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Argentina: Taxation without representation or how to disguise a new tax under the form of an additional prepayment of Income Tax

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1. **Main features of the new extraordinary prepayment on account of Income Tax**

General Resolution 5248/22 (the Resolution), issued by the Argentine Tax Agency (AFIP), and gazetted on August 16, 2022, set forth an extraordinary ("one-time") prepayment on account of Income Tax payable by corporate taxpayers contemplated in article 73 of the Income Tax law (ITL)[i].

Affected taxpayers

The extraordinary prepayment apply to corporate taxpayers that meet any one of the following conditions: (i) the income tax liability for taxable year 2021 or taxable year 2022 is at least AR$100M (approx. u$s 730,000, at the official FX rate) or (ii) the net taxable income assessed for taxable year 2021 or taxable year 2022, before the deduction of accumulated NOLs, is at least AR$300M (approx. u$s 2.2M).

Relevant taxable years for purposes of determining whether the above thresholds are met, in accordance to the Resolution, are: (i) taxable year 2021, if the taxpayer's year-end took place from August to December 2021; (ii) taxable year 2022, if the taxpayer's year-end took place from January to July 2022.

Application of the extraordinary prepayment

The amount of the extraordinary prepayment is to be credited against the income tax liability corresponding to the taxable year immediately following that taken as the basis for the calculation, as per the following rules: (i) tax closings between August and December 2021, in taxable year 2022; and (ii) Tax closings between January and July 2022, in taxable year 2023.

Amount of the extraordinary prepayment

The amount of the extraordinary prepayment is to be arrived at in accordance with the following rules: (i) corporate taxpayers for which the amount of the ordinary income tax prepayments is greater than AR$0: 25% of the amount assessed for the income tax prepayments under the ordinary

regime; (ii) for all other corporate taxpayers: 15% of the net taxable income assessed for the prior taxable year, before the deduction of accumulated tax NOLs

Payment dates

The resulting amount of the extraordinary prepayment is to be paid in three equal and consecutive monthly installments, and the due dates depend on the month of the year-end, starting on October 22, 2022.

2. The Constitutional principle of Reserve or legality

From a legal perspective the public-private collision inherent to taxation is so significant to social equilibrium that states' permissible scope of action and private protection against state overflows in this field are usually set forth in the foundational documents of every organized society. And, thus, modern western constitutionalism adopts almost unanimously the principle of reserve or legality as the clear dividing line between the states' power to impose and the taxpayers' guarantee against illegal levies.

In accordance to this principle, it is beyond all disputes that nobody is obliged to contribute to public needs beyond the scope of a legal mandate, i.e., a law enacted by parliaments in the exercise of the state tax jurisdiction.

The principle of reserve is expressly contemplated in the Argentine Constitution (article 19, and its progeny, articles 4, 14, 17, 18, 28 and 33). Pursuant to these constitutional rules, a law passed by Congress is needed to (i) set forth regulations exercising the State's policy power which limit the legal freedom of persons (articles 14, 28, and 33); (ii) set forth and apply criminal sanctions (article 18); and (iii) set forth and impose levies exercising the State's tax power (articles 4 and 17); and (iv) expropriate for reasons of public utility (article 17).

In the instant case, the issue is whether the Executive Power (through the tax agency, AFIP) is contravening the principle of reserve by creating administratively a new levy, something that is far beyond its constitutional and legal competence.

3. Relevant aspects of AFIP's competence and the Income tax system concerning prepayments and withholdings on account of the final tax liability

The rules governing the organization and competence of AFIP[ii][1] allow the Agency, *inter alia*, to issue general mandatory rules for taxpayers, other responsible parties, and even and third parties, in matters in which the laws authorize AFIP to regulate their situation vis-à-vis the Administration. In particular, concerning what is relevant here, AFIP may dictate mandatory regulations in relation to the form and deadline for tax return submissions , and forms for the administrative liquidation of taxes; modes, terms and extrinsic forms for the perception of taxes, as well as payments on account, advances, accessories and fines; the creation, action and suppression of withholding, collection and information agents; and, in general, any other measure that may be deemed convenient by the Agency to facilitate the application, collection and control of taxes.

Moreover, the Tax procedure law,[iii] empowers AFIP to require, until the expiration of the

general term or until the date of presentation of the tax returns, whichever is later, the payment of amounts on account of the final tax liability for the tax period for which the advances are settled.

In this sense, the Argentine Supreme Court of Justice has long held that (i) from a formal point of view, advances (and payments on account) are tax obligations independent of the tax to which they correspond; (ii) but from a substantial point of view, such advances or payments on account are so inherently related to the final tax, that they cannot exceed the amount of the final tax to which they are linked.

Within this logic, i.e., prepayments and withholding are to be settled on account of the final tax liability and cannot exceed it. The Resolution on prepayments[iv] (i) set forth 10 prepayments for corporate taxpayers, determined on the basis of the tax assessed for the immediately preceding period, net of accumulated NOLs; and (ii) permits the taxpayers, whenever they have reasons to believe that the prepayments according to the general regime described above, will exceed the final amount of the tax obligation of the current tax period, to make the prepayments for an amount equivalent to that resulting from the estimate of the final tax liability they may make. This option may be exercised from the first advance payment when the taxpayer considers that the amounts of prepayments to be made in accordance with the general regime will exceed, by more than 40%, the estimated amount of the final tax obligation for the period.

