

Operation Zealots and Corruption at the Tax Courts

Kelly Kramer
Partner

+1 202 263 3007
kkramer@mayerbrown.com

Eduardo Telles
Partner

+55 21 2127 4229
etelles@mayerbrown.com

Salim J. Saud Neto
Partner

+55 21 2127 4297
sjsaud@mayerbrown.com

August 2015

Presenting Today



Kelly Kramer
Partner

+1 202 263 3007
kkramer@mayerbrown.com



Salim J. Saud Neto
Partner

+55 21 2127 4297
sjsaud@mayerbrown.com



Eduardo Telles
Partner

+55 21 2127 4229
etelles@mayerbrown.com

Corruption Risks – Brazilian Tax System

Brazil's tax system poses significant corruption risks

- Taxpayers typically interact with only one auditor
- Two levels of administrative review, featuring taxpayer representatives as judges at second administrative level
- Two or three (if constitutional or federal law issue is argued) levels of judicial review, leading to time-consuming proceedings
- No provisions to resolve disputes via settlement – taxpayer must either pay assessment or dispute it
- Success fees for law firms in tax cases are still common
- CARF (Administrative Council of Tax Appeals) – 2nd administrative level for federal tax assessments appeals.

CARF

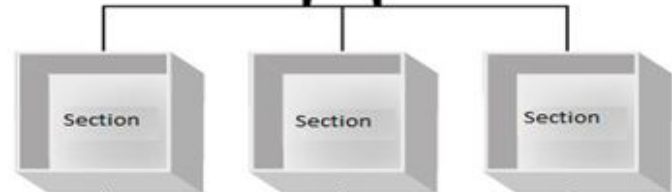
CARF

The Administrative Council of Tax Appeal is the entity to which taxpayers can appeal after the assessment by Federal Revenue

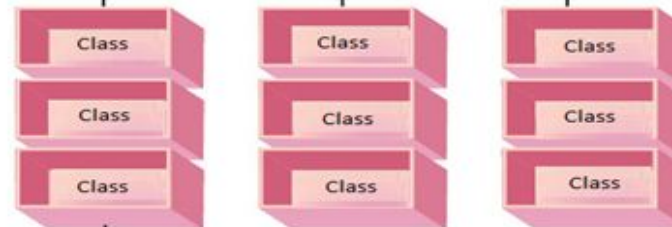
President



3 judgment Sections



Each Section is composed by judgments Classes



Each Class has 6 members



3 appointed by the Public Treasury

3 appointed by taxpayers

Operation Zealots: History

February 2014

- The Federal Prosecutors Office, the Federal Police, the Internal Revenue Service, and the Office of the Comptroller General of the Federal Government initiated an investigation based on an anonymous letter alleging corruption in the tax courts
- According to the letter, some taxpayers paid money to CARF officials in exchange for the officials' promise to vote in the taxpayers' favor



Operation Zealots: History



March 26, 2015

- Federal Prosecutor’s Office investigation of alleged fraud in the judgements becomes public
- 74 CARF trials between 2005 and 2013 are under investigation
 - BRL 19.6 billion (USD 5.63 Billion) are estimated to have been diverted from the public treasury
 - BRL 5.7 billion (USD 1.63 Billion) are proven
- The primary suspicion are debts levied and collected by the IRS which were subsequently canceled following manipulated CARF trials

Congressional Investigation



May 5, 2015

- The Senate formed a Congressional Investigation Committee (CPI) to investigate the alleged fraud at CARF
- Works expected to be conducted until end of September 2015.



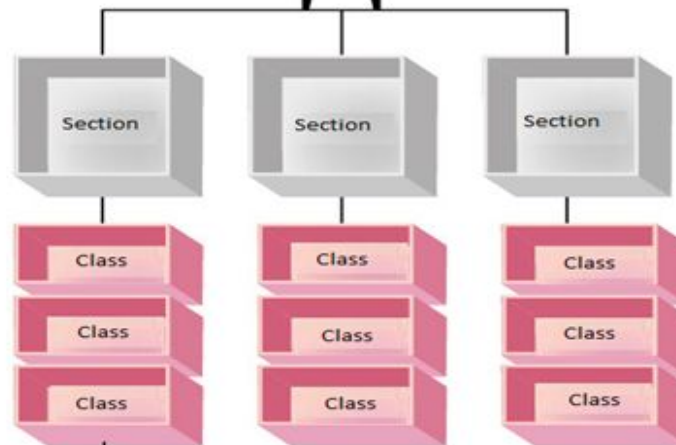
Alleged Corruption at CARF

CARF
The Administrative Council of Tax Appeal is the entity to which taxpayers can appeal after the assessment by Federal Revenue

