

NEWSLETTER

May 26, 2010

Subject: *criminal liability for tax evasion (Art. 212 of Ukrainian Criminal Code) – marginal amounts underpaid which may give rise to criminal liability as well as some other issues of importance*

For today there are a number of bills concerning relief from criminal liability for tax evasion. This exemption shall be given to the tax payers on condition that they have legalized previously received profit. However, so far bills still remain only bills. And current situation is the following.

The risk of becoming the subject of criminal liability (or at least institution of criminal proceeding) for tax evasion in Ukraine is in place not only for those who actually evades from taxes but in fact for anyone in case of dispute with tax authorities regarding material sum. Unfortunately in Ukraine such situations occur quite often and this was in fact the principal motivation for us to prepare the present newsletter.

In the present newsletter we consider some aspects of how to assess the risk that criminal liability for tax evasion under Art. 212 of the Criminal Code of Ukraine is likely to be applied.

1.

The first aspect we are to consider is how to determine the marginal amounts of underpaid taxes (other mandatory payments) which give rise for criminal liability and what criminal liability is applicable.

Article 212 of the Criminal Code of Ukraine (hereinafter – “the Code”) provides for the liability for tax evasion:

- Part 1 of Article 212 of the Code sets fourth criminal liability for intentional evasion from taxes, duties (other mandatory payments) which constitute the part of tax system and have been introduced in the order stipulated by law, if actions, committed by official of an enterprise or organization of any form of ownership (as well as by person carrying out economic activity without establishment of legal entity or by any other person, obliged to pay taxes), led to actual underpayment into budgets or state purpose funds in *considerable amounts*.
- Part 2 of Article 212 of the Code stipulates liability for the same actions performed by the group of persons by previous concert or if such actions led to actual underpayment into budgets or state purpose funds in *large amounts*.
- Part 3 of Article 212 of the Code provides for the liability for the actions indicated in parts 1 and 2 of respective Article if such actions were committed by person who had been earlier convicted of tax evasion or if such actions led to actual underpayment into budgets or state purpose funds in *very large amounts*.
- However, in accordance with part 4 of Article 212 of the Code a person that committed actions indicated in part 1 and part 2 of this Article for the first time shall be relieved from the liability (before institution of respective court action according to interpretation of Constitutional Court of Ukraine) if such person had paid respective taxes, duties (other mandatory payments) before institution of criminal proceeding against him/her and reimbursed the damages caused to the state by late payment (financial sanctions, penal interest).

How to transform the abovementioned “considerable”, “large” and “very large amounts” into the clear quantitative indicators for specific case is described herebelow:

According to the footnote to Article 212 of the Code

- *considerable amounts* of monetary funds shall mean the sums of unpaid taxes, duties and other mandatory payments which 1000 and more times exceed the exemption limit (i.e. non-taxable amount of income), stipulated by law,
- *large amounts* of monetary funds shall mean the sums of unpaid taxes, duties and other mandatory payments which 3000 and more times exceed the exemption limit, stipulated by law,
- *very large amounts* shall mean the sums of unpaid taxes, duties and other mandatory payments which 5000 and more times exceed the exemption limit, stipulated by law.

The term “exemption limit” is defined by the Law of Ukraine “On Personal Income Tax” of May 22, 2003 # 889-IV (hereinafter – “the Law # 889”). Para. 22.5 of the Law # 889 stipulates the following:

"If provisions of other laws contain reference to the exemption limit then for the purpose of their implementation the sum of 17 Hryvnias shall be used; however for provisions of administrative and criminal legislation with regard to **qualification of crimes** or offences **the exemption limit shall be equal to the social tax benefit** as it is determined by sub-para. 6.1.1 of para. 6.1 of Art. 6 of this Law for respective year (with account to the provisions of para. 22.4 of this Article). "

According to para. 6.1.1 of the Law # 889 (version effective since 2006) the social tax benefit is equal to the amount of 50% of the minimum monthly wage set by the law as of the 1st of January of reporting tax year.

