COFINS AND PIS DEDUCTIONS OF ALLOWANCE FOR DOUBTFUL ACCOUNTS – PCLD

A) CONTEXT OF THE TOPIC

1. First of all, it is important to clarify that this study refers to the deduction, in the PIS and COFINS' tax basis, of the **net expenses of reversals of allowances for doubtful accounts (PCLD) and the recovery of credits written off to losses**, pursuant to the rules for the grouping of accounts of the Central Bank of Brazil itself for Publication Purposes.

2. For such, taxpayers will demonstrate that such amounts correspond to actual expenses, tied to their financial intermediation activities, pursuant to the legislation regulating on the matter, also supported by the Accounting Plan of the Institutions of the National Financial System – "COSIF" issued by the Central Bank of Brazil (BACEN) and even by the Office of the General Counsel for the Federal Treasury, through PGFN/CAT Opinion no. 325/2009[1], as exposed below.

3. It should be clarified that this paper does not intend to resume the old discussion on the dichotomy between the ascertainment regimes of the PCLD imposed by BACEN and the tax rules for the purpose of deducting the IRPJ and CSL tax bases of financial institutions, or even claim to exclude from the PIS and COFINS' tax basis revenues from defaulted sales, since the assumptions used to analyze the mentioned matter do not affect the case at issue.

4. In fact, in the discussion relative to the IRPJ and CSL, what is sought is the application of the rules of the regulatory body – BACEN, overlapping the fiscal rules, which is not identified in this claim, since Law no. 9,718/98 expressly provides, in the formation of the PIS and COFINS' tax basis, the possibility of exclusion/deduction of expenses incurred in financial intermediation transactions, including those relating to the PCLD.

5. The same basis, that there is an express legal provision for the sought deduction, rules out any attempt of matching this claim with the thesis of exclusion, from the PIS and COFINS' tax basis, of revenues with defaulted sales, since this claim was not approved by the legislature, who only authorized the deduction of canceled sales in its article 3, paragraph2, item I.

[1]COSIF - The rules established in this Accounting Plan aim to standardize the accounting records of administrative acts and facts, rationalize the use of accounts, set rules, criteria, and procedures that are necessary to obtain and disseminate data, enable the monitoring of the financial system, as well as the analysis, performance assessment and control, so that the prepared financial statements may express, with reliability and clarity, the actual economic and financial situation of the institution and financial conglomerates. (Circ. 1273). The National Monetary Council has jurisdiction to issue general accounting and statistical rules to be complied by financial institutions. This jurisdiction was delegated to the Central Bank of Brazil, at a meeting of that Council, dated July 19, 1978. (Res 1120 RA art. 15, Res 1655 RA art.16, Res 1724 article. 1, Res 1770 RA art. 12, Circ. 1273.

B) LEGISLATIVE BACKGROUND

6. Before specifically demonstrating the possibility of excluding the PCLD from the tax basis of the PIS and COFINS, it is important to keep in mind that the original intention of Law no. 9,718/98 was to subject the total revenue to the levy of the mentioned contributions, also with regard to financial institutions which, until then, would pay the PIS pursuant to Constitutional Amendment no. 17/97 (until December 1999), and were exempt from the COFINS, pursuant to article 11, sole paragraph, of Complementary Law no. 70/91.

7. However, this intention was invalidated by the Federal Supreme Court, which, in the trial of Extraordinary Appeals (RE) nos. 357.950-9/RS, 390.840-5/MG, and 358.273-9/RS, ruled on the unconstitutionality of paragraph 1, of article 3, of Law no. 9,718/98 which, before Constitutional Amendment no. 20/98, aimed to tax the total revenues of legal entities.

8. Although for financial institutions the mentioned discussion continues, especially considering the conclusions of PGFN/CAT Opinion no. 2,773/2007, which originated topic 372 of the general repercussion of the Federal Supreme Court, as of January 2015, Law no. 12,973/2014 has changed the legal provisions for the PIS and COFINS' tax basis, including the one provided for in article 3 of Law no. 9,718/98.

