



**COUNTRY
COMPARATIVE
GUIDES 2023**

The Legal 500 Country Comparative Guides

Costa Rica

TAX DISPUTES

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This country-specific Q&A provides an overview of tax disputes laws and regulations applicable in Costa Rica.

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COSTA RICA TAX DISPUTES



1. Is it necessary for a taxpayer to register with the tax authority? Are separate registrations required for corporate income tax and value added tax/sales tax?

Yes, every taxpayer is required to register before the tax authority. There are no additional registrations required for corporate income tax and value added tax.

Section 128 of the General Tax Code establishes the general obligations of taxpayers when operating in Costa Rica, within these, enunciates the obligation of taxpayers to register appropriately and keep updated their information before the tax authorities. Additionally, complementary regulations regarding the corporate income tax and value added tax, confirm the obligation of taxpayers to register.

In Costa Rica there is a single tax registry, where all persons and corporations that conduct economic activity subject to taxes under the surveillance of the Tax Authorities are required to be registered in. In this matter, when registering, the taxpayer selects which taxes its activity will be affected by.

There are different value added tax rates applicable to products/services and to special taxpayers, hence the importance of a proper registration before the tax authorities.

2. In general terms, when a taxpayer files a tax return, does the tax authority check it and issue a tax assessment - or there a system of self-assessment where the taxpayer makes their own assessment which stands unless checked?

Costa Rica has a system of self-assessment where the tax return filed by the taxpayer stands unless audited.

In Costa Rican tax regulation, self-assessment figures as an important principle when submitting tax reports and paying taxes. The self-assessment in Costa Rican tax

regulation can be found in sections 79, 81 and 130 of the General Tax Code, article 20 of the Income Tax Law, article 27 of the Value Added Tax Law, among others.

Furthermore, the judicial precedents on this matter have been clear regarding the presumption of validity and veracity that the information filed by the taxpayers holds. The First Court of the Supreme Court of Costa Rica established when considering this topic:

"Regarding the income tax, which is of interest for the outcome of the present process, it is important to note that the principle of self-assessment by the taxpayers is applicable. This means, that it is up to the taxpayer himself to determine the tax obligation, based on the legal system, fixing the taxable and non-taxable income as well as the deductible and non-deductible expenses, to calculate the tax quota due. All this is reported to the Tax Authority through the respective report, which is presumed correct and valid. In other words, the duty to declare, supposes the accuracy of the information submitted. However, its content, veracity and correctness are subject to subsequent inspection by the competent authorities, which will verify whether any irregularity on the information submitted." (Free translation) (Judgement 842-F-51-20110 of April 20, 2009)

Therefore, because of Costa Rican self-assessment system, tax returns filed by taxpayers stand unless revised.

3. Can a taxpayer amend the taxpayer's return after it has been filed? Are there any time limits to do this?

Taxpayers can amend their returns after filed. The returns can be amended in any time before the communication of the beginning of a tax audit that intends to issue a notice of deficiency.

Section 130 of General Tax Code establishes the faculty of taxpayers to amend their returns, always considering specific limitations on these amendments (e.g.,

taxpayers should only file amendments on authorized locations, amendments can affect any elements of the tax base, amendments should include payment of interests for incomplete payments and irregular reports).

Regarding the time limit to amend the return, the recently mentioned Section, establishes that amendments are not allowed, after the communication of the beginning of a tax audit. Even when this time limit is clearly demarked in regulation, amendments can be submitted after the initial notice of the tax audit; however, this amendment would require an evaluation and acceptance by the tax authorities conducting the audit.

4. Please summarise the main methods for a tax authority to challenge the amount of tax a taxpayer has paid by way of an initial assessment/self-assessment.

The main method for the tax authority to challenge the amount paid by the taxpayer is the tax audit procedure.

This procedure is broadly regulated in Sections 124 and 144 of the General Tax Code which grants faculties to the Tax Authorities to conduct a procedure to determine if taxpayers have fully complied with their tax obligations. A tax audit can be focused on a specific aspect or entail a broad analysis of the taxpayer's substantive tax duties.