To facilitate the qualification of the actions under Art. 212 of the Code herebelow we present calculations of the minimum wage and social tax benefit in the following table:

	2006	2007	2008	2009	2010 ¹
Minimum wage	UAH 350	UAH 400	UAH 515	UAH 605	UAH 869
Social tax benefit	UAH 350 / 100 * 50 = UAH 175	UAH 400 / 100 * 50 = UAH 200	UAH 515 / 100 * 50 = UAH 257.5	UAH 605 / 100 * 50 = UAH 302.5	UAH 869 / 100 * 50 = UAH 434.5
Qualification under part 1 of Art. 212 of the Code	(UAH 350 / 100 * 50) * 1000 = UAH 175,000	(UAH 400 / 100 * 50) * 1000 = UAH 200,000	(UAH 515 / 100 * 50) * 1000 = UAH 257,500	(UAH 605 / 100 * 50) * 1000 = UAH 302,500	(UAH 869 / 100 * 50) * 1000 = UAH 434,500
Qualification under part 2 of Art. 212 of the Code	(UAH 350 / 100 * 50) * 3000 = UAH 525,000	(UAH 400 / 100 * 50) * 3000 = UAH 600,000	(UAH 515 / 100 * 50) * 3000 = UAH 772,500	(UAH 605 / 100 * 50) * 3000 = UAH 907,500	(UAH 869 / 100 * 50) * 3000 = UAH 1 303,500
Qualification under part 3 of Art. 212 of the Code	(UAH 350 / 100 * 50) * 5000 = UAH 875,000	(UAH 400 / 100 * 50) * 5000 = UAH 1,000,000	(UAH 515 / 100 * 50) * 5000 = UAH 1,287,500	(UAH 605 / 100 * 50) * 5000 = UAH 1,512,500	(UAH 869 / 100 * 50) * 5000 = UAH 2,172,500

¹ According to the Law of Ukraine “On setting of subsistence minimum and minimum monthly wage” of October 20, 2009 #1646-VI

At the same time in order to qualify the offence only *taxes, duties and other mandatory payments which constitute the part of the tax system and were introduced by law* shall be considered (as stipulates part 1 of Art. 212 of the Code). Tax, duty, other mandatory payment is defined is the mandatory remittance into budget of certain level or state purpose fund which is done by a taxpayer in the order and under conditions stipulated by tax laws of Ukraine. Hence some tax obligations indicated in tax notification, issued on the basis of tax examination, shall not be considered to qualify the offence, i.e. only the sum of taxes (duties) shall be considered without sanctions.

The same conclusion is presented in the Resolution of Plenum of the Supreme Court of Ukraine of October 8, 2005 # 15. Thus, part 3 of para. 11 of this Resolution reads:

"For determination of the sum of monetary funds underpaid into budget or state purpose fund as a result of evasion from taxes, duties and other mandatory payments **finances and penal interest shall not be taken into consideration.**"

In practice the situations may occur that the actions on tax evasion are prolonged and take place for more than a year.

For example, tax inspection carries out tax audit of the enterprise for the years 2007 and 2008. In such case the issue arises what exemption limit shall be applied for the purposes of qualification as in fact exemption limits for 2007 and 2008 were different. In 2007 exemption limit made UAH 200 while in 2008 it makes UAH 257.5 (please refer to the Table above). Hence respective marginal amounts for qualification under part 3 of Article 212 of the Code will make:

- for the actions committed in 2007 - UAH 1,000,000 (5,000 * UAH 200);
- for the actions committed in 2008 – UAH 1,287,500 (5,000 * UAH 257.5).