9. In fact, by altering the concept of operating gross revenue, including "(...) revenues of the main activity or purpose of the legal entity, not encompassed in items I to III (...)" and at the same time amending Law no. 9,718/98, so that the PIS and COFINS' tax basis may fit into this new definition, Law no. 12,973/2014 intended precisely to end the discussion surrounding the constitutionality of the collection of the mentioned taxes on revenues other than those from the sale of goods and provision of services.

10. It occurs that, even in the effectiveness of the unconstitutional paragraph 1, of article 3, of Law no. 9,718/98, which provided for broader limits on the tax basis of the contributions, the intention of the legislature was never to tax the entire gross revenue, but to accept, by express legal provision, the exclusion of given costs and expenses inherent to revenues subject to taxation.

11. So much so that the Office of the General Counsel for the Federal Treasury in the already mentioned PGFN/CAT Opinion no. 2,773/2007, justified the alleged distinguished treatment attributed to financial institutions in relation to the other legal entities, based exactly on paragraphs 5 and 6 of article 3, of Law no. 9,718/98, specifically those dealing with the allowed exclusions, as can be seen as follows:

> "the declaration of unconstitutionality stated in letter "d" cannot modify the reality that for financial institutions and insurance companies the tax basis of the COFINS and PIS is still the gross revenue of the legal entity, with the exclusions contained in paragraphs 5 and 6 of the same article 3, without including, however, non-operating revenues, since article 2 and the heading of article 3 were not declared to be unconstitutional;"

12. In other words, although it is not the purpose of that position to question the validity of the mentioned conclusion, it is clear that the Office of the General Counsel for the Federal Treasury itself acknowledges that the inclusion of

other revenues, other than those consisting of the sale of goods and the provision of services, mainly the revenues earned from financial intermediation, presupposes the exclusion of expenses related to the exercise of this same activity.

13. As known, the financial institutions have been, to date, subject to the cumulative system of the PIS and COFINS, pursuant to article 8, I, of Law no. 10,637/02 and of article 10, I, of Law no. 10,833/2003[2].

14. In this sense, article 1, I, and III, "a", of Law no. 9,701/1998, provided that, for the purpose of ascertaining the PIS and COFINS' tax basis, commercial banks and other financial institutions could exclude/deduct, inter alia, the "(...) *fundraising costs in transactions carried out in the inter-financial market, including with negotiable instruments* (...)".

15. In fact, before Law no. 9,718/1998 came into force, for the purpose of ascertaining the PIS, Financial Institutions were allowed to deduct expenses that were exclusively related to the fundraising activities in the inter-financial market.

16. Although Law no. 9,701/1998 only referred to the ascertainment of the PIS, it is worth mentioning that paragraph 5, of article 3, of Law no. 9,718/1998, expressly provided that with respect to financial institutions, the same exclusions and deductions offered for PIS ascertainment purposes will be accepted in the ascertainment of the tax basis of the COFINS, as inferred by the possibility of deducting such fundraising expenses from the tax basis of both contributions.

17. However, the enactment of Provisional Measure ("MP") no. 1,807 of 1999 then followed, which included paragraph 6 to article 3, of Law no. 9,718/1998, extending the already provided for exclusions and deductions, and now comprising, more broadly, the "expenses incurred in the financial intermediation transactions"[3] supported by commercial banks and other financial institutions, which led to MP no. 2,158-35, of Aug. 24, 2001, still in force.

