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# WORKING PAPERS

#36

Tax evasion and tax fraud  
in the bankruptcy process:  
empirical evidence from  
Portugal



Ana Dinis; Cidália Lopes; Alexandre Silva



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>> **FICHA TÉCNICA****TAX EVASION AND TAX FRAUD IN THE BANKRUPTCY PROCESS:  
EMPIRICAL EVIDENCE FROM PORTUGAL**

WORKING PAPERS Nº 36 / 2015

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Editor: Edições Húmus

1ª Edição: Fevereiro de 2015

ISBN: 978-989-755-145-1

Localização web: <http://www.gestaodefraude.eu>

Preço: gratuito na edição electrónica, acesso por download.

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Paper in I2FC:2014 - Multiple Perspectives of the Shadow Economy

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>> **RESUMO**

O presente artigo tem como objetivo analisar o regime de tributação das sociedades insolventes em sede de IRC e a forma como este processo pode conduzir a mais evasão e fraude fiscais, em Portugal. Assim, é nossa expectativa poder-se responder à seguinte pergunta de investigação: A complexidade do sistema fiscal permite a evasão e a fraude fiscais no processo de insolvência? Para o efeito, elabora-se, em primeiro, uma revisão dos principais estudos que, no contexto nacional e internacional, analisam e debatem os principais problemas criados pelo regime fiscal das sociedades insolventes na perspetiva da evasão e fraude fiscal. Em segundo, apresentam-se os resultados de um estudo, conduzido em Portugal, em 2013, o qual avalia qualitativamente as perceções dos Administradores da Insolvência (AI), em relação ao regime fiscal das sociedades insolventes. A técnica de recolha de informação usada foi o recurso a questionário aplicado a toda a população de AI. Obtivemos uma taxa de resposta de 15,48%. Concluiu-se que o sistema fiscal português não está simplificado no regime de tributação das sociedades insolventes, levantando muitas dúvidas acerca da sujeição das sociedades insolventes a imposto. Acresce ainda que, o CIRE, ao dar primazia à insolvência, em prol da recuperação de empresas, está a dar mais espaço à evasão e fraude fiscais neste processo em Portugal. E, neste sentido, julga-se muito necessário a harmonização de procedimentos, jurídicos e fiscais, do CIRE e do CIRC, em ordem a um tratamento mais coerente do imposto no processo de insolvência, por forma a evitar a evasão e a fraude fiscais no processo de insolvência.

**Palavras-chave:** Sociedades Insolventes. Imposto sobre o Rendimento das Pessoas Colectivas (IRC). Evasão e fraude fiscais.

**JEL Codes:** G33 (Insolvência. Liquidação). H26 (Evasão fiscal). K34 (Lei fiscal).

## &gt;&gt; ABSTRACT

*This article aims to analyze the taxation of insolvent companies and how this process can lead to more tax evasion and tax fraud, in Portugal. Thus, this paper intends to explore how the complexity of the tax system allows tax evasion and tax fraud in insolvency proceedings. This paper is divided in two parts. At first, a review of major studies in national and international context, analyze and debate the issues raised by taxation of insolvent companies from the perspective of tax evasion and fraud. In this regard, the complexity of business insolvency, which becomes even more controversial when embracing the taxation of insolvent companies. Many of the problems that arise for the correct identification of the tax treatment applicable to processes happen to set between tax law and bankruptcy law. Second, we present the results of a study conducted in Portugal in 2013, which qualitatively assesses the perceptions of the Insolvency Administrators (AI), in relation to the taxation of insolvent companies. The technique used for gathering information was the use of questionnaires administered to the entire population of AI. A response rate of 15.48% was obtained. It was concluded that the Portuguese tax system do not make taxation of insolvent companies a clear process, raising many questions about the subject of insolvent companies to tax. Furthermore, the CIRE by giving primacy to the insolvency, for the sake of business recovery, leads to the possibility of tax evasion and fraud. To sum up, it is deemed indispensable the harmonization of procedures, legal and tax, the CIRE and the CIRC in order to a more consistent treatment of tax in insolvency proceedings, in order to annul the tax evasion and tax fraud case insolvency and also allow business recovery.*

**Keywords:** insolvent firms. Tax on Corporate Income Tax (IRC). Tax evasion and fraud.

**JEL Codes:** G33 (Bankruptcy. Liquidation). H26(Tax evasion). K34 (Tax Law).

## >> INTRODUCTION

The present study deals with the complexity of the Portuguese tax system, in particular with regard to the framing of the insolvent companies in terms of corporate income tax (IRC), a reality girt to companies with headquarters or effective direction in Portuguese territory, and examines how the tax treatment in the insolvency process can lead to tax evasion and tax fraud.

Now, as we shall see, the insolvent corporate taxation is a matter so complex, that doesn't allow the consensus among the various stakeholders of the insolvency proceedings, the insolvency Administrator (AI), Tax and Customs Authority (ATA) and Judicial Magistrates (MJ), as regards corporate taxation.

It is whether, the bankrupt estate are or not subject to taxation and if the proceeds of the liquidation of insolvent assets should be covered by the CIRC. Will be insolvent corporations taxpayers? Should the proceeds from the liquidation of the bankrupt estate to be subject to taxation in IRC?