President

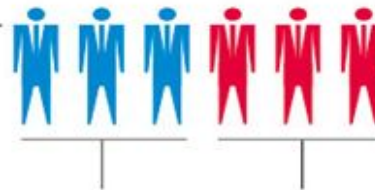


3 judgment Sections



Each Section is composed by judgments Classes

Each Class has 6 members

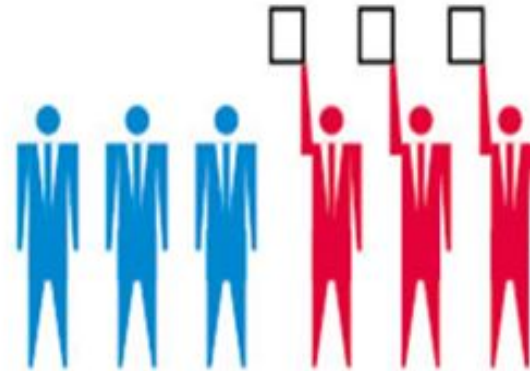


3 appointed by the Public Treasury

3 appointed by taxpayers

Alleged Corruption at CARF

The counselors appointed by taxpayers usually vote in their favor



At least one counselor appointed by the Public Treasury must be corrupted

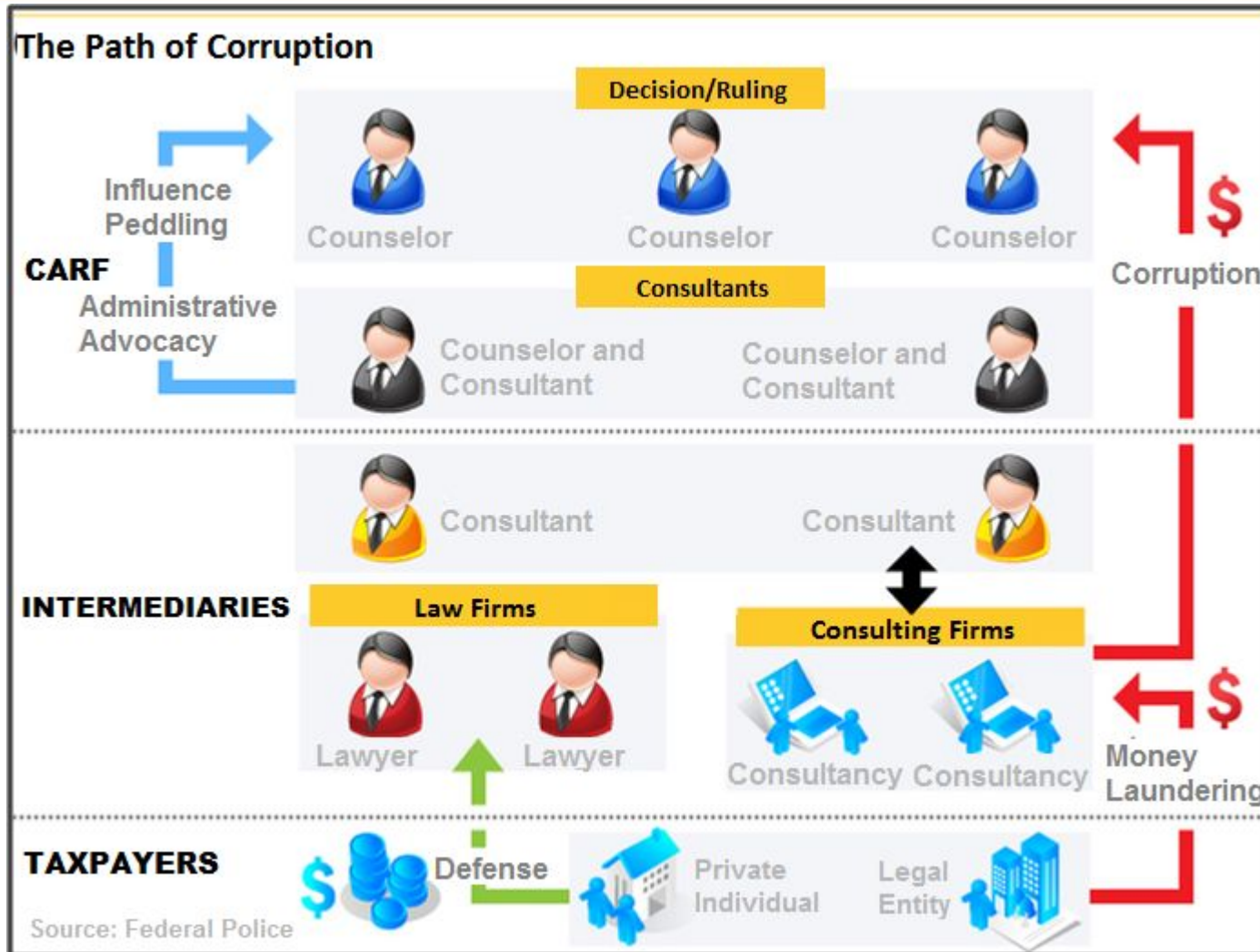


The Scheme

- According to authorities, CARF counselors, former counselors and public servants were using privileged access to information to identify “potential customers”, which they contacted through lobbying firms, consulting firms or law firms
- Companies allegedly paid bribes of up to 10% of the potential tax liability in cases involving tax debts of BRL 1 billion to BRL 3 billion, canceling or decreasing the Federal Revenue tax collections