18. **What therefore occurred was the complement to the statement provided for in article 1, III, "a" of Law 9,701/1998, which, until then, established the permission to deduct the "(...) *fundraising costs in transactions carried out in the inter-financial market* (...)" from the tax basis of the Contributions to the PIS and COFINS, making it more comprehensive, which generically encompasses the total "(...)*expenses incurred in the financial intermediation transactions* (...)", as set forth in article 3, paragraph 6, I, "a" of said Law no. 9,718/1998.**

C) EXPENSES OF THE FINANCIAL INTERMEDIATION ACCORDING TO THE CENTRAL BANK AND THE OFFICE OF THE GENERAL

[2] Art. 8. The following remain subject to the legislation rules for the contribution to the PIS/Pasep, in force prior to this Law, the provisions of articles 1 to 6 not applying thereto: Production of legal effects
I – the legal entities mentioned in paragraphs 6, 8 and 9 of art. 3 of Law no. 9,718, dated November 27, 1998 (paragraphs introduced by Provisional Measure no. 2,158-35, dated August 24, 2001), and Law no. 7,102, dated June 20, 1983;
Art. 10. The following remain subject to the legislation rules of the COFINS, in force prior to this Law, the provisions of articles 1 to 8 not applying thereto:
I - the legal entities mentioned in paragraphs 6, 8 and 9 of art. 3 of Law no. 9,718, of 1998, and in Law no. 7,102, dated June 20, 1983;

[3] "Art. 3. The revenue referred to in art. 2 comprises the gross revenue dealt with in art. 12 of Law Decree no. 1,598, of December 26, 1977 (...) Paragraph 6. In the determination of the tax basis of the PIS/PASEP and COFINS conditions, the legal entities mentioned in paragraph 1 of art. 22 of Law no. 8,212, of 1991, in addition to the exclusions and deductions stated in paragraph 5, may exclude or deduct:
I - in the case of commercial banks, investment banks, development banks, savings banks, loan, financing and investment associations, real estate loan associations, brokerage firms, securities distributors, leasing companies and credit unions: a) **expenses incurred in financial intermediation transactions;** (emphasis added)

19. What can be observed, from the introduction of paragraph 6, I, *a*, of art. 3 of Law no. 9,718/98, is that in addition to the raising of funds in the inter-financial market, expenses incurred in financial intermediation transactions can also be taken into account in the calculation of the tax basis of such taxes.

20. What happens is that, in the absence of specific concepts in the tax legislation law of what would be said financial intermediation expenses, it is up to the law interpreter to examine the scope of this concept in the regulation imposed on the financial institutions by the Central Bank of Brazil, the regulatory authority of that activity, under Law no. 4,595/64, as well as in doctrine concepts and positions rendered by tax authorities on the matter.

21. In this sense, it is important to clarify that the taxpayers, in the capacity of financial institutions authorized to operate by BACEN, are obliged to follow the accounting standards established by that body, including with regard to the formation of a PCLD.

22. Specifically concerning this aspect, "COSIF" is extremely clarifying as to any doubt that may arise relating to the classification of PCLD expenses under the concept of financial intermediation expenses, as follows:

TITLE :ACCOUNTING PLAN OF INSTITUTIONS OF THE NATIONAL FINANCIAL SYSTEM – COSIF
CHAPTER :Documents – 3
SECTION :Model Document no. 8

Document no. 8 – Income Statement

1. Income Statement for the Half-Year
Purpose: publication
Basic Standards: 1.22.2-3, 1.26.2, 1.29.1, 1.30.1

2. Income Statement for the Year

Purpose: publication
Basic Standards: 1.22.2-3, 1.25.4, 1.26.2, 1.29.1, 1.30.1

3. Consolidated Statement for the Half-Year

Purpose: publication
Basic Standards: 1.21.2, 1.24.3, 1.24.5

4. Consolidated Statement for the Year

Purpose: publication
Basic Standards: 1.21.2, 1.24.3, 1.24.5

5. Model
INCOME STATEMENT
At: __/__/__

Institution or Conglomerate:
Address:
Tax ID:

