



14<sup>th</sup> Assembly  
13 September 2024

# Panel 1 - Tax and Morality

International Association of Tax Judges

# Tax and Morality - Topics

- Topic 1 – To what extent can tax judges give effect to concerns about equity and ability to pay? *Lex dura sed lex?*
- Topic 2 - Consequences of violation of fundamental rights or general principles of proper administration by the tax administration

*Health break*

- Topic 3 - Abuse of Rights – the Role of the Court
- Topic 4 - Tax Consequences of the Criminal or Immoral Character of Income, Turnover, and Expenses
- Topic 5 - Tax consequences of incorrect accounting

# Topic 1

To what extent can tax judges give effect to concerns about equity and ability to pay?

Bernard McCabe

Judge, Federal Circuit and Family Court of Australia

# Purpose and objectives in taxation law

- Focus on the role of taxation and the objectives of the taxation system and those who administer it ....
- There is a large body of literature accumulated over a long period which discusses the social, moral and economic dimensions of taxation law and policy.

# The social obligation to pay tax

***Economics.org.au*** highlights of:

The House of Representatives  
Select Committee on Print Media  
Kerry Packer Appearance  
November 4, 1991

A cynical view...



# Purpose and objectives of taxation law

- There are at least two separate questions requiring consideration: first, whether particular taxes are substantively just, equitable, efficient and appropriate; and second, whether enforcement, adjudication and collection of taxes – ie, the system of tax administration – serves those goals or undermines them.
- As tax judges, we are more concerned with the second question.

# The Australian approach

- Australia's constitution provides for a strict separation of powers between the legislative, executive and judicial branches of government.
- Taxation disputes may be litigated at first instance before the Administrative Appeals Tribunal (the AAT), which is part of the executive, or before the Federal Court, which is part of the judiciary. Both bodies apply the same legislation.



# Purposive approach to interpretation

- ACTS INTERPRETATION ACT 1901 - SECT 15AA
- Interpretation best achieving Act's purpose or object
- In interpreting a provision of an Act, the interpretation that would best achieve the purpose or object of the Act (whether or not that purpose or object is expressly stated in the Act) is to be preferred to each other interpretation.

# Purposive approach to interpretation

“...the duty of a court is to give the words of a statutory provision the meaning that the legislature is taken to have intended them to have. Ordinarily, that meaning (the legal meaning) will correspond with the grammatical meaning of the provision. But not always. ...”

- *Project Blue Sky Inc v Australian Broadcasting Authority* [1998] HCA 28 at [78] per McHugh, Gummow, Kirby and Hayne JJ

# The purposive approach to interpretation

- But judges (and Tribunal members) are still interpreting the text of the statute, even as they have regard to context:

“...the task of statutory construction must begin with a consideration of the [statutory] text. So must the task of statutory construction end. ...”

- *Commissioner of Taxation v Consolidated Media Holdings Ltd* [2012] HCA 55 at [39] per French CJ, Hayne, Crennan, Bell and Gageler JJ

# Limits to the purposive approach

- The AAT and the Court are both required to apply the law. The binary nature of most taxation legislation in Australia offers limited scope for giving effect to objectives such as equity and ability to pay when making constructional choices.

# The correct or preferable decision?

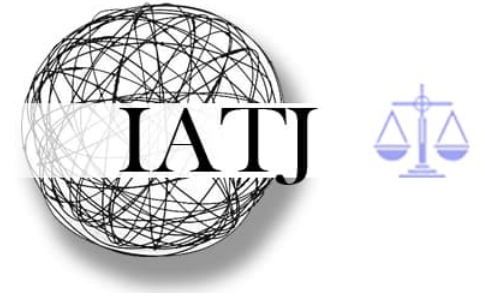
- Australian tax legislation does provide some discretionary relief powers that take into account equity and the ability to pay. These powers are exercised by executive decision makers and subject to merits review by the AAT, which is charged with making the 'correct or preferable decision'. The powers include:
  - The discretionary power to remit penalties and interest; and
  - The discretionary power of debt release.

# Topic 1 - Comments

To what extent are judges concerned with equity and ability to pay?