This procedure initiates with the communication of the initial notice to the audited taxpayer. Next, the tax authority requires information from the taxpayer and third parties to verify the validity of the return filed by the taxpayer. The procedure finalizes with the issue of the assessment of the tax authority, which can confirm the compliance of the audited party or determine that the return is irregular. This assessment is communicated to the taxpayer for him to consider the allegations and take a decision of whether to accept it or refute it.

There are two different types of audits that can be pursued by the Tax Authority, an ordinary determinative procedure and a prior-liquidation procedure, both with different terms, and the initiation of one or other will depend on the evidence held by the Tax Authority before starting the audit, obtained from other public entities (e.g., social security entity).

5. What is the procedure where a taxpayer has not registered so is unknown to the tax authority (for example a newly

incorporated company or a foreign company operating through a permanent establishment?)

The same procedure as described in the previous question applies when challenging a taxpayer's return when this taxpayer is not registered before the tax authority.

According to current tax regulation there is not a different procedure to be followed when challenging the amount of tax, a taxpayer has paid or reported, whether it is registered or not before the tax authorities.

There are important considerations regarding sanctions and extensions on the statute of limitations that need to be taken into consideration if the audited company was not registered before the tax authority.

6. What are the time limits that apply to such challenges (disregarding any override of these limits to comply with obligations to relief from double taxation under a tax treaty)?

There is a statute of limitations of a 4-year term on which the Tax Administration has the faculty to initiate the tax audit. This term is extended to 10 years when the taxpayer is not registered before the tax authorities, when the returns are considered fraudulent, or the taxpayer did not file the legally required sworn statements.

The initial notice of the tax audit interrupts the count of the statute of limitations term. Therefore, once the Tax Administration communicates the taxpayer the opening of a tax audit, it will have four years to analyse relevant information, communicate the tax audit findings, and issue the notice of deficiency.

As a relevant aspect that may affect an audit procedure, if a two-month term of suspension on the audit occurs, were there are no acts attempting the conclusion of the procedure and the issuance of the final assessment, the interruption of the statute of limitations caused by the communication of the initial notice of the tax audit loses its effects.

Even though there are no statutory time limits regarding a tax audit's duration, on average, it can be expected to last approximately 24 months, from the communication of the initial notice to the issue of the notice of deficiency. In most cases, the Tax Administration presents the tax audit findings to the taxpayer within 6 to 12 months after the audit started. In the event the

taxpayer does not agree with the proposed additional tax assessment, the Tax Administration will issue the notice of deficiency in the following 6 to 12 months.

7. How is tax fraud defined in your law?

Tax fraud is defined as any action or omission that defrauds the Public Treasury with a purpose of obtaining an economical benefit.

Tax fraud can be committed by evading the payment of taxes, evading payment of amounts withheld from third parties or that should have been retained, or by enjoying unjustified tax refunds or exemptions.

Criminal sanctions apply to the fraudulent party when the defrauded amount exceeds approximately USD 360,000.

8. How is tax fraud treated? Does the tax authority conduct a criminal investigation with a view to seeking a prosecution and custodial sentence?

The tax authority does not carry out the criminal investigation to eventually seek prosecution, however, if when conducting a tax audit procedure, the tax authority considers that the irregularities on the taxpayer's self-assessment may imply fraud, this entity can submit an accusation to the prosecutor's office.

The prosecutor's office is the only institution capable of conducting criminal investigation. After receiving an accusation of a possible tax fraud, the prosecutor's office leads an investigation and analyses the evidence compiled by the Tax Authority to determine if a tax fraud was committed. In the scenario that the investigation concludes the taxpayer has committed tax fraud, this entity will begin a judicial process intending criminal sanctions.

9. In practice, how often is a taxpayer audited after a return is filed? Does a tax authority need to have any justification to commence an audit?

Classified large taxpayers are often audited on their income tax and value added tax returns, in the other hand, middle and small taxpayers are not that frequently audited on these matters. Tax audits on large taxpayers occur at least once every four years.

Because of the economic importance of the large taxpayers' tax returns, and the limited resources of the

tax authorities, efforts to control correct return filings are mainly focused on the large taxpayers.

The tax authority does require an objective justification to initiate an audit, however there is not a restrictive list of motives to impulse the authority to begin the audit. Examples of common situations that may alert and motivate the tax authority into auditing taxpayers are a) reporting unusual profits, b) journalistic reports questioning the financial status of a company, c) inconsistent returns between companies and their suppliers.