In this sense, the ATA has understood the bankruptcy or insolvent as a taxable person and the consequent subjection to the liquidation of insolvent assets IRC. In turn, the AI argue that a society insolvent is no longer occupied principally an activity of commercial, industrial or agricultural nature, and that, therefore, from the moment in which all goods are seized for the bankrupt estate, the proceeds of liquidation is not subject to taxation in IRC, and this opinion is corroborated by some national jurisprudence.

The insolvent corporate taxation is, therefore, in our opinion, a controversial topic, associated mainly to lack of simplification of the tax system in Portugal. It is therefore this complexity of our tax system that allows that there are so many doubts in this respect and that in our view, can lead to tax evasion and tax fraud in the insolvency process.

The present research tries to present a critical view of the Portuguese tax system on corporate insolvency, particularly those factors that determine or would no longer determine the placing under IRC of the bankrupt estate and the proceeds from the liquidation, using an empirical study based on a sample referenced, which focuses on the profile and work developed by AI, in Portugal.

In order to achieve the proposed objectives, we structured this article as described below.

Here are some preliminary considerations on the legal regime of insolvent companies and a brief analysis the fiscal regime of the insolvency

proceedings in Portugal and the various studies conducted internationally. Dedicated after our study to research methodology and data analysis, and develop the methodological aspects of our investigation, with the statistical testing, with a view to confirmation of hypotheses, and discussion of the results obtained. Finally, thirdly and lastly, we will present the main final considerations.

## >> 2. LITERATURE REVIEW

### 2.1. The legal regime of the insolvent companies: some preliminary considerations

In Portugal, the legal regime of the insolvent companies is regulated in its essence by *Código da Insolvência e da Recuperação de Empresas* (CIRE).

In the sentence that declare bankruptcy, the judge decrees the seizure, for immediate delivery to the administrator in insolvency proceedings, the debtor's accounting and elements of all of your assets, even if seized, repossessed or seized or detained in any way, article 36 of the CIRE.

The bankrupt estate is intended to satisfy creditors of insolvency, after paying its own debts, and, unless otherwise noted, covers the entire debtor's assets on the date of Declaration of insolvency, as well as the assets and rights which he acquires pending the process, article 46 of the CIRE.

The creditors' meeting deliberates on the closure or maintenance activity of the establishment or establishments within the bankrupt estate, article 156 of the CIRE.

Briefly, in the insolvency procedure's is possible application will the situations which then describe.

On the one hand, existing inadequacy of the bankrupt estate or going on the payment of debts to creditors, the insolvency process is terminated. On the other hand, the creditors may resolve on the maintenance of the activity of the establishment. Then the creditors can still deliberate the closure of establishment.

In the first case, ending the process of insolvency, the company can continue its activity normally. In the second case, and agreed a plan of insolvency, the company's activity can also continue normally. In the third and last case, the company goes into liquidation.

For the application of the CIRE over time, it is possible to analyze the *Estudo de Avaliação Sucessiva* (2010) that the recovery of insolvent companies failed to assert itself in practice as an alternative to the effective dissolution of the company. This statement results, from the observation of the limited number of cases, in which the fundamental option of creditors is the recovery of the insolvent, and that such does not derive from legal constraints.



## 2.2. The Portuguese tax system on insolvency

For SOARES (2004) the Portuguese tax system is complex, difficult, volatile and unstable in time, so it is more than certain that the frequent changes in tax law, particularly as performed in very short time intervals, hinder its interpretation and application, which encourages the evasive behaviors.

That is why LOPES (2008) shows that the fiscal science has given safely until relatively recently more attention to equity and efficiency objectives than the simplicity, and the problems of viability or operation of the tax system.

In fact, CADILHE (2005) states that the public administration is, in general terms, heavy, slow, over regulated and full paper, and that urge, therefore, the need for change.

Over the years of the application and other legal normative CIRE relating to insolvency, the fiscal problems was constant, particularly in the clash of ideas of AI in contraposition with the ATA, which is revealing the complexity of the tax system in the process of insolvency, in Portugal.

The fact that there is no special tax regime for insolvent companies, it becomes necessary to clarify and discuss the fiscal situation of the companies in order to simplify the taxation in the insolvency process less bureaucratic, tax and judicial system and prevent tax evasion and tax fraud in the insolvency process.

Let's see the issues that arise around the insolvency process and that are originated by the complexity of the tax system, as we've been referencing.

§ 2 the CIRC refers, in general, that are subject to tax legal person.

Thus, generally is IRC taxpayer's legal person residing in national territory, collective exercising or not primarily an activity of commercial, industrial or agricultural nature, and legal person not resident in national territory collective, engaged in its activity with or without permanent establishment.

Will be insolvent companies IRC taxpayers?

The AI (2010) always understood that there is no activity when it deliberates the liquidation of the insolvent debtor's assets and the distribution of the product obtained by lenders, not aimed at profit but only the payment to creditors, not realizing that economic operations of business nature (article 3, paragraph 4, CIRC the opposite). Argue, therefore, that a society insolvent is no longer occupied principally an activity of commercial, industrial or agricultural nature, which do not obtain income exempt from payment of any tax.

However, the position of ATA (2010) was, since always, contrary to the AI, tending to consider that a company that had been dissolved in the wake of a bankruptcy process continued to exist as a taxable person until the date of the closure of the liquidation, and not only when it decided its maintenance, keeping it tied to tax obligations, and thus to timely delivery of declarative tax liabilities.

