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IFC Review

Headlines and Tax Returns: Questionable Expenses, Fictitious Invoices, and the Obligations of the Tax Professional

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Headlines and Tax Returns:

**Questionable Expenses, Fictitious Invoices, and the
Obligations of the Tax Professional**

**ABA 9th Annual U.S.-Latin America Tax
Planning Strategies Conference**

Thursday June 9, 2016

2:00 p.m. – 3:30 p.m.

Concurrent Session A

Description

As questionable expenses, fictitious invoices, and other improper corporate and government actions make headlines in the region, tax professionals face the challenging task of deciding how these events must be reported on various tax returns. Inspired by true events, panelists in this concurrent session will consider the tax treatment of sensitive matters (such as the deductibility of fines, penalties, questionable payments, and similar disbursements) as well as ethical considerations that arise in such circumstances.

Fictitious Invoices

Argentina

Alejandro Ramallo

■ Fictitious Invoices

Agenda

1. Definitions
2. Tax treatment in Spanish Speaking South America (SSSA)
 - i. Argentina
 - ii. Chile
 - iii. Colombia
 - iv. Ecuador
 - v. Peru
 - vi. Venezuela
 - vii. Some Leading cases
3. Tax defense file – Tips to follow
4. SSSA – E billing status 2016

- **Fictitious invoices (FI):**
 - **In general, FI are considered as a document that seems, in its formal aspects, as a regular invoice, but is not a legal invoice with Fiscal attributes.**
 - **FI in few countries unless legal invoice, are normally rejected by the fiscal authorities because the biller is having fiscal issues.**
 - **Lastly, we can consider as FI the payments done without any proper document.**

□ Tax treatment in SSSA (South America)

- Argentina 
- Chile 
- Colombia 
- Ecuador 
- Peru 
- Venezuela 

■ Argentina

- FI are impact by 3 kinds of issues as explained below :

- The tax expense is not deductible in general

 - Exemptions: Fixes Assets or Inventories

■ Legal Sanctions

 - Additional Tax: 35 % of the expense.

 - Tax fines: 200 to 1000% of the tax avoided

 - Criminal Punishment: Imprisonment for up to 9 years for the legal representatives.



□ Chile

- **Expenditure rejected** (They do not qualify as required for income / no documented expenses / disbursements of cash or kind)
- **Legal Sanctions**
 - **Additional Tax: 35 % of the expense.**
- **FI were absence or lack of legal invoices.**
- **The tax expense is not deductible.**
- **Legal Sanctions**
 - **Tax fines: 50 to 300% of the tax avoided.**
 - **Criminal Punishment: Imprisonment for up to 15 years for the legal representative**



□ Colombia

- FI are restricted to a list issued by IRS reporting companies with lack of controls
- The expense is not tax deductible.
- Legal Sanctions
 - Tax fines: maximum 160% of tax avoided by the Company. The legal representative could receive a tax fine of 20% of the tax avoided.
 - Criminal Punishment: It does not apply.



□ Ecuador

- FI are considered as lack of legal invoices.
- The expense is not tax deductible.
 - However, fixed assets is an exception
- Legal Sanctions
 - Tax fines: from U\$S 90 to U\$S 1.500.
 - Criminal Punishment: Imprisonment for up to 3 years for the signing of the tax return and / or legal representative



□ Peru

- FI are considered of legal invoices absence
- The expense is not tax deductible.
- Legal Sanctions
 - Tax fines: maximum 50% of tax avoided.
 - Criminal Punishment: Imprisonment for up to 12 years for the legal representative
 - However, if the document has some formal deficiencies, but effective payment is verified the sanction only is a fine of 4.1%.



□ Venezuela

- FI are considered as lack of legal invoices.
- The expense would be not tax deductible.
- Legal Sanctions
 - Tax fines: Administrative sanctions. Non material amounts.
 - Criminal Punishment: Does not apply.



Leading cases

Argentina – Alejandro Ramallo

- **Argentina**
 - **Austral Consturcciones**
 - **Caso Gotti**
 - **Skanska**

- **Chile**
 - **Caso Penta**

Tax defense file – Tips to follow

- Keep legal invoices and support documentation in a proper record for statute of limitation** (different in any country with 3 & 10 years average).
- Work close to Procurement department in building right procedures manual to accept a new supplier.**
- Often Check IT suppliers database in local ERP, (ideal monthly basis) with the “IRS black-list” (if exist) of suppliers to avoid do business with tax fraudulent or suspicious companies.**