CODE	DESCRIPTION	CURRENT HALF-YEAR/YEAR	PREVIOUS HALF-YEAR/YEAR
10	**REVENUES FROM FINANCIAL INTERMEDIATION**		
711	- Credit Transactions		
713	- Leasing Transactions		
715	- Revenues from Securities Transactions		
716	- Revenues from Derivatives		
717	- Earnings from Exchange Transactions		
719	- Earnings from Mandatory Investments		
15	**FINANCIAL INTERMEDIATION EXPENSES**		
812	- Market Fundraising Transactions		
814	- Loans and On-Lending Transactions		
816	- Leasing Transactions		
(*)	- Earnings from Exchange Transactions		
820	- **Allowance for Doubtful Accounts**		

23. From the analysis of part of the COSIF plan transcribed above, it may be inferred that the grouping code for purposes of publication no. 820 - Provision for Doubtful Accounts - integrates group 15 - financial intermediation expenses, concluding that BACEN itself considers the PCLD expense as a "*financial intermediation*" expense. Grouping code 820 refers to the COSIF accounts related to the Allowance for Doubtful Accounts, namely:

OSIF Account	Denomination
-) 8.1.8.30.30-9	Allowance for Doubtful Accounts
+) 7.1.9.90.30-7	Reversal of Allowance for Doubtful Accounts

24. So much so that the PGFN, by way of PGFN/CAT Opinion no. 325/2009, which, although its scope is a factual matter different from the case at bar, ended up exploiting not only the normative structure, but also the definition of "*financial intermediation*", as also inferred from the mention and transcription of part of the mentioned COSIF, as follows:

"20. Note that **the financial intermediation or intermediated financial activity is carried out through typical financial institutions (banks, credit companies and credits unions), that raise funds with surplus economic agents and on-lends them to deficit economic agents**.

21. It can therefore be seen that the mediation or financial intermediation is the activity of raising funds together with surplus economic entities and on-lending them to the deficit economic units, according to KAUFMAN.

(...) 23. Back to the case at issue, it is clear that the legislation, when referring to expenses incurred in financial intermediation transactions, refers to those operations practiced by typical financial institutions, that is, to intermediated financial activity, where the raising of funds is essential.

24. To prove this affirmation, please refer to the Accounting Plan of the Institutions of the National Financial System - COSIF, created by Circular no 1,273, on December 29, 1987 – which provides for the accounting criteria and procedures to be complied by financial and other institutions authorized to operate by the Central Bank of Brazil, with the purpose of standardizing the procedures for recording and preparing financial statements – to which the financial institutions and entities equivalent thereto are subject (including the Plaintiff, which is a company overseen by the Central Bank of Brazil)

25. COSIF presents a spreadsheet that, in the preparation of the financial statements, must be filled in by the financial institutions and equivalent entities.

26. This spreadsheet states, in item 15, the financial intermediation expenses as follows:

CODE	DESCRIPTION	CURRENT HALF-YEAR/YEAR	PREVIOUS HALF-YEAR/YEAR
10	**REVENUES FROM FINANCIAL INTERMEDIATION**		
711	- Credit Transactions		
713	- Leasing Transactions		
715	- Revenues from Securities Transactions		
716	- Revenues from Derivatives		
717	- Earnings from Exchange Transactions		
719	- Earnings from Mandatory Investments		
15	**FINANCIAL INTERMEDIATION EXPENSES**		
812	- Market Fundraising Transactions		
814	- Loans and On-Lending Transactions		
816	- Leasing Transactions		
(*)	- Earnings from Exchange Transactions		
820	- **Allowance for Doubtful Accounts**		

Financial System Standards – Cosif>Cosif>CHAPTER 3 – DOCUMENTS > Document no. 8 – Income Statement

27. **Note that the expenses recorded in the financial intermediation expenses are** 'expenses with market fundraising transactions', 'expenses with loans and on-lending transactions', 'expenses with leasing transactions', 'earnings from exchange transactions' and '**allowance for doubtful accounts'** (...)" (emphasis added.)