Subsequently, the ATA issued, approved and did enter into force *Circular* No. 1/2010 of 2 February, whose effects had an impact in the sphere of AI, with obligations imposed were not of any legal standard laid down (CIRE), hence the need for amendment to article 65 of the CIRE, which eventually arise by law No. 16/2012, of 20 April.

Although there were many doubts in this respect, TIAGO (2012) came to refer to this was the understanding of the Tax Courts, which was poured in the judgment of *Supremo Tribunal Administrativo* (2011), and which are in accordance with the understanding adopted by ATA, that the declaration of insolvency of the company is not the justification of fulfillment of tax obligations, as stated in declarative of *Circular* No. 1/2010.

To clarify this issue, let's look at some issues examined in the *Relatório do Grupo para o Estudo da Política Fiscal: Competitividade, Eficiência e Justiça do Sistema Fiscal* (2009).

The issues discussed were essentially as follows. Would cease or not declarative obligations and commercial registration, that is, over whether or not the statements of income and of cessation of activity and would suffer material or not the closure of the liquidation? If so, who would be the entity responsible for compliance with these obligations?

The report evidenced the existence of judicial decisions that understood that the liquidation of the insolvent estate do not apply the rules of *Código das Sociedades Comerciais* (CSC) concerning the voluntary liquidation of companies, not existing reporting obligations arising from acts performed during the bankrupt. Hence, this being related to matters of tax personality of the bankrupt estate, but who would design in particular on IRC, the same recommended if you should consider the compatibility of the tax code with the normative standards of CIRE. In this sense, it has appeared the harmonization of conditions of cessation of activity, to reduce where possible the reporting obligations of the insolvent.

So, we proceeded to the long-awaited amendment of CIRE.

Second ESTEVES *et al.* (2012) that modification on CIRE came to clarify the fulfillment of tax obligations, which showed insufficient in the previous regime, in particular as a result of the decision of deliberation of closedown of the insolvent company. With the new wording of article 65, concerning

the annual accounts of the debtor, this question concerning tax compliance was expected to finally clarified, since went on to define, in accordance with paragraph 3, which, with the deliberation of closedown of establishment, in accordance with paragraph 2 of article 156, necessarily quench all the reporting obligations and tax.

LANÇA (2012) shows, however, that still was not properly clarified this issue, because the truth is that the norm of the CIRE seems counter to the tax law, in particular the CIRC, since at the date of the closure of the liquidation is the cessation of activity for tax purposes. Therefore, the doubts are still at the stage of liquidation of the bankrupt estate.

According to *Tribunal do Comércio de Vila Nova de Gaia* (2007), the standards of the liquidation of the company should not be confused with the liquidation of insolvent assets.

But the ATA has a contrary position. But let's see.

ATA (2010) argues that the subjection to taxation standards, even in the process of liquidation of insolvent assets have nothing out of the ordinary in the light of the principles underlying the taxation on IRC. This is because, the fact that it declared bankruptcy and eventually cease the pursuit of the corporate purpose of the company, does not mean that this let to obtain income subject to IRC and stuff like that is because they do not derive only from the effective exercise of an economic activity and it must be taken into account, in particular, the accretions not reflected in the net profit or loss for the financial year. The ATA also states that once declared bankruptcy, stop designing joint exercise economic activity in order to share profits, but if you check the conditions of entry for the IRC, because what is relevant is that, even considering that the insolvent entities not in fact activity, never would by reason of insolvency, being classified as no exercising the main title.

LANÇA (2012) puts it, however, a number of issues. The CIRE being the latest law does not revoke the oldest laws? The new rule of article 65 doesn't mean that an insolvent company that shut down her establishment is in fact relieved of their reporting obligations and tax and make it be subject to IRC in the liquidation of their assets? *Circular* No. 1/2010, even if they do not have the force of law, continuing in force, can lead to a problem of lack of uniformity among the various codes?

How can we analyze, becomes, in our view, required the amendment of tax legislation in respect of insolvent companies, in particular in clarifying the tax regime and the assumptions of the IRC.

On this subject also raised other issues of fair taxation.

What is a fair tax? What is the standard for measuring the degree of fairness of a tax system? Are the issues that SANTOS (2003) places and which considers that do not have objective and universally accepted answer.

And when in the liquidation of insolvent assets, ATA still requires tax will be taken into account the ability to pay of the company insolvent?

According to SANTOS (2003), and in accordance with the principle of ability to pay, a tax system is fair if the apportionment of taxes by citizens is made according to their economic capacity, regardless of the degree of satisfaction that each can withdraw from the enjoyment of public goods and services.

The author discusses this concept of the ability to pay based on *Lei Geral Tributária* (LGT), which considers that the condition of taxpayer is explicitly restricted to ones that are linked to the fulfillment of the tax provision, either as a direct contributor, as a replacement or as responsible. And the establishment of a tax has as primary objective the capture of a recipe, so the tax legislator begins by targeting the possessor of a concrete manifestation of productive capacity - the basic condition so that someone can provide the transfer of economic resources that tax translates, so according to our LGT, only some of the people linked to the fulfillment of tax obligations within the framework of a specific tax, assume the status of taxable person.