# To what extent are judges concerned with equity and ability to pay – The French perspective

- France also follows separation of powers ; French Tax Courts are no courts of equity.
- Arr. 13 Declaration of Human and Civic Rights of 1789 : « For the maintenance of the public force, and for administrative expenses, a general tax is indispensable; it must be equally distributed among all citizens, in proportion to their ability to pay ».
  - constitutional principle of « equality before public burdens »
  - ban on pure confiscatory taxation
  - objective of constitutional value of combating tax evasion and fraud
- During a trial, a taxpayer may submit a “priority question of constitutionality” (QPC) to challenge the law's Constitutionality. If the question is serious, the judge will refer it to the Constitutional Council. The Tax Judge will then apply that Council's decision.
- Without QPC, when a text leaves room for interpretation, the Tax Judge may interpret it, if it is possible and necessary to ensure compliance, in the light of the constitutional principles.
- The Judge cannot grant an *ex gratia* tax remission.



Topic 1: To what extent are judges concerned with equity and ability to pay?

The Swiss Perspective

- Switzerland also follows separation of powers between the judicial, legislative, and executive branch.
- Swiss Courts are bound by the statutory law and precedents, they are not courts of equity, they cannot ignore the law to achieve an equitable result.
- Very rare exceptions with regard to so called “discretionary decisions”, if no records or only incomplete records are available and an assessment according to administration’s best judgement is required: if this assessment is “beyond anything”, nullity can be the result



# Topic 1: To what extent are judges concerned with equity and ability to pay – The U.S. Perspective

- The US also follows separation of powers between the judicial, legislative, and executive branch.
- Formally, we are bound by the statutory law and precedents.
- We are not a court of equity, and we cannot ignore the law to achieve an equitable result. The US Tax Court does not evaluate the law's fairness and must apply it as it is written. We leave the questions of fairness to Congress. See *Metzger Trust v. Commissioner*, 76 T.C. 42, 59-60 (1981), *aff'd* 693 F.2d 459 (5th Cir. 1982).
- The Court can advise taxpayers to make use of tax clinics or pro bono lawyers.

# Topic 1 - Debate

To what extent are judges concerned with equity and ability to pay ?

# Topic 2

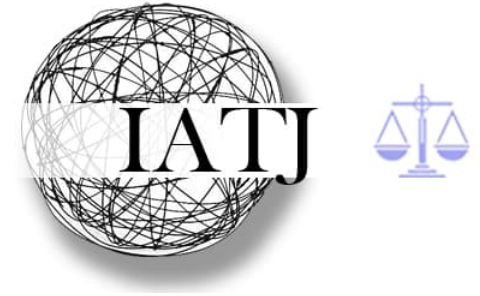
Consequences of violation of  
fundamental rights or general  
principles of proper administration by  
the tax administration

Michael Beusch

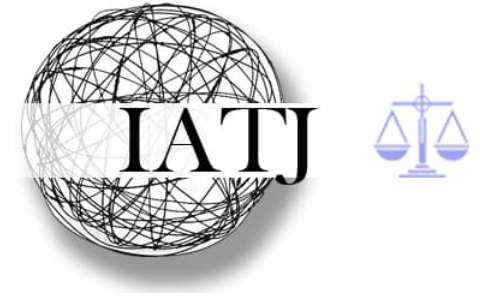
Federal judge, Bundesgericht, Switzerland



- Tax procedures are embedded in a (national) Constitutional setting
- Some of those statue a «fair behaviour-principle», e.g. art. 5 al. 3 of the Swiss Constitution: «**State institutions and private persons shall act in good faith.**»
- Sometimes (domestic) law additionally include specific «feel good» provisions, e.g. art. 65 al. 5 Swiss VAT Act: «**The taxable person may be burdened by the tax imposition only to the extent this is absolutely necessary for enforcement of this Act.**»
- Furthermore: There often is «soft law» such as Code of Conducts, e.g. Swiss Version 2021: “Swiss tax law practice is characterized by respectful interaction between taxpayers, tax representatives and tax administrations.»
- However: Usually tax procedural law contain clear obligations and rights, e.g. the right to be heard or the obligation to provide documents