10. Does the tax authority have to abide by any standards or a code of conduct when carrying out audits? Does the tax authority publish any details of how it in practice conducts audits?

The tax authority is legally required to abide specific rules when conducting a tax audit. The tax authority may not separate from the reglementary procedure established in the General Tax Code when conducting an audit. Separation from the regulatory standards can imply the annulment of the procedure.

11. Does the tax authority have the power to compulsorily request information? Does this extend to emails? Is there a right of appeal against the use of such a power?

The tax authority has the power to compulsorily request information, both from the audited taxpayer and third parties.

Section 104 of the General Tax Code establishes the faculty of the Tax Authority to request information from the taxpayer to verify his compliance with the tax regulation. This faculty is granted to request books, archives, accounting records, and all other relevant information for the audit purposes.

This article has a broad language on the documents that may be required by the Tax Authority, so it is possible that emails regarding the audited return may be requested, however in practice, this request is not common.

There is no right to appeal against the request of information, moreover failure to hand over the requested information may imply sanctions for the noncompliant party. If the request of information is not appropriately legally sustained, and the requested party decides not to hand over the information, this argument could be

alleged in any procedure intending to apply sanctions.

12. Can the tax authority have the power to compulsorily request information from third parties? Is there a right of appeal against the use of such a power?

The tax authority has the power to compulsorily request information from third parties.

Section 105 of the General Tax Code establishes the faculty of the Tax Authority to request relevant information from third parties for tax purposes, when this information regards their economic, financial, and professional relationship with other persons.

There is no right to appeal against the request of information, moreover failure to hand over the requested information may imply sanctions for the noncompliant party. If the request of information is not appropriately legally sustained, and the requested party decides not to hand over the information, this argument could be alleged in any procedure intending to apply sanctions.

A specific procedure is applicable to the Tax Authority when requesting third party information from financial entities. When requesting information from a financial institution, the Tax Authority is obliged to submit an approval request to a judge, motivating the relevance of the information held by the financial institution. If the judge approves the request, the Tax Authority can then demand the information from the financial entity.

13. Is it possible to settle an audit by way of a binding agreement, i.e. without litigation?

Yes, it is possible to settle an audit without litigation by a binding agreement. After the audit is completed, the Tax Authority will deliver the tax audit findings, which can be accepted by the taxpayer.

If the proposition issued by the Tax Authority is accepted, the taxpayer would be required to compensate the Tax Authority with the amount of taxes unpaid, the interests for the incomplete payment and the applicable penalties.

However, on this scenario, there is no room for negotiation on the amount of additional tax, interest and penalties the Tax Authority is charging.

14. If a taxpayer is concerned about how

they are being treated, or the speed at which an audit is being conducted, do they have any remedies?

There are no specific formal complaints stipulated in the tax regulation to complaint about the conduct of the Tax Authority during an audit procedure, however, Section 358 of the Public Administration General Law (regulation applicable to all procedures promoted by an entity of the Public Administration) establishes the *Formal Complaint* as a mean to protest any irregularities and violations being committed in any procedure.

In case of mistreatments or complaints regarding the speed of an audit, a formal complaint could be filed before the superior of the manager of the audit process.

15. If a taxpayer disagrees with a tax assessment, does the taxpayer have a right of appeal?

Yes, taxpayers have the right to appeal the additional tax assessment (i.e., Notice of Deficiency), issued by the Tax Authority. When the Tax Administration communicates the Notice of Deficiency, the taxpayer can directly file a lawsuit before the Administrative Court (i.e., Tribunal Contencioso Administrativo) or follow the administrative claim phase.

The optional administrative claim phase includes two appeals: an administrative revocation plea before the same office that issued the Notice of Deficiency; and an appeal before the Administrative Tax Court (i.e., Tribunal Fiscal Administrativo). After the final judgment of this Administrative Tax Court, taxpayers still can initiate the judicial claim before the Administrative Court.

16. Is the right of appeal to an administrative body (independent or otherwise) or judicial in nature (i.e. to a tribunal or court)?

