as expert examination by a court-appointed expert. This claim will depend on the view of the judge regarding the utility of such evidence for the judgment.

## 4.6 Relevance of Jurisprudence and Guidelines to Judicial Tax Litigation

The jurisprudence of the superior courts, the Brazilian Supreme Court and the Superior Court of Justice is crucial for judicial tax litigation, considering the number of tax rules and principles in the Brazilian Constitution and its complementary laws. The jurisprudence of international courts, however, is not often used in judicial tax discussions, and, when it is, it is used as a comparative argument, not a decisive one.

Court precedents are not binding, except when rendered under specific circumstances. Nonetheless, they have significant influence on judges when issuing a decision.

Academic studies are also relevant, as tax authors and professors are commonly hired to give opinions over cases lodged before a court.

The international guidelines from OECD are not relevant since these rules were not incorporated into the Brazilian tax system and cannot yet be enforced in Brazil. There are a few citations in judgments regarding international matters, but these quotes are always argumentative and not binding.

## 5. Judicial Litigation: Appeals

### 5.1 System for Appealing Judicial Tax Litigation

The Brazilian procedural system allows appeals from final or interlocutory decisions. Interlocutory appeals may be filed against certain decisions expressly indicated by the Brazilian Civil Procedure Code.

Appeals are submitted to a multi-judge panel in the state or federal court of appeals, which is composed of an even number of judges, who may review the trial court's decision in light of their interpretation of the law and the facts of a case.

The appellate court's decisions can be subject to appeals filed with the Superior Court of Justice and/or the Federal Supreme Court – jurisdiction hinges on the nature of the controversy.

The Superior Court of Justice hears appeals against appellate court decisions that arguably violated federal law or have given federal law an interpretation that differs from that handed down by another appellate court. The Superior Court of Justice is restricted to evaluating matters of law.

The Federal Supreme Court hears appeals against appellate court decisions that have arguably violated the Federal Constitution. To be given leave to appeal, an appellant is required to provide evidence that the constitutional issues addressed in the appeal have widespread repercussions.

### 5.2 Stages in the Tax Appeal Procedure

The first stage of an appeal is the state or federal court panel of justices, which is known as the second instance of the judiciary.

After that, depending on the argument against the appellate court decision, it is possible to issue an appeal to the third instance of the judiciary, as stated in **5.1 System for Appealing**

**Judicial Tax Litigation**, to the Superior Court of Justice and/or the Federal Supreme Court.

After the final decision is issued at an appellate court or one of the superior courts, the lawsuit is sent back to the single judge to execute and/or enforce the final decision.

### 5.3 Judges and Decisions in Tax Appeals

The first instance panel is composed of singular trial judges, who take office after passing a complex public examination.

The second instance – the appellate courts – is composed of justices appointed according to criteria such as merit and length of service as a trial judge. One fifth of appellate court seats are mandatorily filled by members of the public prosecutor's office and practising attorneys.

The third instance has different rules for the composition of the panels of justices: The Superior Court of Justice is formed of 33 judges who are appointed by the President upon approval by the Senate. This selection has to respect the quota of one third of justices coming from federal appellate courts, another third from state appellate courts and the final third must be private practitioners/public prosecutors.

The Federal Supreme Court is composed of 11 justices appointed by the President upon approval by the Senate and does not have any quotas.

## 6. Alternative Dispute Resolution (ADR) Mechanisms

### 6.1 Mechanisms for Tax-Related ADR in this Jurisdiction

Recently, after the approval of the Provisional Measure No 899 (MP) in April 2020, Federal Law 13.988 to regulate tax transactions (offers in compromise – OIC) was issued by the federal tax administration.

The Measure brings the practical possibility of settling pending administrative and judicial proceedings, reinforcing the historical ADR instrument present in the Brazilian National Tax Code (CTN) since 1966.

Following its approval, the National Treasury Attorney's Office has already issued Regulation PGFN 9.917/2020 to regulate the OIC in federal judicial proceedings.

The OIC mechanism offers the possibility of discounts for the payment of tax debts, especially those considered by the inspec-

tion authorities as challenging to recover, due to the profile of the taxpayers.