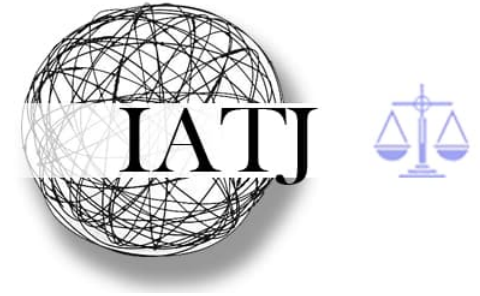
- If the tax-administration violates taxpayer's rights, e.g. the right to be heard, this is usually sanctioned (by Courts), unless the Court procedure can be considered offering a sufficient remedy / catch-up
  - Swiss case law often considers the violation being repaired, however imposing the costs of procedure to the tax-administration
- Legitimate expectations are to be honoured, e.g. if the tax administration has given a «wrong answer» to a taxpayer's specific request
  - Swiss case law rules in favour of the taxpayer if (s)he has displayed the facts properly and the answer of the tax-administration is not so obviously wrong that anyone would have realized that



- What about evidence obtained in another procedure, e.g. a criminal procedure, the taxpayer claiming that «those rules» have not been respected?
  - Swiss case law usually states this being a problem of the «other procedure»
- What about illegally obtained evidence, having disregarded procedural rules? «Tainted fruits of the poisonous tree»?
  - Swiss case law usually pretends not to base the judgement on this evidence avoiding to discuss the issue



- How are «problems» (to be) solved when «clear» statutory provisions come into conflict with «vague» constitutional rules, programmatic provisions or «soft law»?
- What about «unfair behaviour» of the tax administration (asking for abundant documentation [proportionality], setting [too] short time limits)?
  - Swiss case law, unless blatantly arbitrarily, usually «shrugs», stating that the behaviour might not have been nice, yet not sufficient for a recusation



- What about «indecent behaviour» («bullying», threats)
  - Swiss case law rarely states tax-administration's behaviour «beyond limit»; if so, there is a recusation of the tax-officer involved, another tax-officer has to redo the entire procedure («back to the start») and costs are to be borne by the tax administration
- What about lengthy procedures (with the un noble goal to wear out «businesss» seeking tax-certainty)? Is there a «tax-discount» if procedures procrastinate?
  - Swiss case law usually reminds taxpayers of their rights to accelerate the procedure («appeal against delay») and refers to the statutory prescription as «final limit» (i.e. 15 or 10 years)



# Topic 2 - Comments

Consequences of violation of fundamental rights or general principles of proper administration by the tax administration

## Topic 2: Consequences of violation of fundamental rights or of principles of proper tax administration – The U.S. Perspective

- Tax procedures are by statute and IRS regulations.
- The Taxpayer Bill of Rights (TBOR) is codified in Section 7803(a)(3), and provides that taxpayers have the rights to be informed, quality service, appeal, fair and just tax system, etc.
- However, TBOR does not “confer any new rights on taxpayers; it merely lists taxpayer rights as afforded by other provisions of the Code.” *Atlanta Pacific Management Group, LLC v. Commissioner*, 152 T.C. 330 (2019). The US Tax Court does not have statutory enforcement authority.
- Illegal evidence, as a general rule, the Court will not look behind a deficiency notice to examine the evidence used or the propriety of the tax authority’s motives or of the administrative policy or procedure involved in making determinations. *Greenberg’s Express, Inc. v. Commissioner*, 62 T.C. 324, (1974).
- The US Tax Court under section 7430 can award petitioners administrative and court costs
- The Court may also impose sanctions for misbehavior in Court proceedings. See Rule 104

# Consequences of violation of fundamental rights or of principles of proper tax administration – Australian perspective

## The Taxpayer's Charter in Australia

- 1. Where a decision is attended by serious maladministration, there *may be a* jurisdictional error – which means there was no decision at all;
- 2. The Administrative Appeals Tribunal conducts merits review of decisions through hearings de novo, potentially curing defects.
- 3. The Commissioner of Taxation is a model litigant and must conform to the requirements of the *Legal Practice Direction 2017*.
- 4. The Court has a discretion to exclude improperly or illegally obtained evidence (s 138, *Evidence Act 1995*)
- 5. The Court or Tribunal may refer misconduct to the Inspector-General of Taxation or the Australian Federal Police.

# Consequences of violation of fundamental rights or general principles of proper administration: the French view

- No general « fair behaviour-principle ». But:
  - the Tax Codes are full of procedural provisions instituting guarantees for taxpayers ;
  - Taxpayers may invoke the tax authorities' formal interpretation of the law or the tax authorities' formal position on a factual situation, even if it is illegal;
  - Tax authorities may not mislead the taxpayer as to his rights.
- A procedural irregularity results in a tax discharge if it deprived the taxpayer of a guarantee, and thus may have had an influence on the reassessment decision.
  - The Court procedure offers in general no remedy.
- Evidence obtained under dubious conditions:
  - tax authorities may not rely on documents obtained by an administrative or judicial authority under conditions subsequently declared illegal by a court.
  - In other cases, a document cannot be disregarded from the assessment procedure solely on the grounds of its origin.