As explained in the previous question, the appeal can be submitted both as an administrative claim and/or as a judicial claim.

If the taxpayer chooses the judicial process, he will need to file a lawsuit before the Administrative Court requesting the annulment of the assessment and the reimbursement of the amount paid under protest (in case the taxpayer paid under protest) in the next 4 years after the communication of the last act of the administrative procedure.

17. Is the hearing in public? Is the decision published? What other information about the appeal can be accessed by a third party/the public?

Every administrative procedure and its file are confidential to third parties, including the hearing.

The judicial process, including its file, is of public access to any accredited lawyer, and the hearings held in this process can be attended by any interested party. The judicial rulings are published in an electronic platform of public access, to be consulted by interested parties as precedent.

18. Is the procedure mainly written or a combination of written and oral?

Both procedures, administrative and judicial, have a combination of written and oral phases, but in practice, due to the nature of the tax analysis and evidence submitted in these procedures the written phases predominate.

19. Is there a document discovery process?

No, there is not a document discovery process as commonly known in common law.

In the administrative procedure, the Tax Authority already counts with all the information it requires to sustain its conclusions, obtained from the requests of information previously communicated to the taxpayer, and the taxpayer can access the administrative file at any point during the procedure, making it possible for him to use any information contained in the file to formulate his claims and demerit the conclusions stated in the Notice of Deficiency.

In the judicial process, the main evidence is the administrative file, that as previously explained, can be accessed by the taxpayer at any point. In this process, the plaintiff is responsible for demonstrating that his case theory is correct and consistent with the applicable law; in this matter he needs to provide the judge with all the elements and evidence necessary to sustain that case theory.

20. Are witnesses called to give evidence?

Yes, witnesses can be called in both procedures (administrative and judicial) to give evidence. Witnesses result important in tax litigation when the tax aspects under dispute are highly technical or require specific

knowledge in a particular field, for instance, in a dispute regarding a transfer pricing adjustment.

21. Is the burden on the taxpayer to disprove the assessment the subject of the appeal?

Yes, during the appeal procedure it is the burden of the taxpayer to disprove the assessment issued by the Tax Authority.

In tax litigation procedures, it is responsibility of the appealing party to prove that its case theory is the most plausible and that the assessment made by the Tax Authority is inconsistent with the applicable regulation.

In criminal tax litigation cases, the burden of proof lies with the Prosecutor's Office, that would oversee proving that the taxpayer committed tax fraud in a Criminal Court.

22. How long does an appeal usually take to conclude?

If the taxpayer chooses to follow the administrative claim phase, he will have a 30-business day term to file the administrative appeal against the Notice of Deficiency. The Tax Administration will take between 6 to 24 months to issue a ruling regarding such appeal.

If the Tax Administration's decision is to maintain the additional tax assessment, the taxpayer will have a 30 business-day term to file an appeal before the Administrative Tax Court. Once the Tax Administration admits this appeal, an additional 30-business day term will be granted to the taxpayer to restate its arguments and present further evidence. The Administrative Tax Court will take between 6 to 36 months to issue a final decision regarding this appeal.

In the scenario of a judicial claim, the term of this process may differ a lot between cases. Because every case regards very different matters, and the Administrative Court has limited time to attend every case, the judicial process can last several years. From the moment the lawsuit is filed in the Administrative Court to the issuance of the final ruling, the process can last approximately 4 years (with no delays involved). After the judgement is issued by the Administrative Court, an appeal can be filed before the First Chamber of the Supreme Court (ie "Sala Primera de la Corte Suprema de Justicia"), which may last up to 4 years to issue a ruling on the appeal.

23. Does the taxpayer have to pay the assessment pending the outcome of the appeal?

No, if the taxpayer follows the administrative claim phase, he does not have to pay the assessment when pending the outcome of the appeal.

The taxpayer has the faculty to pay under protest the amount assessed by the Tax Authority in the Notice of Deficiency, and in case the administrative office or the Administrative Tax Court accept partially or totally the arguments of the appeal, the government would be obliged to return the deposited funds plus the respective interests. This possibility is regulated in Section 144 of the General Tax Code.

