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Compliance and Tax Implications

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The world is following with attention the developments of one of the major all-time corruption scandals, involving one of the symbols of the Brazilian economy, Petrobras. If it was not enough fuzz, now the Federal tax authorities are facing another problem, which is rumor of corruption within the Administrative Court of Federal Tax Appeals ("CARF"). But what can be the potential tax consequences of these two adverse situations?

Any losses caused by the corruption will not be deductible for tax purposes, considering that, for any expense to be deductible, it is required such expense to be incurred in the normal course of business, and that such expense was necessary to maintain and/or develop the source of income.

In addition, any payments performed a company in connection with corruption may be understood as a "payment without a cause", which may attract withholding tax of 35%, grossed-up.

Companies that negotiated with governmental entities and that are under investigation in this corruption scandal are facing problems to be paid by governmental entities, since they were included in the government's black list of suppliers, and to raise funds in the market. With this adverse scenario, some of the major construction companies will have to sell assets to keep their operations in place. As of 2015, losses accrued with the sale of immovable/long-term assets may only be offset against capital gains obtained in future periods, so that if these companies sell their assets at a loss – which is possible in view of the urgency of such sales – they will not be able to use the loss to offset profits from operational activities. Again, any expenses incurred by such companies in connection with the corruption cannot be deductible in Brazil.

And what could be the potential consequences of payment of bribes by non-resident companies? Based on Brazilian tax code, in any case characterized as tax evasion, there is jointly liabilty for anyone who may have had interests in the tax triggering event. So, whatever taxes the implicated persons avoided to pay due to corruption, the payers might be found jointly liable for such taxes due. By being found jointly liable, there is a risk of the Federal attorneys including the bribe payers as severally and jointly liable in tax collection lawsuits, and try to seize any assets that they have in Brazil, including companies' shares.

With regards to CARF, it is sad to watch such an important tribunal being dragged into a corruption scandal, which has led many people to request its end. CARF had its sessions suspended for the time being by order of the Ministry of Finance. No one can defend the mainenance of the corrupts of course, but taxpayers must support the existence and the continuation of CARF, a tax court in which taxpayers may litigate without having to post guarantees, and where they may have their cases heard, analyzed and judged by tax practitioners. Some of the most important decisions on international taxation were taken by such a court, as it is the case of transfer pricing, foreign profits, withholding taxes, application of treaties, etc.

All these adverse consequences evidence the importance of companies operating in Brazil (or with business involving Brazilian companies) having a strict compliance program.

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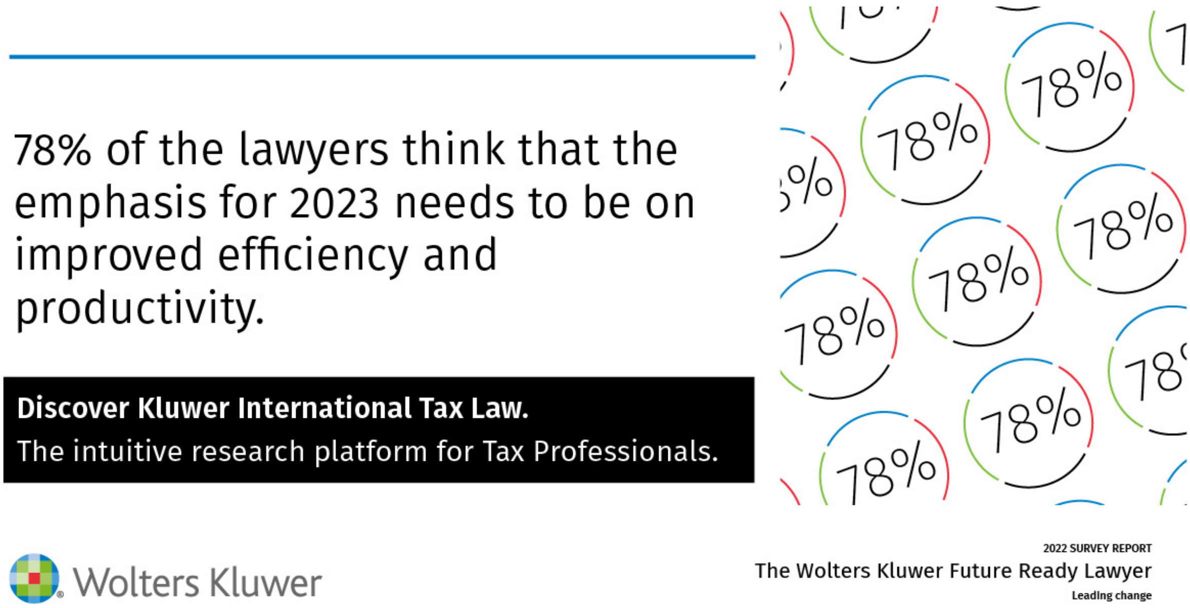

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