### 6.2 Settlement of Tax Disputes by Means of ADR

The OIC is now the only ADR mechanism in the Brazilian federal tax system to settle both pending administrative and judicial proceedings.

### 6.3 Agreements to Reduce Tax Assessments, Interest or Penalties

The OIC, as stated in the Federal Law 13.988/2020, refer only to interest and penalties and do not cover agreements to reduce tax assessments.

The discounts in the Brazilian OIC do not apply to the principal tax assessment, nor to amounts of fines arising from crimes or tax fraud.

### 6.4 Avoiding Disputes by Means of Binding Advance Information and Ruling Requests

Requests for binding advance information and ruling requests may be an effective alternative to prevent disputes.

A taxpayer may file a request for ruling on the interpretation of the tax law applicable to any specific fact. Such rulings will be effective until the law changes, or until the taxpayer is notified that the tax authorities have revoked the verdict. Tax authorities do not need court authorisation to rescind a ruling.

Tax authorities may revoke a ruling at any time, at which point there is no legal defence to keep the decision in force. However, if the authorities issue an assessment because a taxpayer continued to follow a revoked ruling, the taxpayer may always discuss that matter in an administrative or judicial court.

As stated in **6.1 Mechanisms for Tax-Related ADR in this Jurisdiction**, the Brazilian tax system does not have alternative ways to solve disputes in tax matters. However, the draft bill under discussion refers only to interest and penalties and does not cover agreements to reduce tax assessments.

### 6.5 Further Particulars Concerning Tax ADR Mechanisms

The challenge of OIC in the Brazilian tax system is that the law is binding on all public workers in all spheres of government, who have no discretionary power. The Federal Constitution states that only the law may impose or exclude tax obligations.

In the past few years, due to Brazil's economic crisis, the federal and state governments have legally approved periodic tax amnesty programmes that have allowed the payment of tax debts in installments and granted reduced fines and interest.

The authors have published a recent article stating that tax policy in Brazil should change to adopt a contribution-focused relationship between taxpayer and tax authorities. This new relationship should be the turning point in the effectiveness of the OIC mechanism in Brazil.

### **6.6 Use of ADR in Transfer Pricing and Cases of Indirect Determination of Tax**

Brazilian transfer pricing rules are substantially based on a fixed profit system, rather than on overall margins (OECD model), and thus require a careful analysis of intercompany prices and conditions to be carried out by specialists, should intercompany sales be significant in the business model.

These rules were adopted in Brazil in 1996. The conciliation of the Brazilian transfer pricing rules with internationally accepted transfer pricing methods became one of the biggest challenges faced by multinational enterprises in Brazil, with difficulties relating mainly to the deviation of the Brazilian rules from the OECD's Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations. Regarding such differences, it should be noted that there is no leeway for advance pricing agreements under the Brazilian transfer pricing legislation, and that Brazilian law has adopted fixed margins for the various methods, regardless of the nature of a taxpayer's business, industry or role in the transaction (ie, there is no functional analysis). The law provides that the Minister of Finance may establish other statutory margins for each industry to determine the parameter price in controlled transactions.

Cross-border transactions carried out by legal entities incorporated in Brazil shall be subject to transfer pricing controls when entered into with related parties, or with parties located in low tax jurisdictions or jurisdictions with underdeveloped tax regimes, irrespective of whether the two parties qualify as associated enterprises.

The Brazilian transfer pricing rules do not apply to cross-border payments of a trade mark or patent royalties, nor to fees payable as compensation for the transfer of technology, or the rendering of technical, administrative or scientific assistance services with a transfer of technology or know-how. The relevant agreements are to be registered with the Brazilian Intellectual Property Agency and the Central Bank of Brazil.

In this context, Brazil has reserved the right not to include arbitration clauses of the 2017 OECD MTC in their tax treaties already signed, stating clearly the intention of not adopting arbitration in transfer pricing. According to the OECD, this inability to start an arbitration procedure is an important gap in the Brazilian international tax framework.