24. Are there any restrictions on who can conduct or appear in the appeal on behalf of the taxpayer?

The appearance in administrative procedures is regulated by the Section 133 of the General Tax Code. This article stipulates that in all procedures interested parties can act personally or through their duly appointed representatives. The Administrative Court confirmed in recent case-law that in any phase of the administrative procedure, including the appeal procedure, the taxpayer can appear through their duly appointed representatives.

However, the appearance in judicial procedures is regulated by Sections 17 of the Administrative Process Code, 1256 of the Civil Code, and 20.1 of the Civil Process Code, all which establish the obligation of all parties to be accompanied by a lawyer in all phases of the process.

25. Is there a system where the “loser pays” the winner’s legal/professional costs of an appeal?

Yes, in judicial processes there is a system where the “loser pays” the winner’s costs. This system has specific parameters on the amounts that losers should pay the winner party; these parameters depend on the economic value of the process. Using this system in the administrative judicial process is justified by Section 193 of the Administrative Process Code.

In the administrative procedure (before the Tax Authorities and the Administrative Tax Court) this system is not applicable, neither party should pay at any point the costs that the other part incurred during the

procedure.

26. Is it possible to use alternative forms of dispute resolution – such as voluntary mediation or binding arbitration? Are there any restrictions on when this alternative form of dispute resolution can be pursued?

Alternative forms of dispute resolution for tax matters are not applicable in Costa Rica.

27. Is there a right of onward appeal? If so, what are all the levels of onward appeal before the case reaches the highest appellate court.

Yes, both procedures, administrative and judicial, have levels of onward appeal.

In the administrative procedure there are two levels before reaching the highest administrative court. The first appeal (revocation plea) is filed before the same office who issued the additional tax assessment. If this office rejects the appeal, the taxpayer can appeal against the Administrative Tax Court. As explained before, even when the Administrative Tax Court rejects the appeal, the taxpayer can file a lawsuit before the Administrative Court requesting revision and annulment of the assessment.

The judicial process has only one ordinary appeal, that can be submitted against the unfavourable judicial ruling. After conducting the judicial process, the Administrative Court will dictate a judicial ruling, which in case of an unfavourable result can be appealed before the First Chamber of the Supreme Court.

28. What are the main penalties that can be applied when additional tax is charged? What are the minimum and maximum penalties?

The main penalties that can be applied when additional tax is charged consist of monetary penalties which sum will depend on the severity of the infraction. The penalties for irregular tax returns that imply additional tax charges can be found in Section 81 of the General Tax Code.

Penalties are calculated over a monetary sanction base. The sanction base in cases of inaccurate returns consist in the difference between the amount paid by the taxpayer and the amount requested by the Tax Authority

in the Notice of Deficiency.

The minimum penalty applicable consist in a 50% of the monetary sanction base. The maximum penalty applicable consist in a 150% of the monetary sanction base.

These penalties are a separate amount to be paid by the taxpayer from the initial tax and the interests generated by the incomplete payment.

29. If penalties can be mitigated, what factors are taken into account?

Sanctions can be mitigated if specific assumptions and conditions are complied. The mitigation of penalties can be found regulated in Section 88 of the General Tax Code.

The conditions necessary to mitigate the penalties are:

- a) When the taxpayer spontaneously remedies his non-compliance without any action conducted by the Tax Authority, the sanction would be reduced by 75%.
- b) When the taxpayer remedies his non-compliance after the action of the Tax Administration, but before the

communication of the Notice of Deficiency, the sanction would be reduced by 50%.

c) When, the taxpayer has already received communication of the Notice of Deficiency and within the term established to appeal it, he accepts the assessment and remedies his non-compliance, the penalty would be reduced by 25%.

30. Within your jurisdiction, are you finding that tax authorities are more inclined to bring challenges in particular areas? If so, what are these?

The Tax Authority does focus their main efforts in a specific group of taxpayers. Because of the economic importance of their contributions, they are more frequently targeted for audits.

The most common areas on which the Tax Authorities are inclined to challenge returns are in the financial sector and those returns filed by qualified large taxpayers.

The most recent audits have revised deeply the proper payment of withholding tax and transfer pricing agreements between related companies.

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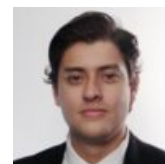
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