**Insolvency & Restructuring - Brazil**

## New tax debt payment programme for court-supervised reorganisation

Contributed by **Castro, Barros, Sobral, Gomes Advogados**

January 16 2015



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### Article 10-A

Article 43 of Law 13,043/2014(1) altered Law 10,522/2002 by adding Article 10-A, which creates a special programme that allows companies that have filed for or are undergoing court-supervised reorganisation to pay their federal tax debts in instalments.

The new Article 10-A allows for the payment of federal tax debts regardless of whether they are definitively constituted or classified as actionable. This means that debts that are still being discussed administratively or judicially can be included – in the latter case, through pre-emptive suits filed by the taxpayer to cancel assessments or through contestation of collection suits filed by the National Revenue Prosecution Office.

The first paragraph of Article 10-A provides that debts already included under instalment payment programmes established by other laws cannot be included in the new programme. However, in an apparent contradiction, the third paragraph of the same article states that:

> "*businesspeople or companies can, at their discretion, withdraw from ongoing instalment payment programs, regardless of the modality, and request inclusion of the remaining balance for instalment payment under the terms of this article.*"

### Payment model

The special financing modality established by Law 10,522/2002 allows the federal tax debts of businesspeople and companies to be paid in up to 84 consecutive monthly instalments. This is calculated on a sliding scale of minimum percentages, applied on the amount of the consolidated debt as follows:

- 1st to 12th instalment – 0.666%;
- 13th to 24th instalment – 1%;
- 25th to 83rd instalment – 1.333%; and
- 84th instalment – remaining balance.

The instalment payments must observe the other conditions established in Law 10,522/2002, except in relation to:

- the need to post an acceptable *in rem* or *in personam* guarantee for debts already classified as actionable;
- the automatic approval of participation if the tax administration has not issued a decision within 90 days;
- the ban on including debts from:
  - taxes subject to withholding at source;
  - deductions from other parties or subrogation;
  - tax on financial transactions (regardless of whether it is withheld at source); and
  - amounts received by collection agents not paid to the government; and
- the need to pay 10% or 20% of the total consolidated debt in the first instalment where debts already included under another instalment payment programme are being re-included or where such debts are being included for a second time, respectively.

### Criticisms and considerations

Although the new programme has been a long time coming – it took effect nearly nine years after the inclusion of Paragraph 3 in Article 155-A of the National Tax Code(2) and the entry into force of the current Reorganisation and Bankruptcy Law (Law 11,101/2005), which requires the creation of special rules that allow distressed companies to pay their tax debts in instalments – it has not satisfied businesspeople and companies. The delay in enacting the law generated high expectations for more flexible rules, which could preserve companies and maintain jobs and tax revenues. Unfortunately, these expectations have not been met, as the new programme has rigid rules. For example, companies cannot adjust reorganisation plans that have been or will be approved by creditors, thus preventing the size and schedule for paying instalments to be attuned to the actual conditions of the distressed company.

Moreover, the settlement period for paying the entire debt is shorter than that under similar federal government programmes, such as the Crisis REFIS, which allowed for payment in up to 180 months. Under the new programme, the total debt must be paid in seven years – a period that is insufficient for most companies undergoing reorganisation because of the need to set aside revenue to pay other creditors, whether or not they are subject to judicial proceeding.

In this respect, Law 11,101/2005 establishes that labour debts must be settled within one year (Article 54). Therefore, although the first 12 instalments have a relatively low payment percentage, it would have been better for the legislature to allow a one-year grace period before payments began, so that companies could focus on paying labour debts, which take priority over tax debts (Article 83).

Another problem with the seven-year payment period is that tax debts might need to be paid before debts to creditors holding *in rem* guarantees. This is contradictory because, according to Article 83 of Law 11,101/2005, claims secured by *in rem* guarantees take priority over tax claims. The situation is even more convoluted because the new programme is silent on the payment of tax debts from fines (ie, fines for late payment or improper recordkeeping/reporting). If the reorganisation plan fails and the company is declared bankrupt, then debts from these fines are classified as unsecured, meaning that they are subject to payment only after all claims to creditors holding some type of guarantee are settled.

Another criticism of the new instalment programme is that companies undergoing reorganisation must cease any administrative or judicial proceedings in which they are contesting a tax obligation. This is seen as unfair because in many cases contestation is not just a ploy to gain time, but instead is based on solid arguments that the assessment is excessive or illegal.

The new programme may also reopen the discussion on the need for a tax regularity certificate (CND) in order to obtain approval of a court-supervised reorganisation plan. Since the tax administration is not subject to court-supervised reorganisation plans, Article 57 of Law 11,101/2005 stipulates that after a plan is approved by the general creditors' meeting, or after the 30-day period for dissenting creditors to object has lapsed, the debtor must present a CND, making this (at least in theory) a requirement for court approval of a reorganisation plan (Article 58).

During the legal void between the enactment of Law 11,101/2005 and the passage of Law 13,043/2014, there were no rules for instalment payments of tax debts by companies undergoing court-supervised reorganisation. During this period, case law established that there was no obligation to present a CND in order to be granted a reorganisation plan. This was a reasonable position, as it would be unfair to require distressed firms to settle their tax debts without the ability to avail of an instalment programme tailored for companies in this situation, as is required by Article 6 (7) of the Reorganisation and Bankruptcy Law.

Since the guiding principle of the Reorganisation and Bankruptcy Law is preservation of the company (Article 47), many believe that once the follow-on regulations have been issued under Law 13,043/2014, it should be possible to waive the obligation to present a CND on a case-by-case basis – in particular, by considering the debtor's capacity to pay and the terms of the reorganisation plan approved by creditors and the court.

The logical policy would be that if the terms of the special instalment programme are shown to be insufficient to settle the tax debt, or adherence to the programme poses a serious risk to the success of the reorganisation plan, the CND requirement should be waived in order to ensure that the company can be preserved. On the other hand, if the debtor's financial situation permits tax debts to be paid under the programme, given the conditions of the approved reorganisation plan, it should be required to adhere to the programme.

The biggest problem is that, in practice, this assessment can occur only after the reorganisation plan has been approved by the creditors, which usually takes place 150 days after the court has accepted a petition for reorganisation. Since adherence to the programme is a lengthy bureaucratic process, the best policy would be for the court not to wait for its conclusion and the consequent issuance of a CND before approving the creditor-approved reorganisation plan, as to do otherwise could hinder the company's recovery.

A possible solution to this impasse would be to allow the reorganisation plan to stipulate that the debtor must adhere to the instalment programme and submit a CND to the court within a reasonable timeframe, so that the court can approve the reorganisation without a CND. In this case, the judicial trustee and the creditors would oversee compliance with the commitment under the possible penalty of bankruptcy if the obligation is not met.

**Comment**

Despite these serious criticisms, the programme has some positive points:

- There is no requirement to post a guarantee for adherence.
- Initial payments are at a lower percentage of the consolidated debt, allowing more revenue to be directed towards the payment of other creditors and creating more breathing space for the company to recover.

However, despite filling a gap dating back nine years, the new programme will likely create more problems than solutions, due to both its rigid payment structure and its failure to address important practical considerations. Nevertheless, in some cases the programme will serve as an effective mechanism to enable distressed companies to settle federal tax debts and recover their stability.

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Adriana Nogueira Tôrres, an associate in CBSG's tax department, assisted in the preparation of this update.

## Endnotes

(1) As a result of Provisional Measure 651/2014 being converted into law.

(2) Introduced by Complementary Law 118/2005.