## **7. Administrative and Criminal Tax Offences**

### **7.1 Interaction of Tax Assessments with Tax Infringements**

Usually, tax authorities file tax assessments to claim taxes not paid, without criminal implications. However, the tax authorities may also seek to impose aggravated penalties when the conduct of the taxpayer is deemed to be fraudulent. These penalties may lead to the filing of a criminal investigation.

Most commonly, criminal tax litigation takes the form of a public criminal action filed by the Public Prosecutor's Office. If a final unfavourable decision is granted at the administrative level and there is no payment of tax (or payment in instalments), the Public Prosecutor must file a criminal action to investigate a crime against the tax system.

In this context, the most common tax crimes are fraudulent tax evasion (ie, failing to pay or underpaying tax by omitting information or submitting a false return to the tax authorities) and misappropriation of pension monies (ie, failing to pay contributions collected from contributors to the social security system).

### **7.2 Relationship Between Administrative and Criminal Processes**

A criminal investigation can only start once the administrative proceeding is completed, and after the tax authorities have established a sufficient amount of the tax debt. This timing was stated by the Brazilian Supreme Court, which ruled that a criminal offence can only be charged after a tax case has been completed at the administrative level, and a failure to pay taxes has been recognised.

However, sometimes a criminal tax complaint is submitted by the Public Prosecutor's Office before an administrative proceeding has been completed. In these cases, a defence adopted by taxpayers, and broadly accepted, is to inform the Public Prosecutor's Office immediately that the tax debt is still under discussion. Therefore, there is no crime to be investigated, so the criminal investigation should be halted, and any police inquiry suspended. If a court determines that an investigation should continue, it is possible to apply for an order of habeas corpus to end the improper investigation, on the basis that no crime has been committed.

### **7.3 Initiation of Administrative Processes and Criminal Cases**

A criminal investigation can only start once administrative tax proceedings are completed, through the submission of a criminal tax complaint. The Public Prosecutor's Office then decides

whether to call for a police inquiry or start a criminal prosecution.

A police inquiry is a procedure precedent to criminal prosecution. It is an administrative investigation carried out by the police authorities, intended to collect evidence regarding the existence of a criminal infraction and the identity of the offender. In the case of a tax crime, the purpose of a police inquiry is to identify the person responsible for the offence, as the tax authorities have already demonstrated the materiality of the offence.

## **7.4 Stages of Administrative Processes and Criminal Cases**

Once the administrative proceedings are completed and the amount of the tax debt is definitively established, there are grounds to start a criminal prosecution to investigate a tax crime, which can begin through either a police inquiry to determine the author of the offence, or an accusation (if the Public Prosecutor's Office believes it has sufficient evidence regarding the offender), which, if accepted by the competent court, will result in a criminal action.

Once the investigation is complete, the police inquiry will be sent to the Public Prosecutor's Office. After that, the Public Prosecutor can then take one of the following steps:

- make a formal accusation;
- return the procedure to the police for further investigation; or
- withdraw the charge (which rarely occurs, since tax authorities will have proved that a crime was committed).

The Public Prosecutor's Office will go to court if it considers that there is reasonable evidence of the materiality of the offence against the accused.

Once an accusation is made, the competent court will examine it and open a criminal trial if it believes that an indictment is admissible under law. During the court phase, a preliminary defence is presented and analysed by the court. The accusation is then confirmed or rejected. The prosecution will only be dismissed at this point if there is obvious illegality.

Once the criminal case has been accepted, a date is set for the hearing of evidence, during which witnesses will be heard (including expert witnesses, if any) and the defendant questioned. At the end of this stage, the parties must submit their arguments orally or, if permitted by the judge, in writing. The judge will then issue the criminal judgment.

A way to avoid prosecution is to pay the tax or agree to pay it in instalments as soon as the administrative proceeding is complete. Payment of the tax debt in full will release the taxpayer from the possibility of punishment and can be made at any time, even after the decision to prosecute is issued, provided that it is made before the final judgment. However, payment in instalments can only be arranged before the criminal prosecution starts, in which case the state's punitive powers will be suspended. In the case of payment in instalments, the criminal action will be discontinued until full payment is made, and will be resumed in the event of default by the taxpayer.