# Topic 2 – Debate

Consequences of violation of fundamental rights  
or general principles of proper administration by  
the tax administration

*Health Break*

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# Topic 3

## Abuse of Rights – the Role of the Court

Peter Wattel

Advocate-general, Netherlands Supreme Court

# Abuse of rights – the role of the court

- Four questions:
- Is a tax court required *ex officio* or on appeal by the tax administration to disregard or redefine legal but abusive arrangements to prevent deliberate frustration of the legislator's intention?
- Is there a Statute law basis (required) or a judge-made *fraus legis* (abuse of rights) doctrine?
- How does one establish (bad) intent?
- Is a transaction on arm's length conditions always legitimate?



# Netherlands National Law

- Many SAARs in statute law, especially interest deduction limitations, but also a very general judge-made GAAR from Roman law: *fraus legis*
- (obviously, often the question arises whether the tax administration may still rely on *fraus legis* if the taxpayer manages to avoid the SAAR)

Two requirements to disregard or redefine a tax avoiding transaction:

- Subjective: intent: the overriding motive for entering into the transaction is avoidance of taxation; obviously: “abuse” *implies* (bad) intent
- Objective: the chosen method of tax reduction violates object and purpose of the law.

*Ultimum remedium*, only to engage after unsatisfactory results of:

- Purposive (teleological) interpretation of the law
- Fiscal characterization of the facts and contracts in derogation of civil law

# Netherlands national law

- (bad) intent is a question of fact – therefore, it must be posited by the tax administration and requires evidence to be adduced by the administration of its presence is contested
- By contrast, whether the envisaged tax effect is contrary to object and purpose of the law, is a question of law, which in principle must be answered by the court of its own motion – *ius curia novit*

# Indicators for defeat of object and purpose of the law (or of intent?)

- Artificiality: the transaction (paradigm example: intercompany loan) is commercially irrational, unexplainable, or useless)
- Repeatability
- Absent the tax effect, the transaction is foreseeably disadvantageous
- Circularity of the (series of) transaction(s)
- In effect, the taxpayer creates a situation in which it can determine its own tax burden
- How does one establish (bad) intent?
  - “Nothing either good or bad, but thinking makes it so” (Hamlet, Act II, Scene 2, line 259 (J.F. Avery Jones: The mental element in anti-avoidance legislation; British Tax Review, 1983, No. 2).
  - ECJ: ‘objective factors’ – *apparent* intent?

# EU Law: General abuse of rights doctrine - objective and subjective element

Seminal (non tax) Case: C-110/99, *Emsland-Stärke*:

“52. A finding of an abuse requires, first, a combination of objective circumstances in which, despite formal observance of the conditions laid down by the Community rules, the purpose of those rules has not been achieved.

53. It requires, second, a subjective element consisting in the intention to obtain an advantage from the Community rules by creating artificially the conditions laid down for obtaining it. (...).

54. It is for the national court to establish the existence of those two elements, evidence of which must be adduced in accordance with the rules of national law, provided that the effectiveness of Community law is not thereby undermined.”

Seminal Tax Case: C-196/04 *Cadbury Schweppes*: “wholly artificial arrangement”

# EU Law: Abuse may be curbed directly on the basis of an unwritten principle of EU law

Seminal Case C-251/16, *Edward Cussens a.o.*,

"32. (...), according to the Court's case-law, refusal of a right or an advantage on account of abusive or fraudulent acts is simply the consequence of the finding that, in the event of fraud or abuse of rights, the objective conditions required in order to obtain the advantage sought are not, in fact, met, and accordingly such a refusal does not require a specific legal basis

33. Therefore, the principle that abusive practices are prohibited may be relied on against a taxable person to refuse him, inter alia, the right to exemption from VAT, even in the absence of provisions of national law providing for such refusal (...)."

# EU Law: From a *competence* to an *obligation* to curb abuse of rights:

Cases C-115/16, C-118/16 and C-119/16, *N Luxembourg 1 a.o.*:

"96. (...) there is, in EU law, a general legal principle that EU law cannot be relied on for abusive or fraudulent ends (...).