Thus, for SANTOS (2003) once off the capitation solution, the basic option that offers the legislator is the choice for the tax base of an element able to indict the economic capacity of a person, whether in your sources (e.g., income), both in its manifestations (v. g, a consumption).

Therefore, it is our understanding that not being IRC a capitation tax cannot be required only by the mere fact of insolvent society exist. It is necessary first of all take into account the economic capacity of the insolvent companies.

Thus, in relation to the insolvency process, put also other issues. The liquidation of insolvent assets is a productive activity that originates from liquid enrichment, for what is considered income?

When we look at the article 1 of CIRE, when defines the concept of insolvency process, we must consider that the product of this settlement is increased wealth and which competes for the determination of the collectable?

According to TIAGO (2012) in companies declared insolvent, is not the fact that it is a universal implementation of goods and of being faced with a poor economic situation, which prevents if fortuitous and unexpected gains can verify, sales of goods for values that can not only solver all debts as generate leftovers, increases in wealth. As such, the author shows that there

is any reason to insolvent companies to evade taxation in IRC, and that the taxable profit of the insolvent company is determined with reference to the whole period of liquidation of corporate assets.

Given the concept of extra income, for purposes of IRC, and whereas the taxation of income in IRC focuses on economic reality constituted by profit, the judgment of *Supremo Tribunal Administrativo* (2003), evidence that the sale of goods forming part of the fixed assets of a company however declared bankrupt, made us autos to liquidation of the respective active, not part of the concept of capital gains and capital losses referred to in Circ.

Also *Supremo Tribunal Administrativo* (2011) stresses that the declaration of insolvency is one of the fundamentals of dissolution of societies and that dissolution is equivalent to the death of the offender, and confirms the previous sentence.

With the decision of the liquidation of the company, this dissolves and becomes a bankrupt estate.

Will the bankrupt estate a collective entity and consequently IRC taxable person?

Having regard to the principles which governed the tax reform in Portugal and the change in the structure of taxation of income, there is no doubt that in IRC and being determined to maintain the activity of a company which is insolvent, the total fulfillment of its obligations to you is inherent tax accounting, and it comes to a taxpayer, as requires. The problem arises with regard to collective people who continue their insolvent activity, following the decision of the creditors ' meeting, which decides the closure of establishment, in accordance with the procedure defined in CIRE.

In Portugal, the ATA has understood the bankruptcy or insolvent as a taxable person of IRC. But make sense this meaning?

TIAGO (2012) stresses that as if emanating from ATA, the tax personality of insolvent as defined in article 15 of LGT, is not affected by the declaration of insolvency, because inherent in the respective process of liquidation is the realization of transactions covered by the incidence of IRC. In accordance with paragraph 5 of article 8 of the CIRC, which states that the cessation of activity occurs on the date of the closure of the liquidation, the author argues that until the closure of liquidation the company maintains the legal personality and as such is subject to rights and obligations, continue to be applicable, with any necessary adaptations and in everything that is not incompatible with the procedural regime of liquidation the provisions governing the societies dissolved, as has paragraph 2 of article 146 of the CSC.

But for AI (2010) when a society insolvent keeps the activity, there is no doubt that the fiscal situation while tax taxpayer. Different is, however, the situation of the insolvent entity that ceases to that activity, and, therefore, ceases to be a taxable person for the purposes of IRC. This is because after the declaration of insolvency, the entity concerned ceases to constitute an economic structure that aims to achieve profit through the development of a commercial, industrial or agricultural activity, to become a set of goods, without any functional link between themselves, which are intended, so alone, to satisfy lenders. So, after the declaration of insolvency operates the dissolution of society which leads to the conclusion that the subjective point of view, such entity will from that moment on, configure any of the figures provided for in article 2 of the CIRC, while taxable.

The CIRE provides tax relief in IRC, in accordance with its article 268.

In the perspective of ATA (2010) you can only move the scope of taxation for exemption that what *a priori* is subject, and assumes the subjection to IRC, of the bankrupt estate, regardless of whether they decide the settlement or the maintenance of society declared insolvent.

This ATA's position makes sense?

For SALDANHA SANCHES (2010), the tax bill is always filled with a set of small exceptions, special schemes, tax benefits that though in his final reckoning deeply alter the distribution of the tax burden, almost always escape the lack of the vast majority of taxpayers. Are exceptions that splinter the internal logic of the system and the principles of burden, are a set of exceptional standards that normal taxpayers had understand, but to convey the exact notion that the tax laws are unfair.

Even if, as advocates XAVIER DE BASTO (1994), the abuse of tax benefits and regulations exception regimes are, in principle, source of complexity and often constitute an incentive to discover new avenues for tax evasion, the benefits are justified as policies to encourage certain types of behavior more desirable or certain activities.

We consider that, in the positions it has taken, the ATA emphasizes the maintenance of companies declared insolvent, preferring its sanitation, rather than promotes its settlement, with a view to extinction. We understand then that from the perspective of ATA the insolvent company's recovery is that it must be the primary objective of insolvency proceedings.