SSSA - E-Billing status 2016

	Argentina	Chile	Colombia	Ecuador	Peru	Venezuela
Electronical Invoices are mandatory?	Yes, with exceptions	Yes (on going)	Yes (on going)	Yes (on going)	Yes (on going)	No
Could you check a list of FI or "IRS black-list" suppliers database?	Yes	No	Yes, but it is limited	S/D	Yes	No
Are legal representatives responsables by tax issues/punishments?	Yes	Yes	Yes	Yes	Yes	Yes

Deduction of Questionable Expenses in Colombia: The Position of the Colombian Council of State

Colombia
Andrea Nieto

Agenda

- I. Introduction. Requirements on the deduction of expenses.**
- II. Statements by the Council of State**
- III. Methodological analysis followed by the Council of State and obligations of the tax professional.**

Deduction of Questionable Expenses in Colombia: The Position of the Council of State

□ I. Introduction.

- Requirements on the deduction of expenses under tax regulations:
 - Causal Relationship
 - Necessity
 - Proportionality

Deduction of Questionable Expenses in Colombia: The Position of the Council of State

□ Mandatory contributions to Public Entities.


	Tax Administration	Council of State
Contribution paid to the Superintendence of Companies	It is not necessarily or customarily incurred, even if its payment is mandatory.	It is a necessary expense as the company is complying with a legal duty. Indirect causality is sufficient in this case.

Deduction of Questionable Expenses in Colombia: The Position of the Council of State

□ Labor Indemnities

	Tax Administration		Council of State
	Before the Council of State	In its Rulings	
Labor Indemnities	<ul style="list-style-type: none"> - Qualify as labor payments and must comply with the requirements for the deductibility of labor payments (withholding tax) (2011) - Are not deductible as do not have causal relationship (2009) 	<p>Payments for compensations are deductible and have relationship causality. (2000-2014)</p>	<ul style="list-style-type: none"> • Indemnities for justified or unjustified dismissal do not constitute a labor payment - Do not have causal relationship and are not necessary with the activity producing the income.

	Tax Administration	Council of State
Conciliations	<p>Qualify as labor payments and must comply with the requirements for the deductibility of labor payments (withholding tax)</p>	<p>It is necessary to evaluate the components of the payment.</p>



Deduction of Questionable Expenses in Colombia: The Position of the Council of State

□ Penalties

		Tax Administration	Council of State
Penalties	Environmental penalties, clean-up and closure costs	Do not have causal relationship with the activity producing the income.	Do not have causal relationship with the activity producing the income.
	Anti-trust settlements		
	Tax penalties		

Deduction of Questionable Expenses in Colombia: The Position of the Council of State

- **Bribe Payments and Fictitious Invoices: Treatment of expenses incurred in performance of criminal activities.**
 - Fictitious invoices: Included in the Criminal Code as crime: "Fraud in private document".
 - Bribes: Included in the Criminal Code as crime: "Bribery"

Deduction of Questionable Expenses in Colombia: The Position of the Council of State

□ III. Conclusion

- Methodological analysis followed by the Council of State:
 - Analysis of the corporate purpose of the taxpayer
 - Interference of the expense in the activity producing income
 - If the expense is compulsory in accordance with the law, with the obligations related to corporate governance or with commercial practice.

Deductibility of Expenses

Switzerland

Nils Harbeke

Agenda

- 1. Introduction**
- 2. Penalties in general**
- 3. Tax penalties**
- 4. DoJ penalties**
- 5. «Useful payments»**

Introduction

Statutory accounting	Tax	
Statutory accounts	Tax-Deductible	Expenses incurred for valid business reasons in general
		Some explicit examples in the tax law; tax itself is tax-deductible
	Not Tax-Deductible	Special limitations on tax-deductibility (e.g., tax penalties)

- ❑ **Swiss corporate income tax base: statutory stand-alone accounts; no separate tax accounts**
- ❑ **Expense item deductible if incurred for «valid business reasons»**
- ❑ **Special feature: Swiss corporate income tax levied on profit after tax**
- ❑ **Tax laws provide for some (few) special provisions to limit deductions, e.g., tax penalties**

Penalties in general

Statutory accounting	Tax	
Statutory accounts	Tax-Deductible	Expenses incurred for valid business reasons in general
	Tax-Deductible	Some explicit examples in the tax law; tax itself is tax-deductible
	Not Tax-Deductible	Special limitations on tax-deductibility (e.g., tax penalties)

«Tax-deductible expenses include

- Swiss taxes and non-refundable foreign taxes...