97. That general principle of law must be complied with by individuals. Indeed, the application of EU legislation cannot be extended to cover transactions carried out for the purpose of fraudulently or wrongfully obtaining advantages provided for by EU law (...).

98. It thus follows from that principle that a Member State **must refuse** to grant the benefit of the provisions of EU law where they are relied upon not with a view to achieving [their] objectives (...) but with the aim of benefiting from an advantage in EU law although the conditions for (...) that advantage are fulfilled only formally. (...).

122 (...). The general principle of EU law that EU law cannot be relied on for abusive or fraudulent ends must be interpreted as meaning that, where there is a fraudulent or abusive practice, the national authorities and courts are to refuse a taxpayer the exemption of interest payments from any taxes that is provided for in Article 1(1) of Directive 2003/49, even if there are no domestic or agreement-based provisions providing for such a refusal."

# EU Law: Is *Arm's Length* a safe harbour?

- Case C-484/19, *Lexel AB v Skatteverket*; a clear case of BEPS, but:

“56. It must be held that [the Swedish anti-BEPS rule] may include within its scope transactions which are carried out at arm's length and which, consequently, are not purely artificial or fictitious arrangements created with a view to escaping the tax normally due on the profits generated by activities carried out on national territory.”

- Pending Case C-585/22, *X BV v Staatssecretaris van Financiën*;  
Opinion A-G Emiliou:

“71. (...). Consequently, I urge the Court to revisit the approach it took in the judgment in *Lexel* on the matter at issue.”

# Consequences for (tax) courts in EU Member States

- An obligation *ex officio* to disregard or redefine schemes abusively relying on EU law, even if national law provides no basis for refusal of EU law benefits, therefore directly on the basis of an unwritten legal principle that abuse of (EU) rights is prohibited;
- It is immaterial (i) whether EU law is relied on to frustrate EU law or national law, (ii) which substantive field of law is involved and (iii) whether and to which extent that field has been harmonized, coordinated or unified at EU level: EU law simply cannot be relied on for abusive purposes.
- All of the specific anti-abuse provisions in the EU corporate tax directives and in the Anti tax avoidance directive (ATAD) will have to be interpreted in accordance with that general principle of EU law.
- Arm's length conditions of profit-shifting intra-group transactions should not be a safe harbour



# Topic 3 - Comments

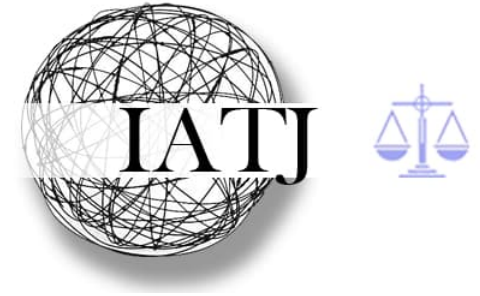
Abuse of Rights – the Role of the Court

# Abuse of rights : French perspective

- France : « homeland of human rights » ... and of anti abuse rules :
  - GAAR of art. L. 64 LPF (abuse of law by simulation or « fraude à la loi » ; exclusively tax-related purpose)
  - New « mini » anti abuse of law procedure of art. L. 64 A LPF (use of a text against its author's intentions with mainly tax-related purposes)
  - Art. 205 A CGI (for corporate income tax)
  - + Unwritten general principle of law (outside the above-mentioned statutory provisions)
- Abuse of law must be invoked by the Tax administration, which has the burden of proof.
- Objective and subjective criteria. But conditions often intrinsically linked in artificial schemes.
- Wide scope. Applicable in international context.
- No guarantee of art. L. 80 A LPF (opposability of the administration's interpretation of the law) for artificial arrangements devised for no other purpose than mitigating tax

# Abuse of rights in Australia

- Sham transactions and arrangements are, by definition, without legal effect - so they cannot have the taxation consequences contended for by the taxpayer.
- Schemes established for the dominant purpose of securing a tax benefit are dealt with under Part IVA of the Income Tax Assessment Act 1936 and parallel provisions (eg Div 165 GST Act). These GAARs permit the Commissioner to deny the taxpayer the benefit of the scheme, and impose significant penalties.
- "(...). Obtaining the tax benefit is not enough. Desiring the tax benefit is not enough. The obtaining of the tax benefit must have been the main object or aim of what is said to be the scheme when viewed objectively in its surrounding context." *Full Federal Court Minerva Financial Group Pty Ltd v Commissioner of Taxation* [2022] FCAFC 1092