However, if we analyze the own *Estudo de Avaliação Sucessiva* (2010) do not notice the position of the ATA, since it is not established that the stigma of bankruptcy that prevents the recovery, but the lack of economic and financial conditions of the majority of companies that arrive at a situation of impending or current insolvency and, to some extent, the presentation of an insolvency plan aiming at the recovery of the insolvent debtor is in practice, more a way of postponing the payment of liabilities, since it has resulted in the delay in satisfaction of creditors' rights.

The CIRE by providing tax benefits in the process of insolvency in IRC, which apart from taxation the realization of assets of an insolvent company in those specific circumstances, to what extent respects the principle of equality?

If, on the one hand, the question put is: why not include the sales tax benefits made by the insolvency administrator, so arguably they are not taxed, since the intended effect is exactly the same – the satisfaction of creditors of the insolvent company? On the other hand analyzing the article 268 of CIRE, we can interpret that effectively the same only considers the exemption of those operations, because these are the only ones in which effectively insolvent companies should consider IRC taxpayers, by continuing its activity – situation applicable only in those circumstances, in the process of insolvency. But to ask: what is the logic of exempting the restitution of goods in payment to creditors and no sales to third parties?

In view of the fact that article may have different interpretations, can, in our view, lead to tax evasion and tax fraud.

As results from the above, we can conclude that this theme is a very complex matter, controversy and unfinished discussion in academy and in business and professional life.

We will see then how the theme of insolvent corporate taxation is complex, even in the international context.

## **2.3. The taxation of insolvent companies – international comparisons and results of studies on Brazil, in Spain, in the USA and Italy**

### *2.3.1. The taxation of insolvent companies in Brazil*

In Brazil, the Bankruptcy Institute is currently governed by the provisions of *Lei de Recuperação de Empresas e Falências*, Law nº 11,101.



The phenomenon of corporate insolvency has been a subject of study in various areas, and its approach has been very controversial. FERNANDES and MARIO (2010) underline, in this context, the complexity of the theme, which becomes even more controversial when embraces another theme as the taxation of insolvent companies. The authors highlight that with bankruptcy the bankrupt is ousted from his heritage and the bankruptcy, as an accounting entity for purposes of analyses and controls, but which has no legal personality in positive law and that much less equates to person for tax purposes. We have highlighted the fact that the authors did not agree with the incidence of taxation on the assets held, when referring to the complete liquidation of assets to pay creditors, since you can't treat the block sale of assets as a recipe, because it is only the best value obtained of those assets in forced process. Taxing on the resources seized for bankruptcy to settle their debts has no economic or even legal support. What's taxed is heritage and not the recipe and, even more so remaining guarantees for lenders.

Also SPADOTTO (2005) states, that the tax debts constitute one of the main obstacles to the economic recovery of a company.

For MARQUES (2005) the tribute is the main link between the tax regime and the bankruptcy regime and the restructuring of the legal framework of insolvency is needed, with the main objective of approaching the two regimes.

Citing VALVERDE (2000) a bankruptcy act wears out fast in permanent attrition with fraud and that the gaps that the cunning artifice can eventually open in the law, no matter how closed it is, require repairs.

### 2.3.2. *The taxation of insolvent companies in Spain*

In Spain, the *Ley Concursal* 22/2003 establishes the judicial procedure to treat the process triggered by the insolvency of a debtor, the so-called *concurso de acreedores*.

Second MORENO-TERNERO (2002) the problem of bankruptcy is the fact that you have to assign a given quantity of a divisible when there are not enough to satisfy the demands of all creditors.

With regard to tax issues raised in the process of insolvency, showed the opinion piece of MEDINA (2012) regarding tax implications in the reform of the *Ley Concursal*, in particular the fact that the reform has been accompanied by a number of other legislative changes as for example at the level of the *Ley General Tributaria*. Was already a necessary reform, in particular by the fact that, according to the author, the interpretation of the law could then rise to a multiplicity of judicial opinions. However, the same author empha-



sizes that this amendment will have an impact that will not generate any benefit to the *concurso de acredores*, since when you encourage the credit standing of the public creditors in the event of bankruptcy, will safeguard the position of creditors, which is the main interest of insolvency proceedings, but yield to the public interest, which will be favored to the detriment of economic operators. The author presents the example of British insolvency practice, after the abolition of the privileges of public credits, allowed a greater satisfaction of creditors, and that allowed them to increase their *rentas disponibles* and consequently the possibilities of investment and consumption, thus stimulating the economy and, of course, the tax revenue of the Government.

ESCOLÀ (2004) argues that although the Ministry of Justice insists on highlighting that the purpose of the new regulation of bankruptcy is to support and ensure continuity of viable enterprises that are temporarily involved in a situation of insolvency, the regulation will be far from easy to achieve this goal, because the payment of debts is the main objective of the new regulation. Still, the author highlights that the objective the new law is modernizing the Spanish bankruptcy law, until then governed by standards ancient and jumbled, that could provide adequate solutions to the situations of bankruptcy of the economics of century XXI. In order to adapt to new needs of the economy, the bankruptcy process was simplified.

### 2.3.3. *Taxation of insolvent companies in USA*

The American insolvency process is regulated by federal law, the *Bankruptcy Code*.

For SMITH (2008) the uncertainty of taxation encourages the insolence, and favors the corruption of men, even when they are neither insolent nor corrupt. A tax reckless offers a great temptation for fraud. The law, contrary all the principles common of Justice, first creates the temptation and after punishes those who commit it; and usually also increases the punishment in proportion to the own temptation to commit the crime.