... but not Tax **Penalties**»

→ Debate about tax-deductibility of penalties in general

Tax-deductibility of penalties (other than tax penalties)?				
		Doctrine	Recent Case law	Federal Council
		Various views in Swiss legal doctrine	<ul style="list-style-type: none"> Decision of the Zurich Administrative Court Deductibility of penalty against a car manufacturer under EU antitrust law? 	SFC report, 9.12.2014, concerning tax-deductibility of fines and financial administrative sanctions
Type of Penalty	Disgorgement of profits	Deductible	Deductible	Deductible
	Penal character / «Fine»	<ul style="list-style-type: none"> Not tax-deductible No «valid business reason» <input type="checkbox"/>	<ul style="list-style-type: none"> Deductible Only <u>tax</u> penalties are explicitly excluded by the law. 	<ul style="list-style-type: none"> Deductible Only <u>tax</u> penalties are explicitly excluded by the law.
		Pending tax law revision: <u>Explicit</u> adaption of the Federal Council's view.		

Tax Penalties

Statutory accounting	Tax	
Statutory accounts	Tax-Deductible	Expenses incurred for valid business reasons in general
	Tax-Deductible	Some explicit examples in the tax law; tax itself is tax-deductible
	Not Tax-Deductible	Special limitations on tax-deductibility (e.g., tax penalties)

«Tax-deductible expenses include

- Swiss taxes and non-refundable foreign taxes...

... but not **Tax** Penalties»

- ❑ Unclear if tax penalties paid outside Switzerland are also excluded
- ❑ Current discussions: Deductibility of penalties paid by Swiss banks to the US Department of Justice (DoJ) under Non-Prosecution Agreements (NPA)? – «DOJ penalties»

DOJ penalties (I)

□ Background

- «Joint Statement» USA/Switzerland, dated August 29, 2013: «US-program»
- Way for Swiss banks to settle potentially non-tax compliant situations

□ 4 categories of Swiss banks

- Category 1**
- Criminal proceedings already pending in the US
 - Bank cannot join the US-program
 - Individual negotiations only

- Category 2**
- «Good reasons» to believe that the bank violated US law in the past
 - Request to DoJ for «Non Prosecution Agreement» (NPA) until 12.31.2013
 - In the NPA the DoJ agrees not to institute criminal proceedings...
...if the bank discloses information about the bank's US business...
□.and if the bank pays a penalty to the DoJ□

- Category 3**
- Bank believes that US law was not violated
 - No penalty□

- Category 4**
- Bank has only «local clients» as per the FATCA definition
 - No penalty

DOJ penalties (II)

Statutory accounting	Tax	
Statutory accounts	Tax-Deductible	Expenses incurred for valid business reasons in general
	Tax-Deductible	Some explicit examples in the tax law; tax itself is tax-deductible
	Not Tax-Deductible	Special limitations on tax-deductibility (e.g., tax penalties)

«Tax-deductible expenses include
 - Swiss taxes and non-refundable foreign taxes...
 ... but not Tax Penalties»

Tax-deductibility of DoJ penalty for Swiss «Category 2» banks?		
«Tax» Penalty?	Tax «Penalty»?	Disgorgement of profits?
<ul style="list-style-type: none"> * DoJ payment does not necessarily imply actual violation of tax law. * Bank is not concerned as tax payer but involved as having - potentially - assisted in tax avoidance. * Bank may pay the penalty solely to minimize reputational risks. * No final court decision but settlement based on agreement. 	<ul style="list-style-type: none"> ✓ «Substitute penalty» instead of a penalty the bank would - potentially - have to pay in case of US criminal proceedings. ✓ Calculation of the DoJ penalty considers the bank's «guiltiness» (i.e., the later the bank account was opened the higher the penalty). ✓ DoJ Penalty does not fit into the Swiss legal system, i.e., qualification as «penalty sui generis». 	<ul style="list-style-type: none"> ✓ DoJ penalty is levied because of the bank's past business activities and the amount of the penalty depends on the size of these business activities. ✓ The penalty is schematically calculated based on the bank account opening date and on the bank account balances.
Swiss Federal Council report, 9.12.2014		
As far as the payment to the DoJ has a penal character the payment is not deductiblebut it is deductible as far as the purpose of the payment to the DoJ is a disgorgement of profits.	
→ Total payment to be split into two components		

«Useful payments»

Statutory accounting	Tax	
Statutory accounts	Tax-Deductible	Expenses incurred for valid business reasons in general
	Tax-Deductible	Some explicit examples in the tax law; tax itself is tax-deductible
	Not Tax-Deductible	Special limitations on tax-deductibility (e.g., tax penalties)

«Costs incurred for corruption in the meaning of the Swiss Penal Code are not tax-deductible»