Another possibility not provided by law, but occasionally seen in practice, is the suspension of the investigation, when, given the unsatisfactory result of the administrative procedure, the taxpayer chooses to continue with the judicial process, by depositing into court an amount that corresponds to the deferred tax, or by presenting a letter of bank guarantee.

## **7.5 Possibility of Fine Reductions**

The filing of a tax assessment, at least at the federal level, gives rise to an automatic fine of 75% of the tax due. The amount of the penalty can be doubled if it is established that the taxpayer also committed fraud.

An upfront payment will reduce this amount considerably if made before any additional assessment. After that, fines that can be avoided refer to judicial litigation, which has an automatic penalty of another 10% over the tax due.

## **7.6 Possibility of Agreements to Prevent Trial**

As stated before, the Brazilian tax system does not recognise tax agreements. In other words, there is no legal or constitutional basis authorising taxpayers to negotiate with the government in order to reach an agreement on the final interpretation of the applicable legislation in respect of the tax due, or to prevent trial and fines.

The only possibility, as already stated, is the occasional tax amnesty programme, which are indicated by a Law of Amnesty.

## **7.7 Appeals Against Criminal Tax Decisions**

It is a fundamental principle of criminal law that a party has the right to have a first instance decision re-examined by a superior court, without the payment of court fees.

The parties can appeal against court decisions, in full or in part, to a higher court that has jurisdiction over the matter, which can be a state or a federal court. Deadlines for filing appeals are set out in the Criminal Procedure Code and vary depending on the type of motion.

Once an appeal is decided, another request can be filed before the Superior Court of Justice on the grounds of violation of federal law, and before the Federal Supreme Court on the grounds of a breach of constitutional law.

## 7.8 Rules Challenging Transactions and Operations in this Jurisdiction

Recent cases regarding the GAAR and transfer pricing rules challenged by the tax authority's assessment have given rise to administrative procedures that are ruled on a case-by-case basis. For the GAAR cases, the main concern is the lack of proof of the economic purpose of a transaction or operations. For transfer pricing rules, the main concern is the deviation of Brazilian transfer pricing rules from the OECD's Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (eg, the adoption of fixed margins regardless of the nature of the taxpayer's business, industry or role in the transaction).

Tax authorities usually address these subjects during a tax audit to contest the transaction or operation as described by a taxpayer, followed by a tax assessment that can be discussed during the administrative or judicial proceeding.

## 8. Cross-Border Tax Disputes

### 8.1 Mechanisms to Deal with Double Taxation

If double taxation occurs due to an additional tax assessment or tax adjustment in a cross-border situation, it is common to use domestic litigation against such an administrative decision.

In this scenario, if an additional tax assessment or a tax adjustment is issued, the case will be treated by administrative and judicial courts as it is stated in the Brazilian tax system, considering the laws applicable in the Brazilian territory.

The Brazilian tax system does not have regulations regarding the compensation adjustments to avoid double taxation. The only exception, with some conditions that must be complied with, refers to transactions performed with foreign companies that are controlled by a Brazilian legal entity.

### 8.2 Application of GAAR/SAAR to Cross-Border Situations

Since the mid-1990s, the federal government has implemented SAARs, which are considered by the Brazilian Federal Revenue Service (RFB) to be enough to mitigate the effects of the international tax planning that motivated the BEPS Project. These rules have been implemented in Brazil through legislative changes since 1998, based on the OECD's recommendations in the Harmful Tax Competition Report.

Examples of SAARs adopted by Brazil are taxation on worldwide income, transfer pricing rules, a list of low-tax jurisdictions (blacklist) and privileged tax regimes (grey list), an increased rate of income tax on payments to low-tax jurisdictions, limitation on the deductibility of such payments, and thin-capitalisation rules, among others.

In the context of actions aimed at promoting transparency and the international exchange of information, the RFB issued rules to implement the following measures:

- country-by-country declaration;
- exchange of information; and
- mandatory declaration of the beneficial owner of Brazilian companies.

