



Tax Newsletter

Timely news and information on national tax issues

The Tax Administration has intensified its TP review procedures due to the economic and tax impact of COVID-19

As a result of the current global crisis caused by the COVID-19 pandemic, public finances have been severely affected. In El Salvador, given the extended economic lockdown, public finances are facing an increasing risk of default, according to a recent study by the Salvadorian Foundation for Economic and Social Development (FUSADES). Some of the economic and financial indicators that reflect the above are:

- Projected GDP with contraction scenarios of between -5.4% and -7.4% (largest drop in 4 decades);
 - **Annual fall in gross collection of tax revenue estimated at between \$645 million and \$717 million, compared to 2019;**
 - Increase in the fiscal deficit from 3.1% of GDP to an estimated 10.3% to 16.7%, by the end of 2020;
 - Public debt reaching 93.9% of GDP, versus a pre-pandemic 71.4%.
- Consequently, upon taking office, the new Treasury Minister stated that tax oversight plans would continue and intensify in search of greater collection of tax revenues, with him particularly referencing the "tax anti-evasion plan" that is being implemented.

According to Article 173 of the Tax Code (TC), inspection, investigation and control are competencies and powers of the Tax Administration (TA), to ensure taxpayers' effective compliance with tax obligations.

Main areas of oversight and key points to consider

Based on the above, it is important for taxpayers to be aware of the main areas of oversight by the TA, as well as

to know the key aspects on which the authorities are basing these review procedures, so that taxpayers can be adequately prepared when facing such oversight.

In the span of one year, from January 2019 to February 2020, the Court of Appeals for Internal Revenue and Customs (TAIA per its Spanish acronym) issued a total of 298 rulings (more than in other previous similar period). From these, it is possible to observe that **45% correspond to the Income Tax (ISR)**, 18% to the Tax on the Transfer of Movable Goods and the Rendering of Services (VAT), and the remaining 37% to other taxes and contributions. **Nearly 45% of these are confirmatory rulings.**

Therefore, it is clear that oversight efforts are being focused mainly on the Income Tax, and to a lesser degree, though not to be ignored, the VAT.

For both of these taxes, the objections or questioning raised by the TA significantly stems from the **deduction of costs or expenses for corporate charges received from related companies**. To determine the deductibility of these charges, the TA verifies what is established in the respective laws. For the income tax, the TA refers to Art. 29-A of the Income Tax Law, and for the VAT, it refers to the second clause of Article 65 and the first clause, letter j) of Art. 65-A of the VAT Law, as well as that established in Art. 158, Art. 158-A, Art. 206 and Art. 206-A of the TC.

Prior to detailing the key points to consider, following we present a diagram summarizing the process followed by the TA for reviewing corporate charges:



As can be observed, the TA carries out a pre-defined procedure to verify whether the deduction of these costs or expenses is applicable, declaring many of them **inadmissible in the first two stages of the process**. Therefore, following are the key points that based on the regulations, the actions of the TA, and the judgments

issued by the TAIA, are important for taxpayers to consider to better support their positions in the event of a future review:

- 1) **Materialization** - to test the materialization of the expense, the TA requires that taxpayers present:
 - service agreements for the charges received;
 - invoices and receipts for payments made;
 - reports, emails, memos, logbooks or any other document that permits identifying that the services were actually received; and
 - schedules or work plans, among other relevant documentation.

- 2) **Charge is Useful and Necessary** - to verify that the cost or expense is necessary for the business, the TA poses thorough questions and requests extensive information, such as:
 - organizational structure of the current company, to verify the internal departments and functions performed by the taxpayer;
 - number, names and positions of permanent, temporary, or outsourced staff that make up each department, to verify whether there is any duplication of functions;
 - identification of the payment made to related companies, for each itemized service received (not a global charge, but itemized by type of service);
 - Who within the organizational structure requested and authorized the service? A copy of the requests and approvals must be provided;
 - Who or which department received the service, and what was the result, benefit or added value within the operations? Taxpayers must demonstrate the necessity of the corporate charge (**Benefits Test**);
 - Who authorized the budget for these charges? A copy of such authorization must be provided;
 - If there are other corporate charges received from related companies (e.g. royalties), it must be evident that they are of a different nature and at no time could they be interpreted as duplicate charges.

In any event, the materialization and verification of the necessity of the corporate charge will depend to some

extent on the nature of the service being received. However, the preceding points are the ones that initially provide adequate support and validation when facing the TA's oversight procedures.

Finally, once the materialization and necessity of the cost or expense is proven, the TA verifies the other requirements indicated in the diagram, concluding with the verification that these charges are set at **market value**, through a review of the taxpayer's transfer pricing study.

Final considerations

Given the expected intensification of the TA's oversight procedures, and since trends indicate that corporate charges from related parties are one of the main areas reviewed, whether for Income Tax or VAT purposes, it is essential that taxpayers submitting these types of charges give them the proper importance, by verifying at a minimum, the points detailed above.

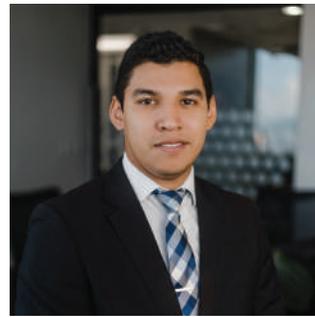
It is also recommended that companies apply the Benefits Test to these expenses, with the purpose of identifying how well supported they are and how prepared the company is to defend and validate the corporate charges received.

Corporate charges tend to be substantial, depending on the nature and specialization of the services received. Therefore, any objection to their deductibility for Income

Tax purposes, or for purposes of crediting VAT credits, could result in significant tax adjustments for companies.



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Tax Calendar

August 2020

The updated 2020 tax calendar is now available on the Tax Administration’s website, which includes public holidays and deadlines for all tax obligations.

S	M	T	W	T	F	S
						1
2	3	4	5	6	7	8
9	10	11	12	13	14	15
16	17	18	19	20	21	22
23	24	25	26	27	28	29
30	31					

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2020 Obligations Calendar**

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Obligations Calendar

August 20

VAT

Declaration and payment of the Tax on the Transfer of Movable Goods and the Rendering of Services (F-07).

Financial Income and Transactions

Monthly declaration of Payment on Account, and Tax Withheld on Income, Financial Transactions, and the Special Contribution for Citizen Security and Coexistence (F-14)

Specific and Ad Valorem Taxes

Declaration and payment of Specific Taxes, Ad Valorem Taxes and Special Contribution (F-06).

Other obligations

- Report on Donations (F-960)
- Report on Specific and Ad Valorem Taxes on Producers and Importers of Alcoholic Beverages, Potable Ethyl Alcohol and Beer, Carbonated Beverages, Isotonic Beverages, Fortified Beverages or Energy Drinks, Juices, Nectars, Soft Drinks and Concentrated or Powder Mixtures for the Preparation of Drinks (F-955).
- Report on Specific and Ad Valorem Taxes on Producers and Importers of Firearms, Ammunitions, Explosives and Similar Items, Producers of Tobacco and Producers, Importers and those that clear fuels through customs (F-988)

- Monthly Report of Sales to Producers, Distributors or Retailers of Tobacco and Tobacco Products (F-956)

August 27

VAT

Monthly Report on Withholdings, Collections, or Payments on Account of VAT (F-930).

Printing Presses

Monthly Report on Documents Printed for Taxpayers Registered under the VAT (F-945)

August 3 - 6

Public holiday due to celebrations of the Feast of San Salvador

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