(please refer to the next slide)

The Scheme



Changes in CARF

- New procedural rules – more strict rules about trial schedules and time limits for issuance of decisions
- New structure – fewer classes with 8 administrative judges (equal number for taxpayers and federal government representatives)
- Brazilian Bar Association (“OAB”) restriction on taxpayers’ representatives maintaining their private practice

Unlawful acts under the CCA

- Promising, offering and giving, directly or indirectly, an undue advantage to a public agent or to a related third party
- Subsidize in any way the unlawful acts prohibited by the law
- Use individuals or legal entities as intermediaries in order to conceal its real interests or the identity of those benefited by the acts
- Frauds related to bidding procedures and administrative contracts
- Embarrass investigations or inspection proceedings



Administrative penalties

- Fine: 0.1% to 20% of the gross revenues of the fiscal year prior to the administrative proceeding
- If revenues cannot be calculated: imposition of fine ranging from BRL 6 thousand to BRL 60 million
- Publication of the conviction decision
- Possibility of piercing the corporate veil



Judicial Penalties

- Loss of the assets derived from the corrupt acts
- Suspension or partial interdiction of activities
- Compulsory dissolution of the legal entity
- Temporary prohibition to receive tax or financial incentives
- Damages caused to the Public Treasury must be reimbursed



Potential for U.S. Enforcement Actions

- The Foreign Corrupt Practices Act
 - Prohibits corrupt payments to government officials
 - Mandates that companies record payments *accurately* in their books and records

Potential for U.S. Enforcement Actions

- The Foreign Corrupt Practices Act
 - DOJ and SEC take aggressive view on jurisdiction
 - Applies to U.S. issuers, domestic concerns, and U.S. citizens
 - Also applies when conduct has U.S. nexus (*e.g.*, e-mails, phone calls, meetings, or bank transfers in or through the United States)
 - Does not reach *all* corrupt payments
 - FCPA only reaches payments made to “obtain or retain business”
 - Corrupt payments to tax authorities arguably don’t meet this test

Potential for U.S. Enforcement Actions

- Payments to Tax Officials Can Be Subject to FCPA

Avoiding or lowering taxes reduces operating costs and thus increases profit margins, thereby freeing up funds that the business is otherwise legally obligated to expend. And this, in turn, enables it to take any number of actions to the disadvantage of competitors. Bribing foreign officials to lower taxes and customs duties certainly *can provide an unfair advantage* over competitors and thereby be of assistance to the payor in obtaining or retaining business.

-- *United States v. Kay*, 359 F.3d 738, 755-56 (5th Cir. 2004).

Potential for U.S. Enforcement Actions

- The DOJ and SEC Take a Broad View:
 - “[B]ribe payments made to secure favorable tax treatment, to reduce or eliminate customs duties, to obtain government action to prevent competitors from entering a market, or to circumvent a licensing or permit requirement, all satisfy the business purpose test.”
 - *Resource Guide to the United States Foreign Corrupt Practices Act*, 13 (DOJ & SEC 2012)

Recent U.S. Enforcement Actions Based on Payments to Foreign Tax Officials

- Layne Christianson (Nov. 2014)
 - Company settled with SEC
 - Agreed to pay more than \$5 million to resolve FCPA charges premised almost entirely on payments to foreign tax officials
 - According to the SEC, “Layne paid nearly \$800,000 to foreign officials in Mali, Guinea, and the Democratic Republic of the Congo (DRC) to reduce its tax liability and avoid associated penalties for delinquent payment. The bribes enabled Layne to realize more than \$3.2 million in improper tax savings.”
 - No DOJ Charges

Questions? Please contact us.

For questions, please reach out to:

Kelly Kramer

Partner

+1 202 263 3007

kkramer@mayerbrown.com

Salim J. Saud Neto

Partner

+55 21 2127 4297

sjsaud@mayerbrown.com

Eduardo Telles

Partner

+55 21 2127 4229

etelles@mayerbrown.com

MAYER • BROWN

MAYER • BROWN
TAUIL & CHEQUER

Thank you.

Mayer Brown is a global legal services provider comprising legal practices that are separate entities (the "Mayer Brown Practices"). The Mayer Brown Practices are: Mayer Brown LLP and Mayer Brown Europe-Brussels LLP, both limited liability partnerships established in Illinois USA; Mayer Brown International LLP, a limited liability partnership incorporated in England and Wales (authorized and regulated by the Solicitors Regulation Authority and registered in England and Wales number OC 303359); Mayer Brown, a SELAS established in France; Mayer Brown JSM, a Hong Kong partnership and its associated legal practices in Asia; and Tauil & Chequer Advogados, a Brazilian law partnership with which Mayer Brown is associated. Mayer Brown Consulting (Singapore) Pte. Ltd and its subsidiary, which are affiliated with Mayer Brown, provide customs and trade advisory and consultancy services, not legal services. "Mayer Brown" and the Mayer Brown logo are the trademarks of the Mayer Brown Practices in their respective jurisdictions.