### Topic 3 : abuse of rights – the Swiss Perspective

- Swiss domestic law knows an explicit anti-abuse provision only in the Withholding Tax Law
- This provision, however, has been elevated to a (judge made) general anti-abuse provision («Steuerumgehung» / «évasion fiscale») – three conditions: 1) bizarre structure (objective); 2) established only with the purpose of reducing taxes (subjective); 3) if admitted, a tax reduction would result -> if all conditions are met, the chosen structure is disregarded and the taxpayer is taxed on the basis of the structure, a normal taxpayer would have established
- In cross-border situations («international»): Unwritten legal anti-abuse principle being inherent in all tax treaties
- Domestically an on international basis: to be taken into account *ex officio*

# Topic 3: Abuse of Rights - U.S. Perspective

- The US Tax Court relies upon a wealth of historic caselaw which weighs facts and circumstances to decide whether a transaction is abusive.
- The Tax Court can disregard transactions that have no substance or economic effect. *Gregory v. Helvering*, 293 U.S. 465 (1935). The Court looks to the “objective economic realities” of a transaction, rather than a particular form employed by the parties. *Frank Lyon Co. v. United States*, 435 U.S. 561, 573 (1978).
- The Court may inquire as to transactions that either:
  - Did not occur,
  - Did not occur as reported,
  - Were performed in violation of some of the background assumptions of commercial dealing, for example arms-length dealing at fair market values.
  - Did take place but had no independent economic significance.
- “To permit the true nature of a transaction to be disguised by mere formalisms, which exist solely to alter tax liabilities, would seriously impair the effective administration of the tax policies of Congress.” *Commissioner v. Court Holding Co.*, 324 U.S. 331, 334, 65 S.Ct. 707, 89 L.Ed. 981 (1945)

# Topic 3 - Debate

Abuse of Rights – the Role of the Court

# Topic 4

## Tax Consequences of the Criminal or Immoral Character of Income, Turnover, and Expenses

Peter Panuthos  
(Chief) Special Trial Judge, US Tax Court

# Tax Consequences of the Criminal or Immoral Character of Income, Turnover, and Expenses

- Does case law take a stand on the criminal or immoral character of income, turnover, or expenses?
- Are illegal proceeds treated any differently under tax law?
- Can illegal expenses be deducted?
- Can fines and penalties be deducted?



Does case law take a stand on the criminal or immoral character of income, turnover, or expenses?

- ➤ Income includes "from whatever source derived". 26 U.S. § 61
- The Supreme Court decided in *Sullivan* that as a policy matter, Congress did not intend to tax the law abiding and let criminals go. *United States v. Sullivan*, 274 U.S. 259, 263 (1927).
- As a result, all proceeds from illegal activity are taxed as income. *James v. United States*, 366 U.S. 213 (1961).

# Can illegal expenses be deducted?

- The Internal Revenue Code makes clear that expenses that are ordinary and necessary to carrying on a trade or business are deductible. IRC § 162
- Generally, even an illegal business may take ordinary and necessary business deductions. However, Congress may provide specific carveouts to this general rule.

# Can litigation fees be deducted for the defense of criminal activities?

- The origin and character of the claim with respect to which legal fees are incurred controls whether the expense is a deductible business expense or a nondeductible personal expense. *United States v. Gilmore*, 372 U.S. 39, 49 (1963).
- Legal fees relating to criminal activity may be deducted as an ordinary and necessary expense when the criminal charges stem from carrying on a trade or business. *Commissioner v. Tellier*, 383 U.S. at 694–95.

# Marijuana Businesses

- Generally, businesses are allowed deductions for ordinary and necessary expenses under IRC § 162. However, there is a specific carveout in Section 280E, which disallows all deductions or credits related to the trafficking of Schedule I or II controlled substances.
- While marijuana is legal in specific states, the federal government treats it as an illegal controlled substance under the Controlled Substance Act. Therefore, while a marijuana grower/distributor can operate legally in a particular state, like California, the taxpayer cannot deduct expenses on a Federal Tax Return.
  - Currently, there is a DOJ proposal to reclassify marijuana to a Schedule III controlled substance.
- However, it does not prohibit marijuana businesses from claiming the cost of goods sold (COGS). *Champ v. Commissioner*, 128 T.C. 173, 178 (2007).
- Some states have disassociated state tax codes from Section 280E to allow marijuana businesses to take state tax deductions.