So, if we take into account also RICHARDSON (2006) we understand that complexity is a determining factor in explaining the level of tax evasion and tax fraud and that there is a positive relationship between both variables. Thus when the complexity of the tax system increases, also increases the level of tax evasion and tax fraud.

As regards the subject of taxation on insolvency NEWTON (2000) despite the appeal to conscience tax, highlights the effect of the tax on certain transactions, which may impose greater constraints on entities that are

in insolvency proceedings, itself already in a weak financial position. It is not uncommon in bankruptcy carry out taxable income during the period of administration, from the sale of all or part of the assets or taxable recoveries; however, operating transactions net of losses and other tax deductions are often unable to compensation to minimize the effect of the tax.

KRAUSE and KAPILOFF (1966) claim that when the bankruptcy is created there is a tax levy directly against the property and against creditors indirectly by reducing its dividend in bankruptcy, so the effect of bankruptcy is to transfer the tax burden of the debtor to creditors. The Government receives a tax as a result of the bankruptcy proceedings, which is obtained at the expense of creditors, so the issue of taxable profit, during the administration of a bankruptcy estate is fraught with social and economic considerations.

#### *2.3.4. The taxation of insolvent companies in Italy*

Under Italian law, *ITÁLIA LEGGE*, considers the insolvency as factual situation, which may lead to the declaration of insolvency or the introduction of other processes intended to subtract the availability of debtor assets and winding to satisfy lenders with active obtained.

Also in taxation, insolvency in Italy generates some controversy. The purpose of the reform of Italian bankruptcy law, TOSI (2005) highlights the utility to take stock of the situation, trying to identify the guidelines of the legislature according to the perspectives of innovation in the system of taxation – tax implications. And is necessary because, according to the author, many of the problems that arise for the correct identification of the treatment applicable to fiscal processes happen for overlap between tax laws and the bankruptcy act, and, in this context, it is advantageous to address the issues raised in the past about fiscal discipline in the insolvency proceedings, the legislature solve definitely the regulatory framework.

Also BUSA (2005) points out one of the main problems of taxation of liquidation of assets and resulting satisfaction of creditors, since it is the intention of the legislator to subject to taxation only the positive outcome of insolvency procedure, creating a definitive solution of continuity in the common system of taxation. This requirement, however, does not conform to the purpose of liquidation, especially the rule in force in bankruptcy procedures. This is because, the ultimate solution to the activity of company is in bankruptcy, is its liquidation and therefore it makes no sense to exist the worry of taxation, since the business activity after the insolvency proceedings should not be subject to tax by that thinks it's unjustifiable such imposition.

As we can see, is a problem that goes way beyond Portugal.

Then, we will evaluate the lack of AI, concerning the taxation of insolvent companies in IRC, in Portugal. We intend to evaluate qualitatively their views and identify the variables that allow us to conclude the subject or not subject to IRC of the bankrupt estate and the complexity of the tax system and with that we find a solution to prevent tax evasion and tax fraud in the insolvency process.

## >> 3. METHODOLOGY

If we look at the complexity as a determining factor in explaining the level of tax evasion and tax fraud and if we consider that there is a positive relationship between both variables, we realize that when the complexity of the tax system increases, also increases the level of tax evasion and tax fraud. Then, we intent, to analyze how the complexity of the tax system allows the evasion and fiscal fraud in the insolvency process.

In order to deepen the analysis of taxation of insolvent companies with regard to its tax regime, notably in IRC, our research sought to determine the perception of the AI.

We present below, the objectives of the study, the hypotheses of research, as well the results obtained.

### 3.1. Research instrument

We tried to provide an answer to the following question: *The complexity of the tax system allows for tax evasion and fraud in the insolvency proceedings?*

Consequently the study's objective was to obtain empirical evidence of the Portuguese reality which would conclude if there was or not tax complexity in the process of insolvency.

To achieve the goals defined, formalized the research hypotheses. So we had:

*Hypothesis 1: CIRE gives primacy to the recovery of the insolvent companies.*

*Hypothesis 2: Recent changes of article 65 of CIRE were enlightening and relevant tax compliance process.*

*Hypothesis 3: The bankrupt estate is taxable (IRC) and has ability to pay/economic.*

*Hypothesis 4: The CIRE contemplates tax benefits and this means an implicit subjection of the bankrupt estate to IRC.*

*Hypothesis 5: The bankruptcy legislation lacks harmonization with tax legislation.*

### 3.2. Sampling

The chances that we defined previously have underlying and as the population AI. Our analysis was based on the population of AI in Portugal. For the collection of data it was used the database of AI.

The technique of gathering information was made using the use of electronic questionnaires, created and sent through the program *LimeSurvey*.

For KAWK and RADLER (2002) the choice of this methodology is based on the cost-efficiency ratio, since the use of questionnaires allows obtaining good results with low cost, allowing the processing of a large amount of information.

Briefly, in the following figure, you can check out our sample and the respective response rate.

