



## Tax Newsletter

Timely news and information on national tax issues

### Obligation to recognize shrinkage in the Record of Inventory Control and its effect on the annual Income Tax settlement

#### **I. Record of Inventory Control: Recognition of shrinkage.**

Article 142 of the Tax Code (TC) establishes that the taxpayers whose operations consist of transfers of movable tangible goods **are obligated to keep records of inventory control**, which should clearly and truthfully reflect:

- its actual movements;
- its valuation;
- the result of the operations;

- the effective and current value of the inventoried goods; as well as,
- the detailed description of the characteristics of the goods that allow one to individualize and fully identify them.

The record of inventory control must be kept on a permanent basis and constitutes a special record that is independent from the other records.

According to article 142-A of the TC, this record should present, among other mandatory requirements:

- The incoming and outgoing inventory items, in physical units and monetary amounts.
- The inventory balance, in physical units and monetary amounts.

It is important to mention that numeral 4 of article 142-A of the TC establishes that, among other aspects, it is necessary to include the “**detail of shrinkage, evaporations or expansions,**” with the purpose of showing the actual inventory balance in physical units and monetary amounts, as of a specific time.

Based on the above, shrinkage **should not be kept in a separate record, but rather within the same Record of Inventory Control.**

This is due to the fact that shrinkage represents a reduction in the number of goods or in the updating of stock on hand, which results in a difference between the contents of the inventory books and the actual amount of products or goods in an establishment, business or company, which in turn, implies a monetary loss.<sup>1</sup>

Thus, by not recognizing in the record of inventory control the number of physical units and the monetary amounts with respect to how they relate to shrinkage, this would imply:

1. Differences between the record of inventory control and the monetary amounts recognized in accounting, as well as with the number of physical units indicated in the Notarial Record of Inventory at the closing of the tax period. This could result in determining unjustified inventory losses (as applicable), which could be objected as **non-deductible expenses** in the annual Income Tax settlement, such as it is established in article 29-A numeral 10 of the Income Tax Law.

2. Non-compliance with respect to keeping a record of inventory control without complying with the requirements established in articles 142 and 142-A of the TC, which would expose a taxpayer to a penalty equivalent to 0.5% of their book capital on their balance sheet, minus the unrealized asset revaluation surplus, which cannot be less than nine monthly minimum wages.

## **II. Considerations regarding the tax treatment of shrinkage according to the Authentic Interpretation of Article 28 of the Income Tax Law.**

Last 29 May 2019, the Legislative Assembly passed Legislative Decree No. 345, which included an authentic interpretation of Article 28 of the Income Tax Law, specifically regarding the definition of “*costs and expenses necessary for producing income and for preservation of the source*”.

According to this authentic interpretation, it is established that the purchasing costs and all those costs that are necessary and pertaining to the business, intended exclusively for such purpose, will be deductible in the Annual Income Tax Return.

An aspect to be emphasized, is that the definition of “*costs and expenses necessary for producing income and for preservation of the source*” includes **all the shrinkage, losses or expenses incurred, regardless of the itemization, in the industrial, commercial or services sectors, which is measurable, recognizable, inherent to the business and has an actual cost for the activity performed, such as the trading of perishable goods, the trading of consumer goods, textiles, the**

*electricity industry in all its stages, and the hydrocarbons sector in all its stages, among others. Due to the above, it is understood that the shrinkage, losses or expenses incurred that meet the conditions established in the Authentic Interpretation could be considered deductible in the annual Income Tax settlement.*

Notwithstanding, it is important to mention that the Authentic Interpretation cited above stipulates that the shrinkage, losses, expenses or costs incurred in the process of generating income subject to Income Tax could be credited and recognized as deductible, provided that the amounts claimed comply with the following requirements:

1. They are duly documented; and
2. They are recognized or credited by the current governing bodies or corresponding regulating entities.
3. They comply with other formal aspects detailed in the Tax Code.

Furthermore, it is clarified that if there is no tax payable at the closing of the tax period in question, the items mentioned above are not admissible as deductible in the annual Income Tax settlement.

Thus, it must be noted that compliance with the obligation to recognize shrinkage in the Record of Inventory Control not only helps to avoid the risk of a penalty in the event of an audit by the Tax Administration, but also this record could constitute documentation and support for the deduction of the amount of shrinkage in the annual Income Tax settlement.

Therefore, in preparation for the annual Income Tax settlement for the year 2019, Companies are encouraged to **perform an internal analysis or an analysis with the support of tax advisors**, regarding

<sup>1</sup> Definition cited from Resolution N° INC. R1204022TM of the Court of Appeals for Internal Taxes and Customs.

the suitable documentation (in addition to the Record of Inventory Control) that could be prepared to better support the cost or expense due to shrinkage of the period, which is being sought to be recognized as an Income Tax deduction. For reference, such types of documentation could consist of:

- Notarial records of the verification of shrinkage, signed by professionals authorized to issue legally certified documents (Certified Public Accountants or Notaries).
- Technical studies on the origin of the shrinkage, which include parameters and statistics. In this case, these serve to document that the shrinkage

generated in one tax period in fact corresponds to situations inherent to the activity performed and not to negligence by the Company's Management, in which case the shrinkage cost would not be deductible in the annual Income Tax settlement.



**Henry Aguirre**

BPS Manager

[haquirre@deloitte.com](mailto:haquirre@deloitte.com)

[www.deloitte.com/sv](http://www.deloitte.com/sv)

# Tax Calendar October 2019

The updated 2019 tax calendar is now available on the Tax Administration's website, which includes the public holidays and the 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 |    |    |

## October 14

### 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, Tax Withheld on Income from 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)
- Statement of Origin and Application of Funds (F-950).

## October 21

### VAT

Monthly Report on Withholdings, Collections, and Advances on Account of VAT (F-930).

### Printing presses

Monthly Report on Documents Printed for Taxpayers of the VAT (F-945).

## Contacts:

**Federico Paz**  
Tax & Legal Managing Partner  
[fepaz@deloitte.com](mailto:fepaz@deloitte.com)

**Ghendrex García**  
Tax and BPS Partner  
[ggarciaq@deloitte.com](mailto:ggarciaq@deloitte.com)

**Cosette Fuentes**  
Legal Services Manager  
[cg.fuentes@deloitte.com](mailto:cg.fuentes@deloitte.com)

**Henry Aguirre**  
BPS Manager  
[haguirre@deloitte.com](mailto:haguirre@deloitte.com)

**Alvaro Miranda**  
Transfer Pricing Manager  
[ajmiranda@deloitte.com](mailto:ajmiranda@deloitte.com)

**Wilmer García**  
Transfer Pricing Manager  
[wsgarcia@deloitte.com](mailto:wsgarcia@deloitte.com)

**Jhonny Flores**  
Tax Consulting Manager  
[jflores@deloitte.com](mailto:jflores@deloitte.com)

**Daysi Acosta**  
Tax Compliance Manager  
[daacosta@deloitte.com](mailto:daacosta@deloitte.com)

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