25. As seen, both BACEN, when imposing an accounting standard to the financial institutions, and the PGFN, when addressing the event of deduction the financial intermediation expenses from the PIS and COFINS' tax basis, but not the PCLD but rather another type of expense, considered that the PCLD is one of the expenses incurred in the financial intermediation.

D) DIRECT RELATIONSHIP OF PCLD WITH THE FINANCIAL INTERMEDIATION

26. In this regard, it should be noted that the mentioned conclusions were not reached hurriedly, since, in the performance of this activity, formed by the funding-investment binomial, the intermediary incurs several corresponding expenses that are intrinsic to its activity, among which, **expenses related to PCLD**.

27. It is worth stressing that the concept of financial intermediation should be analyzed keeping in mind that National Financial System fulfills the function of being a set of bodies that regulates, supervises, and executes the necessary operations for the circulation of currency and credit in the economy, and is thus composed of several institutions, presenting two subsystems: (i) normative and (ii) operating.

28. In fact, the normative subsystem is made up of institutions that set the rules and guidelines for the operation of the financial system, in addition to defining *financial intermediation* parameters, as well as the inspection and activities of operating institutions.

29. In turn, the operating subsystem is composed of institutions that operate in the *financial intermediation*, whose function is to put the transfer of funds between fund providers and borrowers into practice, according to the rules, guidelines, and parameters defined by the normative subsystem[4].

30. This is what can be inferred from the accurate definition of the specialized doctrine:

"All economies today have financial systems in which currency, along with many other systems, plays the role of a financial asset. And the operationalization of the system is carried out by the set of financial institutions aimed at the management of

[4] As per clarifications contained on the website of the Brazilian Federation of Banks ("**FEBRABAN**"), on "http://www.febraban.org.br/febraban.asp?id_pagina=31"

the monetary policy of the government through specific markets, such as the credit, capital, monetary, and foreign exchange markets. In order to maximize liquidity and productivity in the economy, it is necessary to distribute the saved funds to those who need them, who in turn will move the economy through investment.

Due to this, it is virtually impossible to accurately associate the terms and volumes saved with the demand for loans. Therefore, there is a need for an **intermediary that will collect the saved funds**, at an indefinite term, indefinitely, for the agents that need them at a predetermined term. In performing this role, the intermediary acquires a great responsibility for **taking the risk of non-payment by the borrowers**, by adding the savings of several savers in order to supply the demand of big investors." (NOGAMI, Otto. Economia, Ed. IESDE Brasil S.A., 2012, p. 163 - emphasis added)

"According to the conventional view, the financial intermediation process consists of channeling resources from savers to investors. Through this process, the economic agents that have productive investment opportunities (investors) obtain the necessary funds in order to implement their investment plans. That is, a financial intermediary (FI) connects savers (fund offerors) and investors (fund borrowers), facilitating the performance of productive investments in a capitalist economy. An FI is therefore a firm that renders financial intermediation services between fund offerors and applicants.

Financing occurs indirectly: the FI –based on deposits provided by surplus units – acquire primary securities from deficit units (which will make up the FI's securities portfolio) and, on the other hand, grant credit to the deficit units. In the view of Gurley and Shaw (1955), the basic role of the FIs is to remove from the financial market the (majority) share of the primary securities and replace them with secondary securities issued by them. Or otherwise, according to Freixas and Rochet (1997, p. 15) this is an 'economic agent specializing in the (simultaneous) purchase and sale of financial contracts of financial assets (securities)' (...)

Among the several types of FI, the most important are: commercial banks; investments banks; development banks; insurance companies; pension funds; credit, financing, and investment companies; mutual funds; and brokerage firms and securities distributors". (MODENESI, André de Melo, "Teoria da Intermediação Financeira, o modelo ECD e sua aplicação aos Bancos: uma Resenha" In "*Sistema financeiro: uma análise do setor bancário*"; Rio de Janeiro. ed. Elsevier, 2007, p. 62-63.)