# Marijuana Businesses pt. 2 – What are COGS?

- There are different sets of rules for calculating COGS for resellers vs. producers. *Patients Mutual Assistance Collective Corp. v. Commissioner*, 151 T.C. 176 (2018).
- Resellers calculate a limited COGS.
  - Price paid specifically for inventory plus any “transportation or other necessary charges incurred in acquiring possession of the goods.” Treas. Regs. §1.471-3(b) and (c), §1.471-11. See *Richmond Patients Group v. Commissioner*, T.C. Memo. 2020-52.
- Producers can calculate broader costs into COGS.
  - Direct and indirect costs of creating inventory. See §§ 1.471-3(c), 1.471-1. *Patients Mutual Assistance Collective Corp. v. Commissioner*, 151 T.C. 176, 205 (2018).
  - Production/operations, materials, labor, and associated costs

# Can Fines and Penalties be Deducted?

- The Court looks to the particular facts and circumstances to decide whether a claimed deduction will frustrate congressional intent and public policy. *Tank Truck Rentals v. Commissioner*, 356 U.S. 30, 35 (1958).
- Fines and penalties cannot be deducted. *Hoover Motor Express Co. v. United States*, 356 U.S. 38 (1958).
  - To allow a deduction for violations of state law would directly dilute the actual punishment imposed.

# Topic 4 - Comments

Tax Consequences of the Criminal or Immoral  
Character of Income, Turnover, and Expenses



## Topic 4: Criminal or immoral income, turnover and expenses – the Swiss view

- Income derived from unlawful activities is not treated differently for tax purposes from income from lawful activities, provided that it falls within a taxable income category
- Expenses : Principle: indifference to whether the activity or expenditure is lawful or not. They are deductible if “commercially justified” which excludes as such excessive remunerations or “sumptuary expenses” (FIT 58.1.b); Non-deduction of illegal commissions paid (at home or abroad) to obtain or retain contracts (FIT 59.2.a and b)
- Fines and Penalties :
  - Contractual penalties : no special provision => deductible if related to the business ;
  - Compensatory damages related to the business : non-punitive => idem
  - « True » administrative or criminal sanctions, penalties and fines (domestic and abroad): non-deductible (FIT 59.2-c and d).
  - Punitive damages and penalties imposed in violation of the Swiss concept of international public order however are deductible (FIT 59.3).



# Criminal or immoral character of income, turnover and expenses: French perspective

- Income derived from unlawful activities is not treated differently for tax purposes from income from lawful activities, provided that it falls within a taxable income category
- Expenses :
  - Principle: indifference to whether the activity or expenditure is lawful or not ("the net taxable profit is calculated after deduction of all expenses": art. 39 CGI ).
  - Special statutory exceptions to the deduction principle can be connected to "moral" issues : Excessive remunerations; "sumptuary expenses"; illegal commissions paid abroad to obtain or retain contracts ; pecuniary sanctions and penalties of any kind imposed on those who breach legal obligations".
- Fines and Penalties :
  - Contractual penalties : no special provision => deductible if related to the business ;
  - Compensatory damages related to the business : non-punitive => idem
  - Administrative or criminal sanctions, penalties and fines: non-deductible (cf. Art. 39, 2 CGI).
    - Punitive damages inflicted to a French Company in the US have the nature of a pecuniary penalty (CE, 8th December 2023, n° 458968)
    - Provision of article 39, 2 CGI applies also to pecuniary penalties imposed by a foreign authority for breach of a foreign legal.
    - Exception : penalties imposed in violation of the French concept of international public order (=> ordinary tax law = > deductible).

# Taxation and illegal activities in Australia

Income from illegal activities is assessable according to ordinary concepts: *Commissioner of Taxation v La Rosa* [2003] FCAFC 125

Division 26 of the *Income Tax Assessment Act 1997* lists certain expenses that cannot be deducted, including:

- Section 26.5: amounts paid by way of penalties under law or paid on conviction;
- Sections 26.52 and 26.53: a loss or outgoing that is a bribe to public officials;
- Section 26.54: losses or outgoings incurred in furtherance of an element of an indictable offence for which you have been convicted.