Similarly, taxpayers are allowed to request an exclusion from withholdings, whenever the withholdings to be made during the tax period may originated an excess over the tax liability corresponding to the same period.[v]

Based on the foregoing, it is clear that the competence of AFIP to set forth prepayments and withholding on account of the final income tax liability for the tax period is always linked to the latter, as the text of the corresponding general regimes recognized it by allowing the recalculation of prepayments and/or the exclusion from withholdings if and when their application in accordance to the general rules may result in an excess payment over the final tax liability. And this is so because, otherwise, the excess payments would be deemed a payment without legal cause within the Income Tax system.

4. **The Extraordinary Income tax prepayment. A search for characterization: Income tax, Windfall tax, or autonomous levy without a legal basis for application**

Analyzing the true nature of the new extraordinary prepayment is crucial to asserting its legitimacy on constitutional grounds, and the tax agency's competence to create and regulate it through the Resolution.

The whereases of the Resolution through some of their paragraphs appears to justify the creation of the prepayment on the perceived existence of extraordinary profits in some sectors of the economy, in the following terms:

"That at the beginning of this year the world economy was affected as a result of the war in Eastern Europe, due to a general and extraordinary increase in international prices, especially of commodities, food and energy."

"That our country, as a historical exporter of some of the goods that registered extraordinary increases in their international prices, benefited from an improvement in the exchange terms."

"That, as a result of this exceptional situation, local economic stakeholders have benefited by obtaining extraordinary income from the sale of certain products and services." And

"That, in the face of this type of situation, it is necessary for the state to take an active role, generating instruments that allow … a progressive redistribution of income, with the state as a whole being the one that must address inequalities, especially in a context where few companies were the beneficiaries…"

If we look at the transcribed paragraphs, it appears that through an extraordinary prepayment scheme, the Resolution is aimed at apprehending the extraordinary profits of sectors that are not expressly singled out in its dispositive text, but are easily presumed to be basically commodities, food, and energy. This is, however, a sort of dictum more related to an earlier (never approved) Windfall tax bill sent by the Executive Power to Congress on June 8, 2022, that a statement directly related to the features of the extraordinary prepayment contemplated in the Resolution. First, because the extraordinary prepayment is not legally targeted to any particular sector of the economy, and, second, because it is designed to apply (in economic terms) even to medium size entities. In this sense, the idea of a disguised creation of a European style windfall tax targeting particular sectors of the Economy, which would have anyway required a law passed by Congress, fade away.

Notwithstanding the *nomen iuris*, the extraordinary prepayment shared some peculiar features that make it resemble not an income tax prepayment but something else, so that a its constitutional challenge remains open.

AFIP is empowered by law to regulate the times and manner of tax collection, and, as mentioned above, does so via advances, withholdings, and prepayments on account of the final tax liability.

The question here is whether the Agency is allowed to go beyond fixing a prepayment on account of the final tax liability, as it would happen with the extraordinary prepayment which (i) implies an extra 25/15% prepayment based on the previous income tax liability, before deducting accumulated NOLs, and (ii) will not be necessarily absorbed by the tax liability of the current year, simply because the correcting mechanisms otherwise contemplated in the case of ordinary prepayments, are excluded.

Accumulated NOLs are ordinarily deductible for the determination of the Income Tax, i.e., they are compensated to arrive at the income tax liability for the year. The express exclusion of accumulated NOLs for purposes of the extraordinary prepayment calculation, contemplated in the Resolution, is illegitimate an alien to the income tax system, since it is inherent to the latter the offsetting of periods of losses with subsequent periods of taxable profits (or even vice versa, wherever the carryback of losses is allowed), as a way to assure that the tax effectively impact those taxpayers with true taxable economic capacity.

As regard ordinary prepayments on account of the income tax, an option is always allowed to reduce the prepayments, which is precisely aimed at avoiding the distortion that would happen with the extraordinary prepayment which does not allow a similar option is case of current losses or an expected current tax liability lower than that verified in the preceding taxable period.

In that context, if an excess payment if verified, that payment would not be in the nature of an income tax but something else; i.e., a new levy that might have only been created by a law passed by Congress according to the constitutional principle of reserve. This would be an extra levy in the current period that has nothing to do with the income tax assessment (an resulting tax liability) corresponding to that period in accordance with the substantive rules governing the Income Tax.

It would be for the courts to correct the administrative excess of competence embodied in the Resolution, in light of the reserve principle that prevent imposing a levy without a previous law passed by Congress approving it, and to declare the new levy unconstitutional since it blatantly affects the constitutional principle of taxable economic capacity and the property right.

[i] Joint stock corporations and limited liability companies are the most common types of business entities that enjoy fiscal personality and qualify as "corporate taxpayers" subject to income tax on the income they obtain. Corporate taxpayers also include, inter alia, limited partnerships by shares, simple limited partnerships, associations, foundations, cooperatives and civil and mutual entities unless expressly exempt, mixed economy companies (on profits not exempt from tax), trusts, except for those which are transparent, financial trusts, and trusts whose settlors are nonresidents, and mutual funds, under certain conditions.

[ii] Decree 618/97, article 7

[iii] Law 11683, article 21

[iv] Resolution AFIP 5211/22

[v] Resolution AFIP 830/00, article 38, and Annex Vi; Resolution AFIP 5168/22

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