Commissions etc.	Private Bribery	Granting an advantage	Bribery of public officials
Legal relationships; e.g., provisions, retrocessions, etc.	<ul style="list-style-type: none"> • «Useful payment» <u>to a private person</u> • Distortion of competition • Prosecuted only upon complaint of the victim • Act Against Unfair Competition • Not part of the Swiss Penal Code 	<ul style="list-style-type: none"> • Granting of an advantage <u>to a public official</u> which is not due to him in order that he carries out his official duties. • Swiss Penal Code 	<ul style="list-style-type: none"> • Granting of an advantage <u>to a public official</u> in order to cause him to carry out or to fail to carry out <u>an act in connection with his official activity</u> which is contrary to his duty or dependent on his discretion. • Swiss Penal Code
Tax-Deductible	Tax-Deductible	Not Tax-Deductible	Not Tax-Deductible
	Tax law revision: Not tax-deductible under proposed new law.	If the company records bribe money payments in its statutory accounts and does not disclose this when the tax return is filed, this may qualify as tax fraud (criminal offence).	

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Deductibility, Specific Rules, and more

Brazil

Roberto Duque Estrada

Agenda

Brazil / RDE

- 1. Deductibility – general principle/ rule**
- 2. Deductibility – specific rules vs. administrative fines/ penalties**
- 3. Specific rules – tax fines**
- 4. Specific rules – embezzlement**
- 5. Petrobras case**
- 6. Administrative fines/ Penalties**
- 7. Samarco (Vale/BHP) case**
- 8. Whirlpool vs. CADE case**

Deductibility

- **General principal of full deductibility of costs and expenses**

- **General rule (art. 299 of Income Tax Regulations)**
 - **Operational expenses are deductible if:**
 - Necessary to the activity and maintenance of the “production source”; and
 - Usual or normal.

Deductibility

- **Specific rules**
 - **Tax fines (art. 344, § 5^o of Income Tax Regulations)**
 - **Embezzlement (art. 364 of Income Tax Regulations)**

- **Administrative fines/ Penalties**
 - **General rule (art. 299 of Income Tax Regulations)**

Specific rules

□ Tax fines

■ Deductible

- Compensatory
- Failure to comply with ancillary duties

■ Non-deductible

- Punitive (i.e. tax assessment)