An illegal activity may still amount to a *taxable supply* for the purposes of the GST

# Topic 4 - Debate

Tax Consequences of the Criminal or Immoral  
Character of Income, Turnover, and Expenses

# Topic 5

## Tax consequences of incorrect accounting

Émilie Bokdam-Tognetti

Rapporteur public, Conseil d'État, France

# Accounting mistakes (1)

## *Brief synopsis of the French system*

- Calculation of taxable income =  
Ending net assets value – Opening net assets value
- Corporation tax return => based on balance sheet accounts (restated on some points to comply with specific tax rules)
- Is it possible, a posteriori, to correct or change the account/tax balance sheet and draw the conclusions of these changes on the tax due by the taxpayer?

# Accounting mistakes (2)

3 different situations :

- Regular accounting choice made by the taxpayer => binding ; can be held against the taxpayer as well as against the tax administration; no correction
- Irregular entries, accounting mistakes :
  - Unintentional errors or omissions : can be corrected at the initiative of the taxpayer or the administration
  - Deliberate mistakes or omissions : the taxpayer is not entitled to ask for a correction; the tax administration can decide either to correct the mistake or to rely on the irregular entry and enforce it against the taxpayer, and assess tax on this basis.

=> the taxpayer is trapped by his/her own deliberate accounting irregularities

# Accounting mistakes (3)

- Applicable to all deliberate mistakes or omissions which had an impact on the net assets value (under- or overestimation of the net assets value)
- Indifference to the motive of the deliberate accounting mistake: no matter whether or not the taxpayer intended to avoid or evade taxation
  - For ex. : deliberately incorrect improved balance sheets to obtain a loan or convince an investor
- The taxpayer may be taxed on this incorrect basis without being able to claim a right to a correction regarding his/her actual situation. Even if this results in more tax being paid than would have been the case if proper accounting and tax entries had been made.

# Accounting mistakes (4)

- Case-law only.
- No textual basis => Moralizing basis?
  - « Don't mess with tax balance sheets and tax returns... »
- Is it questionable regarding the assessment of one's actual ability to contribute?

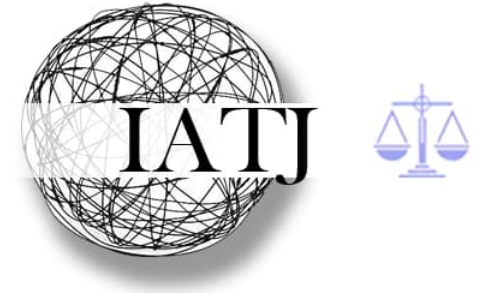


# Topic 5 - Comments

Tax consequences of incorrect accounting

## Topic 5: Accounting Mistakes – the U.S. Perspective

- The U.S. tax system employs self-assessment and reporting.
- Under Section 482, the IRS has broad authority to adjust items (income, deductions, credit, allowances) as necessary to prevent evasion of taxes or to clearly reflect income. *Eli Lilly & Co. v. Commissioner*, 856 F.2d 855 (859)( 7th Cir.), *aff'g in part, rev'g in part, and remanding* 84 T.C. 996 (1985).
- Taxpayers may challenge the IRS' allocations. Challenges require taxpayers to demonstrate that:
  - 1) the Commissioner abused his discretion and that his allocations were arbitrary, capricious, and unreasonable, and
  - 2) that the taxpayer's allocations were made at arm's length. *Sundstrand Corp. v. Commissioner*, 96 T.C. 353 (1991).



## Topic 5: Accounting Mistakes – the Swiss Perspective

- Similar to the French system: Financial statements and profit and loss statements established in line with accounting law regulations are the starting point and – basically – binding (so called “principle of correlation”; FIT 58.1)
- If, however, an entry by the taxpayer is “clearly irregular” (a statement fairly often depending on the appreciation of the authorities), it will be corrected even if the taxpayer did it on purpose – the sanction then is a fine for having tried tax dodging/evasion

# Dealing with accounting mistakes in Australia

- Australian taxpayers complete an annual income tax return as part of a self-assessment system. Businesses registered for GST must also file periodic business activity statements.
- Taxpayers bear the onus of proof in any dispute with the Commissioner.
- Mistakes that result in a tax shortfall may attract an administrative penalty where there was a want of reasonable care, or worse
- 'Safe harbour' provisions can protect taxpayers who use a tax agent that fails to take reasonable care.

# Topic 5 - Debate

Tax consequences of incorrect accounting

We want to thank everyone  
who made this panel necessary