31. To corroborate such a position, article 17 of Law no. 4,595/1964, in defining financial institutions, objectively brings forth the concept of "financial intermediation", as follows:

"Art. 17. For the purposes of the legislation in force, financial institutions are considered the public or private legal entities that have as **their principal or ancillary activity the collection, intermediation, or investment of financial resources of their own or of third parties**, in national or

foreign currency, and the custody of third-party values" (emphasis added.)

32. It is of note, therefore, that the financial intermediation activity consists of two ends (funding and investment) that necessarily co-exist. Thus, in the development of this activity, the institution takes on both the commitment to return to savers the raised funds plus remuneration (interest) and the risk of non-payment by the borrowers of such funds (of the credit granted by the institution) (i.e. at the investment end), **constituting default in an expense inherent to the activity it exercises in this intermediation, since even not having received the funds from the credit borrowers, it is obliged to return them to the investors.**

33. In this regard, it is worth pointing out that Resolution no. 1,138, dated Nov. 21, 2008 of the Federal Accounting Council, presents, among other definitions, which expenditures compose the mentioned intermediation expenses:

"29. In banking activities, by convention, it is assumed that expenses with financial intermediation are to be part of the net wealth formation and not of its distribution.

Financial intermediation expenses - **include expenses with** fundraising operations, **loans, on-lending transactions, leasing and other expenses.**" (emphasis added)

34. This is what can also be inferred from the notes of Décio Porchat[5], when distinguishing the financial market from the capital market, as follows:

"As with any definition proposed by the doctrine, among the several works that address the subject, we will find different definitions for the expression "financial market". The traditional current is based on the existence of two distinct markets, one called financial and the other the capital market. Both would have in common the purpose of mobilizing savings from surplus economic units to those in deficit that require money to fund themselves.

However, while the former would have as a feature the intermediation of a financial institution by raising funds from savers and lending them to borrowers, the second (capital market) would be characterized by the direct raising of funds by the savers' borrowers, without the participation of a financial institution mediating the operation. It is also worth noting that the **intermediation of a financial institution by raising funds among savers and granting credit to borrowers denotes another important feature of the financial market that differentiates it from that of capital, that is, the shifting of the credit risk (originally the saver's, in the capital market) to the financial institution.**

Actually, the financial institution will perform borrowing activities with the savers, who in turn will provide the funding, that is, the financial resource for its lending activities with the borrowers. Within this context, the difference between the cost of

[5]Porchat, Décio, "Mercados Financeiro e de Capitais: Investimentos em renda Fixa."*in Tributação dos Mercados Financeiro e de Capitais e dos Investimentos Internacionais - Série GV Law*, 1ª Ed. Ed. Saraiva, 2011, p. 26 and 27.

funding with savers and the amount available of said funds to borrowers is what in the financial market is conventionally called spread. (...)"

35. In fact, financial intermediation consists of the raising of funds for a given term and at a given cost (interest and other charges) with *surplus* economic agents, to later invest said funds for a given term and cost (bank *spread* and other expenses) in transactions entered into with the deficit economic agents, and the investment risk is assumed by the intermediation institution itself

36. Therefore, upon the setting of the intrinsic relationship between the financial intermediation and the risk of default assumed by the financial institution, it should be noted that the obligation to recognize such risks is strictly regulated by the Central Bank.

E) RULES IMPOSED BY BACEN FOR THE FORMATION OF THE PCLD

37. It is important to bear in mind the guidelines set by Resolution no. 2,682/1999, enacted by BACEN to delimit the "*classification criteria of credit operations and rules for the formation of allowance for doubtful accounts*", which brought about major changes in relation to its predecessor, Resolution no. 1748/1990.