*Figure 1-Sample and response rate*

<b>Intervenientes no processo de insolvência</b>	<b>População</b>	<b>Amostra</b>	<b>Taxa de resposta</b>
Administradores da Insolvência	310	48	15,48%

## >> 4. DATA ANALYSIS AND RESULTS

Data collection is complete; these were subjected to analysis, having used the 20 version of the computer program *Statistical Package for the Social Sciences* (SPSS). The statistical methodology to treat the data was the most adjusted in accordance to the use of statistical tests more suitable for the treatment of qualitative information collected (MILES and HUBERMAN, 1994).

Our objective in this part of our study, therefore, focuses on the identification of the factors that may be associated with the review of the taxation of insolvent companies, with a focus on the complexity of the tax system in the process of insolvency.

### 4.1. Factor analysis

Being difficult to assess all the variables separately or develop action plans taking into account many variables, to identify these dimensions in our investigation was applied an exploratory factorial analysis. The factorial analysis technique was created by SPEARMAN (1904). The factor analysis studies the relationships between variables in an effort to find a set of factors (to a lesser number than the set of original variables) which expresses the original variables share in common. In the specific case of this study, the data collected suggest that the complexity of the tax system is explained by variables that we have identified, and which can be summarized by a factor, namely, the complexity of the tax system, with two directions. The positive part is less complex, i.e., the ease of interpretation of the subject to IRC the insolvent mass, in the bankruptcy process (*FACILIDADE – (I)*) and the downside is increased complexity, i.e. difficulty in interpretation of subject to IRC the insolvent mass in insolvency process (*DIFICULDADE – (II)*). In this sense, we have identified the following variables:

1. *INSOLVÊNCIA* – The AI were asked about changes of CIRE, in order to ascertain whether they were sufficient for the insolvency process of this greater primacy to reorganization.
2. *SUJEIÇÃO A IRC* – The AI were questioned about taxation under IRC of the bankrupt estate.
3. *ALTERAÇÃO REGIME JURÍDICO* – The AI were asked about the importance of changing the CIRE, in order to clarify clearly if the liquidation of the assets of the bankrupt estate would be taxed to IRC.

4. *ALTERAÇÃO CIRC* – The question was posed to AI about the importance of assigning a chapter in the CIRC, especially dedicated to the subject of taxation on insolvency.
5. *ALTERAÇÃO ARTº 65º* - The AI were asked about the importance of the recent amendment to article 65 of CIRE.
6. *SUJEIÇÃO IMPLÍCITA A IRC* – The question that was posed to the AI was if tax benefits in CIRE, would mean an implicit taxation of the bankrupt estate to IRC.
7. *RENDIMENTO* – The issue was placed to AI to receive their opinion about the fact of the product of liquidation of insolvent assets be considered income for AT.
8. *CAPACIDADE CONTRIBUTIVA* -The AI were questioned about the ability to pay of the bankrupt estate.
9. *PLANOS DE RECUPERAÇÃO* – The AI were questioned about the percentage recovery plans that have been approved, in the performance of their duties.
10. *APREENSÃO DE BENS* – The AI were questioned, in the performance of their duties, on the percentage of seizure of goods to the bankrupt estate.
11. *INSUFICIÊNCIA DA MASSA* -The AI were questioned, in the performance of their duties, on the percentage of insolvency proceedings which have been closed for failure of the bankrupt estate.
12. *PRÁTICA PROFISSIONAL* – The AI were asked about the practice that occurs more often in the insolvency process, if insolvency with recovery or insolvency with liquidation.

Factorial analysis, met 2 variables that explain about 45.18% of the total variance of the data, specifically *INSOLVÊNCIA* variable and *SUJEIÇÃO A IRC* variable, as shows us the following picture.

Figure 2 – Variance explained

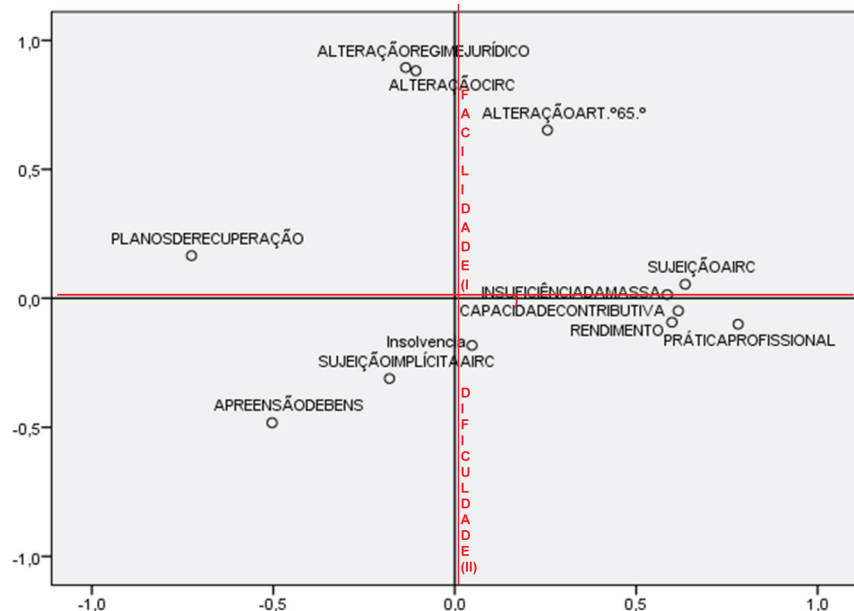
Component	Initial Eigenvalues			Extraction Sums of Squared Loadings		
	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %
1	3,003	25,025	25,025	3,003	25,025	25,025
2	2,418	20,153	45,178	2,418	20,153	45,178
3	1,507	12,56	57,738			
4	1,079	8,988	66,725			
5	0,914	7,619	74,345			
6	0,867	7,224	81,568			
7	0,779	6,489	88,057			