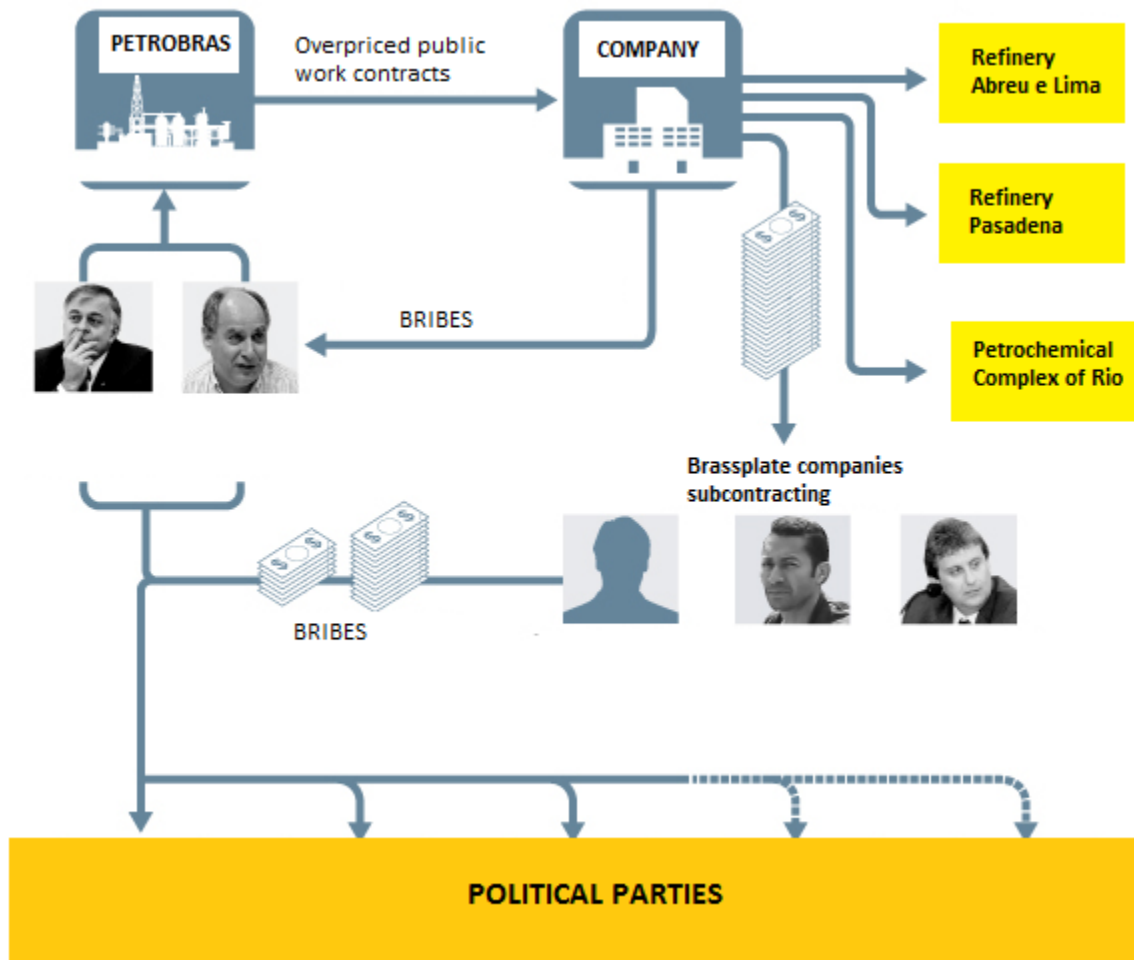
Specific rules

□ Embezzlement (questionable payments)

■ art. 364 of Income Tax Regulations:

Expenses regarding losses due to embezzlement, or misappropriation or theft shall be deductible if committed by an employee or a third party, but only in case there is a labour inquiry running or if a complaint has been filed before competent authorities.

Petrobras case



Petrobras case

- Corruption – Big Loss for Petrobras
 - Amounts recovered will be accounted as income when received
 - The write-off is considered a loss resulting from unlawful activity and subject to the outcome of the investigations in order to establish the actual extent of the losses before they can be effectively deducted from the income tax purpose

Administrative Fines/ Penalties

- **No specific provisions** → **General Rule**
(necessary expenses)

- **Administrative fines :**

- Environmental fines
- Traffic fines
- Fines levied by the Central Bank of Brazil
- Fines levied by CADE (anitrust governmental entity)

Administrative Fines/ Penalties

■ Doctrine (mostly favourable to full deduction)

- necessary to the maintenance of the source of production
 - “unlawfulness of the expense is as irrelevant to its deductibility as the unlawfulness of the revenues is irrelevant to its taxation” (Alberto Xavier)
 - no specific legal prohibition + legal or contractual infraction committed is related to the activity of the company (Ricardo Mariz Oliveira)
 - “risk inherent to the result of economic undertaking” (Joao Dacio Rolim and other)

Administrative Fines/ Penalties

■ Case law (Administrative Taxpayers Council)

- Unfavourable decisions (majority): not necessary to the maintenance of the source of production
 - Failing to observe rules that apply to a certain field (in this case, the electricity company) cannot be considered as an act related to the core of the business activity (Decision 1302-001.486, from 26.08.2014).
 - Allowing the company to deduct such expenses would imply allowing it to transfer part of its penalty to the Public Administration (Decision 1302-001.486, from 26.08.2014).
 - Failing to observe rules in general cannot be deemed necessary to the company's activities (Decision 1802-001.344, from 09.08.2012)

Administrative Fines/ Penalties

- Favourable decisions:
 - **Penalty for failing to comply with energy supply targets – targets are a guarantee that the distributor will not be stuck with its production – penalty is inherent to the business risk – necessary for the maintenance of production source (Decision 108-07.109, from 17/10/2002).**
 - **Fine levied by Central Bank of Brazil –banks are submitted to several rules of the Brazilian Central Bank, thus, any failure to comply with them is inherent to its activities (Decision 101-96.919, from 18/09/2008).**

Samarco case (Vale/BHP)

- **Several penalties – are they deductible?**
 - Settlement w/ Federal Government and State Governments of MG and ES – **R\$ 11 billion**
 - Environmental administrative fines (4 entities) – **approx. R\$ 225 million**
 - Adjustment term w/ Public Prosecutor of the State of MG to repair and compensate for environmental damages – **R\$ 1 billion**
 - Still in litigation before the Judiciary (human rights indemnification and social and environmental indemnification) – **approx. R\$150,3 billion**

Whirlpool vs. CADE case

Cartel conspiracy and price fixing

Whirlpool vs. CADE case

- **The company settled an agreement, which included payments made to...**
 - **... CADE - deductible?**
 - administrative fine

 - **... General Public Interests Defense Fund - deductible?**
 - pecuniary contribution

Thank you!

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