Also focusing on international transparency, two agreements regarding the automatic exchange of financial information were signed by Brazil: the Foreign Account Tax Compliance Act (FATCA) with the USA, and the Common Reporting Standard (CRS), within the framework of the Global Forum on Transparency and Exchange of Information for Tax Purposes.

With the above measures, the RFB will receive a substantial amount of information on the general structure of Brazilian taxpayers, which will change tax inspection proceedings. Because of this, the need to introduce measures that seek to align Brazilian rules with international standards will become even more evident, to avoid having global information used merely for tax collection purposes.

Current jurisprudence does not have any relevant case to establish a comparison for a future situation, as this initiative is new to the Brazilian tax system.

### 8.3 Challenges to International Transfer Pricing Adjustments

Transfer pricing adjustments have been challenged under domestic tax courts, both in the administrative and judicial instance. Generally, tax authorities issue a tax infraction notice questioning the methods used by the taxpayer on a transfer pricing calculation if they are not in line with applicable rules, or if the supporting documentation is unreliable.

Although OECD standards initially inspired Brazil's transfer pricing rules, Brazil deviates significantly from the OECD Transfer Pricing Guidelines, as there are no profit-based methods (profit split or transactional net margin methods) and the idea of a functional and risk analysis is not included. Another relevant difference in the Brazilian transfer pricing standards is the concept of related parties, which is much broader than the idea of "associated enterprises" considered by OECD standards.

It is possible in the near future that the results of the task force created for the admittance of Brazil as a member of the OECD will indicate a new orientation, accepting transnational methods, but there is not the same clarity regarding the change of rules regarding the deduction of royalties.

## 8.4 Unilateral/Bilateral Advance Pricing Agreements

Advance pricing agreements (APAs) are not admitted in Brazil.

## 8.5 Litigation Relating to Cross-Border Situations

The lack of specific legislation regarding cross-border situations gives rise to all sorts of litigation, which is solved on a case-by-case basis, both in the administrative and judicial instance.

To mitigate this complicated situation, taxpayers can file a ruling request or a mutual agreement procedure, as stated in **6.4 Avoiding Disputes by Means of Binding Advance Information and Ruling Requests**, but the lack of legislation will probably result in a more expensive solution for the taxpayer.

In the authors' opinion, specific legislation must accompany the recent changes and the OECD standards – which may soon be implemented, as Brazilian and OECD officials have launched a joint 15-month project to review Brazil's international tax and transfer pricing legislation thoroughly, the better to align it with OECD guidelines and recommendations. In 2019 the OECD and the RFB presented the first joint work on assessing the similarities and differences between the Brazilian and OECD frameworks.

## 9. Costs/Fees

### 9.1 Costs/Fees Relating to Administrative Litigation

Administrative disputes attract no court costs and assure suspension of the enforceability of debt, granting the debt clearance certificate up to the final decision.

### 9.2 Judicial Court Fees

Taxpayers must pay court costs according to tables issued by the Federal Government and the states at the time judicial proceedings are filed. Each instance of judicial courts has its fee.

There is a fee cap for federal courts, and court costs are mostly not significant. Some state courts have a higher cap, such as the State Court of Rio de Janeiro, where the cap is almost BRL40,000 and reflects a percentage of the value discussed in the lawsuit.

The parties are obliged to pay the fees in each instance, with such payment being a requirement to access the court of appeals.

The party who loses the case supports all the costs of a lawsuit.

The writ of mandamus is the only judicial claim in which there isn't an obligation to pay the winning party's costs, regardless of which party won, taxpayer or tax authorities.

## 9.3 Indemnities

At the end of a judicial proceeding, a judge will sentence a defeated litigant to reimburse the other party all anticipated court costs, and to pay judicial attorneys' fees up to 20% of the amount involved according to the chart under Section 85 of the CPC. These fees are mandatory (unless a writ of mandamus is filed) and might become very relevant when significant amounts are discussed.

## 9.4 Costs of Alternative Dispute Resolution

As stated before, the Brazilian tax system does not have alternative ways to solve disputes in tax matters.