8	0,607	5,062	93,119			
9	0,329	2,74	95,859			
10	0,288	2,397	98,256			
11	0,136	1,134	99,39			
12	0,073	0,61	100			

We can also observe that the first variable (*INSOLVÊNCIA*) explains more than 25% of the total variance of the data, and the second variable (*SUJEIÇÃO A IRC*), more than 20%. This analysis suggests us that we can conclude that there is a significant difference and that these variables have a considerable influence in explaining the complexity of the tax system in the insolvency proceedings.

Also in order to better explain the context of the study, in the following figure is presented the complexity of the tax system in the insolvency proceedings, with its directions I and II.

Figure 3 – Graphical representation of the complexity of the tax system in the insolvency proceedings



As we can see, the variables *ALTERAÇÃO REGIME JURÍDICO*, *ALTERAÇÃO CIRC* and *ALTERAÇÃO ART.º 65.º*, contribute positively to the resolution of the problem associated with the complexity of the tax system in the process of insolvency, that is, are variables that represent the ease of



interpretation of the theme of the bankrupt estate taxation in the process of insolvency. We can therefore assume that there is a promotion of AI in favor of the amendment of the bankruptcy and tax legislation, in order to simplify this issue so complex.

As regards *CAPACIDADE CONTRIBUTIVA, RENDIMENTO, PRÁTICA PROFISSIONAL, INSOLVÊNCIA, SUJEIÇÃO IMPLÍCITA A IRC e APREENSÃO DE BENS* variables, we analyze that contribute most strongly to the difficulty of interpretation of the theme of the bankrupt estate taxation in the process of insolvency, which at the same time makes us assume a negative contribution to the resolution of the problem associated with the complexity of the tax system in the process of insolvency. We can therefore note that these are variables which originate tax complexity.

On the one hand, there's complexity associated to diverse interpretation of bankruptcy and tax legislation, in particular as regards the ability to pay of the bankrupt estate, to the fact that the product of the liquidation of insolvent assets could be considered income and assume an implicit subjection to IRC, because there are tax benefits in CIRE. On the other hand, there is complexity associated with the fact that bankruptcy and tax legislation promote reorganization, when in practice that the recovery is not an effective alternative to liquidation, articulated with the difficulty of seizure of goods to the bankrupt estate.

It was shown that although in each issue be underlying theme of the complexity of the tax system, our interpretation is essentially the way the issues were placed there, and their responses were based on the resolution of the issue under study and not the other way around.

We can thus conclude that the Portuguese tax system is not simplified taxation system insolvent companies and raises many questions about the placing of insolvent companies to tax. In this sense, we believe that there is indeed a need, which we consider urgent, or change the rules bankruptcy and fiscal adjustment, applicable to insolvent corporations, allowing that this subject ceases to be problematic, as presented, and that can encourage evasive behavior.

## >> 5. CONCLUSIONS

We have examined and discussed in this article the fiscal regime of insolvent companies in Portugal, in IRC, and we can, in short, complete the following.

In what concerns the tax treatment of an insolvent company, particularly when it decides its liquidation and the maintenance of the company, not the issues are not peaceful, in particular as regards the entry and tax capacity of these companies.

It is our belief that, in the case of insolvent companies, there is the exercise of an economic activity, a profit tax, nor a taxpayer of IRC, when we are facing the bankrupt estate.

Analyzing the article 268 of CIRE, with reference to the benefits related to income taxes of the collective people, we agree that the position taken by the ATA makes sense that you can only move the scope of taxation for exemption that, *a priori*, is subject. But if, on the one hand, the effect seeming to be the same-satisfy claims – the benefit should include sales made by the insolvency administrator, so arguably they are not taxed, especially by respecting the principle of equality in taxation.

The contradiction seems to exist between bankruptcy law and tax law in Portugal, goes across borders, as we were able to verify by analysis of insolvency proceedings in the various countries under study, particularly in Brazil, in Spain, in Italy and in the United States. With regard to tax issues, even the international authors tend to focus on the interest of protection of creditors in the insolvency procedure, indicating the fiscal position as reducing possibilities for creditors to satisfy their claims, and promoters of evasive behavior.

## >> 6. LIMITATION AND SUGGESTIONS FOR FURTHER RESEARCH

In the light of the results obtained, we believe that, although the methodology requires caution in its conclusions, as well as in the generalization of results obtained for the population, mainly by virtue of having received only a percentage of responses close to 16%, it is possible to suggest the answer to our question of investigation. It was noted that the tax system be simplified and concluded it would be urgent harmonization of the procedures of the CIRE and the CIRC to a specific tax treatment in the insolvency process, in order to prevent tax evasion and fraud in the insolvency process.

With this study and with the analysis of the system of taxation of insolvent companies, we hope to have contributed to a more clarifying discussion of a topic as controversial and involving various actors (AI, ATA, MJ) with different perspectives and looks, which originate on the State and costs for companies, which we must not neglect in the current economic context.

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