38. In fact, Resolution no. 1,748/1990 did not provide for the prognosis of the allowances in a preventive manner, as it did not establish clear and objective guidelines as to its formation.

39. In order to fill this, among other gaps, Resolution no. 2682/1999 attempted to define such rules, adapting the system to international standards.

40. The study carried out by Guilherme Gonzalez Cronemberger Parente is in this regard, at the time of his job as a BACEN[6] Inspector, as follows *in verbis*:

"Essentially, the new Resolution establishes 9 risk classification levels for the transactions, to be attributed to the credits granted by the financial institutions. **Minimal aspects to be followed during the classification were also established, as well as the necessary relationship between the delay in the payment of installments and the minimum classification, and it was determined that for delays exceeding 180 days, provision will be made for 100% of the book value of credits."** (emphasis added)

41. This need to set objective criteria for the formation of the PCLD by the Financial Institutions is also observed in an academic work developed on the subject[7], as follows:

"For financial institutions in general, the formation of the PCLD presents distinguished features when compared with the procedures carried out by the other companies, since **the asset**

[6] PARENTE, Guilherme Gonzalez Cronenberger, *in* "*As Novas Normas de Classificação de Crédito e Disclosure das Provisões: uma abordagem introdutória*" – available on http://www.bcb.gov.br/ftp/denor/guilherme-parente-bcb.pdf, on Oct. 13, 2016.

[7] SILVEIRA, Grace Mello, in "*Critérios de provisões para créditos de liquidação duvidosa para instituições financeiras*", article submitted to the School of Economic Sciences of the Federal University of Rio Grande do Sul, in 2010 – Available on http://hdl.handle.net/10183/27220, on Oct. 13, 2016.

to be provisioned has specificities: (...)As a basis for a reliable measurement of allowance for doubtful accounts (PCLD) in financial institutions, the National Monetary Council (CMN), in its Resolution no. 2,682/99, provides for the rules for the formation of an allowance for doubtful accounts, deriving from the classification criteria for credit operations.

"(...) the PCLD for financial institutions and other companies authorized to operate by the Central Bank of Brazil is regulated by the National Monetary Council. In addition to provisions of CPC 01, the financial institutions and other referenced companies are to classify their debtors (and guarantors) by risk levels, categorizing them in relation to the nature, purpose of the transaction, characteristics of the guarantees, and liquidity potential.

It further classifies the credit in relation to default periods, and sets percentages for each set of amounts in arrears (levels B to H) to be considered in the formation of the PCLD.

Thus, constitution of the allowance for doubtful accounts in financial institutions will be formed taking into account the classification of the credit portfolio, which is not expressly provided for in the Conceptual Structure for the Presentation and Preparation of Financial Statements. However, based on NBC T1, **we can already verify that the provision for doubtful debts in financial institutions, currently regulated by CMN resolution no. 2.682/99, meets the requirements established by the Federal Accounting Council (CFC), since it presents reliable bases for measuring the provisioned amount**.

(...)What is important is that the criteria adopted by companies authorized to operate by BACEN can be used by commercial companies, making the commercial organizations have greater and more effective control over their customers that buy in the long term. I believe that the PCLD in Financial Institutions is measured in more reliable sources compared to the other companies, as provided for in NBC T1, in addition, we can also present the issue of comparability of financial statements as another advantage brought forth by Resolution CMN no. 2 682/99, since through this resolution, updated by resolution CMN no. 2.697/00, we can compare the financial statements of the companies regulated by BACEN, thus enabling their use by their users." (emphasis added)

42. Therefore, if for the legal entities not authorized to carry out financial intermediation the constitution of the PCLD is the result of good accounting management, for financial institutions it appears to be a mandatory procedure based on the strict rules established by the Central Bank.

43. In fact, the PCLD seems to be one of the major adjustments to the asset, since it **greatly influences the income of the financial institution**.