## 10. Statistics

### 10.1 Pending Tax Court Cases

Statistics regarding tax court cases are provided by the National Justice Council (CNJ), which is responsible for overseeing the judiciary, and by the Federal Revenue Service, which is responsible for the federal administrative courts. Numbers related to the state and municipal courts of the judiciary are absorbed by the numbers stated in the CNJ report. The state and municipal courts do not provide statistics for the public.

According to the last CNJ report, in 2018 there were approximately 31 million tax execution proceedings in federal and state courts, with only 10% of proceedings coming to an end in 2018. According to the National Treasury Attorney's Office, these judicial proceedings represent BRL 2,196 trillion in debts.

### 10.2 Cases Relating to Different Taxes

According to the National Treasury Attorney's Office statistics, the majority of cases, with a total sum of approximately BRL 11.6 billion, refer to:

- corporate income taxes – corporate income tax (IRPJ) and social contribution on net income (CSLL);
- federal excise tax (IPI);
- import tax (II);
- financial transactions tax (IOF);
- economic domain intervention contribution (CIDE); and
- withholding income tax (IRRF).

Taxes on revenues account for the next highest proportion of cases, with a total sum of approximately BRL 5 billion, these include:

- contribution for the social integration programme (PIS) and
- contribution for social security financing (COFINS).

The state and municipal revenue services do not provide a centralised report, which makes it challenging to establish statistics regarding tax matters.

### 10.3 Parties Succeeding in Litigation

The last publicly available report that emphasises the success of the RFB in 2018 indicates the taxpayer having complete success in 28.5% of cases and partial success in 18.5%, leaving a 53% success rate for the tax authority.

## 11. Strategies

### 11.1 Strategic Guidelines in Tax Controversies

As discussed above, the Brazilian tax system is highly regulated and complex. Therefore, it is important to pay attention to mitigating liabilities when structuring a transaction – for example, a discussion with a tax expert lawyer and an accountant is usually recommended. Such consultation will focus on the types of business entities that are commonly used in Brazil, their residence definitions and implications, and their basic tax treatment. It is also highly recommended to have a second opinion.

In the authors' opinion, the best way to avoid tax controversies in Brazil is to have adequate tax planning, which must observe and respect the previous advance tax rulings of the tax authorities, as well as the previous understandings and legal opinions of the Public Attorney's Office.

It is essential to double check the documents sent to the RFB and establish if every tax law and regulation has been correctly applied after a controversy is initiated at administrative or judicial court; more importantly, it is essential to check that the RFB also followed the legal applicable proceeding.

After that, there are several ways to handle the situation, but the previous decisions of administrative courts must always be considered; more critically, the case law of the Federal Supreme Court and Superior Court of Justice must also be assessed, since the majority of guidelines for the Brazilian tax system are stated in the Constitution and complementary Laws.

After choosing a way to litigate, there are other choices that a taxpayer needs to make with the assistance of a tax expert attorney, relating to the risk management of asset freezing and other enforcement procedures.

Anti-corruption cases regarding tax corruption enforcement have increased significantly over recent years. Most cases involve public officials granting undue discounts in exchange for bribes, and administrative judges rendering votes in favour of taxpayers in exchange for improper benefits. This new context reinforces the need for companies to maintain effective anti-bribery and anti-corruption programmes, including personnel training, creating standard procedures, and implementing controls over tax matters.

Therefore, such context gives rise to an important issue: lawyers, accountants and managers must give even more attention to predetermined standard procedures in order to prevent any future questioning regarding the procedural conduct of a tax matter.



# BRAZIL LAW AND PRACTICE

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**MJ Alves e Burle Advogados e Consultores** was launched in 2017 and is the first law firm to specialise in advocacy in Brazil. It is a Brasília-based and Brasília-oriented firm, with a solid team that engages with other professionals to respond better to clients' needs. The team has expertise in complex tax and civil litigation cases, economic and political strategy and engage-

ment, and is noted for its ability to assess the impact of judicial and political decisions in the legal, political and economic environments. The firm's legal experience includes disputes involving, among others, the banking and finance, construction, IT and telecoms, oil and gas, energy, life sciences, and mining and metals industries.

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