The Supreme Court of Ukraine in part 2 of para. 11 of the Resolution of Plenum of the Supreme Court of Ukraine of October 8, 2005 # 15 and, more clearly, in Resolution of May 28, 2004 # 9 revealed its position in respect of the similar situation which occurred in 2003 and 2004. Thus, para. 3 of the latter of the above Resolutions reads:

"To make a decision in respect of liability for the prolonged offence or to give qualification of such offence **in case some of the actions had been committed before the 1st of January 2004 while the others were committed after this date**, it is necessary to proceed from the amount of exemption limits or social tax benefits calculated **separately for each of the mentioned periods.**"

If upon the results of tax audit of different years (e.g., 2007 and 2008) there is assessment of taxes, underpaid into budget, it is likely that the qualification under part 3 of Art. 212 of the Code will be based on the aggregate amount of exemption limits determined separately for each of the mentioned periods. In other words it is necessary to determine the number of exemption limits in the sum of underpaid taxes for 2007 and carry out similar calculations for 2008. *For example, if the sum of assessed taxes in total makes UAH 1,280,000 and it is composed of two sums assessed for different periods: (i) the sum assessed for 2007 is UAH 300,000 that makes UAH 1,500 of exemption limits (300,000 / 200); and (ii) the sum assessed for 2008 is UAH 980,000 that makes 3,805.8 of exemption limits (980,000 / 257.5). In total the overall sum of assessed taxes in the discussed case will make 5,305.8 exemption limits (social tax benefits), i.e. this amount exceeds 5,000 which is the minimum marginal threshold after exceeding of which liability under part 3 of Art. 212 of the Code becomes applicable.*

For the sake of completeness we note that in this newsletter we do not consider the issue whether each of episodes for which the assessment of taxes was made shall be considered separately (as separate offence) with separate application of the marginal thresholds to each of these episodes or respective assessments shall be summed up as one prolonged offence, composed of several *identical* actions with single intent. Respectively, the detailed analysis of particular cases may provide grounds to divide the total sum of assessed taxes into separate parts (which are in their turn composed of identical actions) each of which shall be subject to separate qualification.

2.

The crucial moment is that according to Art. 212 of the Code the liability for the intentional tax evasion, committed by the official of an enterprise, is applicable in case such actions resulted in **actual underpayment** into budgets or state purpose funds. Such underpayment may be recognized as actual fact only in respect of the taxes acknowledged as subject to payment. This acknowledgement occurs only as a result of the so-called tax reconciliation procedure, i.e. in most cases after ruling of the court of appeal on the substance of tax litigation if taxpayer appealed in due and timely manner. In other words, only in case tax liabilities assessed to an enterprise are considered to be agreed (reconciled), the grounds may occur to apply criminal liability.

3.

As far as closing of the criminal proceeding is concerned we note the following. Part 4 of Art. 212 of the Code stipulates that a person who has committed actions envisaged in part 1 and 2 of this Article shall be relieved from the criminal liability if such person complies with the following conditions: (i) before institution of criminal proceeding (ii) such person had paid taxes, duties (mandatory payments); and reimbursed damages caused to the state by late payment (financial sanctions, penal interest).

It should be mentioned that relief from the criminal liability is carried out only in case if the sum of intentionally unpaid taxes is below the particularly large amounts (see the table above). That is, if the criminal proceeding is initiated under part 3 of Art. 212 of the Code, the fact that the taxes were paid doesn't not relieve the person from the criminal liability for tax evasion.

The second condition is stipulated somewhat unclearly as proceeding from its literal reading it is the person subject to criminal liability (i.e. the official of enterprise) who shall pay tax liabilities and financial sanctions. However, under effective legislation such payment does not impact obligations of the enterprise to pay assessed tax liabilities. That is that under such interpretation tax liabilities and financial sanctions shall be paid twice – by enterprise and its official.

The other interpretation of this condition is that the official of enterprise shall secure payment of tax liabilities by enterprise via own actions. There are no clarifications, adopted by judicial authorities, regarding application of part 4 of Art. 212 of the Code. Therefore, it's difficult to predict how this legal norm will be implemented in practice. Yet, on practice, in all cases we are aware of, the payment of tax liabilities and taxes by enterprise was considered to be sufficient condition to relieve its officials from criminal liability.

It shall also be noted that according to Art. 44 of the Code relief from criminal liability is applied exclusively by court. In other words payment of taxes and financial sanctions does not automatically relieve person from criminal liability.

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The above letter presents the general statement for information purposes only and as such may not be practically used in specific cases without professional advice.

Sincerely yours,
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