44. What is meant by this is that the risk of default and therefore the PCLD expense is not secondary to the typical activities of financial institutions, not even an accounting adjustment, but actual expenses in which the financial institutions incur when they assume the risk of lending operations, as evidenced previously.

45. Therefore, it is necessary to consider the delimitation of strict criteria for the formation of the PCLD imposed by BACEN, if it is accepting its impact on

the adjustment of accounts receivable and, consequently, its nature of effective expense inherent to the *financial intermediation* activity performed by the financial institutions.

46. In fact, in view of what BACEN sees as a risk of loss with doubtful debts, Resolution BACEN no. 2,682/99 imposes on financial institutions the establishment of the corresponding PCLD, with the corresponding entries of doubled items:

C – PCLD (Allowance for Doubtful Accounts)
D – Result: PCLD Expense

47. It is noted that since its formation, the PCLD creates a true expense to the financial institutions, scaled according to the risk level classification of the operation, as per the criteria established in articles 4 and 6 of BACEN Resolution no. 2,682/99, and, as of the 180 days of delay, the PCLD starts to comprise 100% of the operation. With an additional 180 days of delay, that is, 360 days, the credit will be written off and transferred, for control purposes only, to clearing accounts; however, the expense will remain intact since its original constitution.[8]

48. The nature of the expense with the formation of the PCLD, regardless of the risk level of the operation, constitutes an actual expense, provided that only in the event of a receipt through renegotiation should they be appropriated as financial institution revenues, as provided for in paragraph 2, of article 8, of Resolution no. 2,682:

"Paragraph 2. Any gain earned through the renegotiation is to be appropriated to the result at the time of its actual reception."

49. Incidentally, BACEN Circular Letter no. 2,899/2000 is a complement thereto when providing that:

12. We further clarify that:
(...) VIII - any gain earned in the renegotiation of credit transactions, calculated by the difference between the renegotiation value and the book value of the credits, is to be recorded in a subtitle of internal use of the account that records the credit and be appropriated to the result only at the time of its reception, by registering in the EARNINGS FROM CREDIT TRANSACTIONS account, according to the criteria set in the renegotiation or in proportion to the new maturity dates;
IX - the credits written off as losses and that are renegotiated are to be recorded for the exact amount of the renegotiation, subject to the provisions in the previous item as to the recording of the gain, to the credit of the account RECOVERY OF CREDITS WRITTEN OFF AS LOSSES, with the simultaneous writing off of their values of the respective clearing accounts; (...)"

[8] Resolution No. 2,689: **Art. 7. The transaction classified as level H risk is to be transferred to a clearing account, with the corresponding debt in the provision, after six months of its classification in this risk level, the registration in a shorter period not being allowed.**
Sole paragraph. The transaction classified as set forth in the heading of this article is to remain recorded in a clearing account for a minimum five-year period and until all the collection procedures have been exhausted.
Circular Letter no. 2,899:
12. (...) VI - the transaction classified as level H risk should be transferred to the clearing account, subject to the provisions of art. 7. of Resolution n. 2,682, of 1999, provided that there is a delay of more than 180 days; (…)

50. Therefore, it may be observed that the expense with the creation of the PCLD is considered to be effectively incurred, unless it is recovered through one of the ways previously provided for, a very relevant explanation for the comprehension of the effects of its exclusion from the PIS and COFINS 'tax basis, sought herein.

51. It can be verified that the PCLD, though improperly referred to as a provision, according to BACEN's determination, is not merely an expectation of expense for the financial institution, but instead an expense effectively incurred in the financial intermediation, which is recognized by BACEN itself when imposing its accounting treatment.

52. The characterization of the PCLD as an expense obviously occurs since the uncertainty lies in the receipt of the credit in arrears, which is doubtful since it turned into a default, and not in the accounting of its loss, complying with BACEN's strict criteria.

II - CONCLUSION:

Thus, there is a clear possibility of deducting the PCLD from the tax basis of the COFINS and PIS.