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Corporate income taxes and swap transactions by real estate developers

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The Federal Revenue Service of Brazil (*RFB – Receita Federal do Brasil*) has been assessing corporate income tax (IRPJ) and social contribution on net profit (CSLL) on real estate trades carried out by real estate developers that pay income taxes under the presumed profit system. Swaps or trades are common in the sector, because developers often acquire land in exchange for units in the development that will be built on the property.

The assessments are based on the RFB's interpretation of the law in tax rulings and COSIT Ruling no. 09/2014. Until recently, the Administrative Tax Appeals Council (*CARF – Conselho Administrativo de Recursos Fiscais*) had followed the RFB's position, reasoning that if exchanges should be treated as purchase and sale transactions, as provided for in article 533 of the Civil Code, and if gross income under the presumed profit system includes the product from sales carried out by real estate development companies on their own behalf, as provided for in article 224 of the Income Tax Regulations of 1999 (RIR/99 – Regulamento do Imposto de Renda), then the value of the property received in real estate trades should be included in gross income for the purposes of calculating IRPJ and CSLL under the presumed profit system.

Although this position has prevailed, in more recent decisions it did so because of the casting vote on CARF's judgment panels. The casting vote belongs to one of the RFB's representatives, not to one of the panel members representing the taxpayers. In 2020, however, Law 13.988 added article 19-E to Law 10.522/02, which provides that in the event of a tie in deciding an administrative proceeding, the casting vote does not apply and the appeal will be resolved in favor of the taxpayer.

In November 2020, the 1st Panel of the Superior Tax Appeals Chamber (*CSRF – Câmara Superior de Recursos Fiscais*) decided an appeal dealing with real estate trades, and held that the trade transaction was not taxable, even though the real estate company paid income tax under the presumed profit system, because of the tie vote in CARF and the application of article 19-E of Law 10.522/02.

According to the well-reasoned majority opinion in the case, despite Instruction IN 107/88, the transaction was not taxable because (i) the legal fiction adopted in the simplified "presumed profit" tax system cannot be used to tax a transaction that does not increase the taxpayer's wealth or, in other words, that does not constitute a taxable event for the purposes of corporate income tax (article 43, National Tax Code); (ii) a trade involves an exchange of one thing for another, which suggests economic neutrality, and is quite different from a purchase and sale, so that the same tax treatment should not be given to both transactions, even though the Civil Code provides that its provisions on purchase and sale also apply to exchanges, because such treatment would violate articles 108§1, 109 and 110 of the National Tax Code; and (iii) article 227 RIR/99 provides that real estate income is equal to the amount received from the sale of real estate units and, since no units are sold in a real estate trade transaction, there is no income to be taxed.

This is an important precedent and allows real estate developers to continue contesting tax assessed by the RFB at the administrative level, which is a quicker, more specialized and less costly route than the courts, which tended to favor the taxpayer in the taxation of real estate trades under the presumed profit system, based on a decision by the 2nd Panel of the Superior Court of Justice (STJ).

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