

How to Distinguish between Disputable Tax Matters and Criminal Tax Evasion



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There are several reasons for raising this topic now: (i) a newly evolving wave of increasing criminal investigations on tax evasion, (ii) the fact that they're handled in the main by state agencies less than preceding ones (like the tax police) experienced in these issues (like the National Police), (iii) attempts to establish uniform state agency on finance/tax/budget-related and other economic crimes (like a bureau on financial investigations) without even trying to set out more precisely what relevant crimes are.

The increasing number of criminal investigations on tax evasion is seen in the following figures: based on the data reported by the Prosecutor-General's Office, the total number of criminal investigations on the subject (respective article of the *Criminal Code*) launched just in the first 9 months of 2018 totaled 875, which was already more than for the preceding year of 2017 (838). That shows how this issue is growing.

The main practical aspect of how to properly distinguish between tax disputes and criminal tax matters (tax evasion) is the reduction of unnecessary criminal investigations in relation to tax, as such investigations themselves create a significant burden on taxpayers (and their officials). Analysis of judicial practice on tax avoidance shows that the courts now finally distinguish properly between real tax evasion and merely disputable tax-related situations.

Therefore, the main issue is at the bottom of the "pyramid" of relevant law-enforcement bodies, which generates more and more criminal investigations inspired by the state machine in total, presumably aiming to squeeze out more in the form of taxes.

In the past this issue was shot down somewhat practically via the amending of methodological recommendations several years ago on interaction between tax bodies in the process of conducting and using tax audit results where the amendments established that the issues revealed by tax

audits will be shifted to the tax police only when tax audit assessments become agreed. That is, confirmation within the framework of tax appeal and main judicial procedures, yet remain unpaid. That change has significantly reduced the number of cases.

Yet, by gradually shifting investigation powers on these matters from the tax police (due to formally depriving the tax police [as a respective division of the tax authorities] of respective power at legislative level) to other law-enforcement agencies, this issue is coming back, though this is because the said other agencies are not bound by the above regulations of internal implementation of the tax authorities.

Then the question is: what clear practical guidance can be provided in the current situation in order to stop/prevent unnecessary criminal investigations on tax evasion in situations where tax avoidance is not, by definition, in place.

Unfortunately, such guidelines are lacking at general level. Top level judicial rulings on the matter, like the Resolution of the Plenum of the old Supreme Court of 8 October 2004 #15 are more than 14 years old. In the currently rapidly and drastically changing conditions in Ukraine, rulings like that seem to be somewhat outdated and definitely do not address a number of current urging questions of relevant judicial practice.

For practical matters we need something like the pointers contained in the instructions of the US Internal Revenue Service, where the distinction between evasion and avoidance is stated, as the line between them is fine yet definite. Evasion involves deceit, subterfuge, camouflage, concealment, some attempt to color or obscure events, or making things seem other than what they really are. On the other hand, tax avoidance or disputable tax positions fall under the auspices of proper disclosure by taxpayers.

To bring this pointer to the grounds of our national legislation. Article 212 Tax Evasion in the *Criminal Code of Ukraine* defines

tax evasion as intentional action by the responsible taxpayer's officer or individual-taxpayer aimed at evading the payment of tax, which resulted in actual non-payment or underpayment of tax.

For me the key element in this formula is "intent", which is specifically defined itself by the *Criminal Code*. Article 24 defines criminal intent as realization by the individual of a socially distractive nature of action which envision negative consequences from the action. In its turn Part 2 of Article 11 of the *Criminal Code* clarifies in addition that an action, even formally matching the definition of respective crime but not causing and not reasonably able to cause any substantial harm to either person(s) or public or state, shall not be qualified as a crime.

To turn the above into ordinary language, one may say that as tax evasion may be qualified only as that type of action(s) in respect of which one may reasonably assume triggering directly underpayment or non-payment of respective taxes; such assumption shall be based on actual circumstances and regulatory and implementation frameworks. That is, that the existing system of regular tax control and respective audit measures envisaged by the *Tax Code* shall not be disregarded in this respect. If it can be reasonably expected that the system of tax control and tax administration by the tax authorities allow identification and curing of certain irregularities than such non-compliance cannot be viewed as tax evasion because any temporary damage shall be cured by the system.

Let's illustrate this by using an example. Can improper understatement of tax liabilities be viewed as a crime of tax evasion? If the respective factual background is sufficiently disclosed to the tax control system/available for a respective check under normal measures/tools envisaged by the *Tax Code*, then any potential damage from such action shall be viewed as curable and the action shall not be considered as a crime of

tax evasion unless no duly legally confirmed additional tax assessment is finally paid. For example, due to further actions on depriving the taxpayer of funds required for paying the tax).

That is, that any tax disputes relating to tax assessments based on tax audits conducted merely within the frameworks envisaged by the *Tax Code*, cannot be qualified as tax evasion except for the cases when finally, legally confirmed assessment remains unpaid or it is virtually evident that it will remain unpaid.

By the way, this position matches the approach taken earlier, when introduction of amendments to the above-mentioned methodological recommendations on the method of interaction between tax bodies, which proved to be effective in cutting the number of unnecessary criminal investigations.

The above axiom of the absence of a criminal event in case of a tax dispute based merely on the act of a regular tax audit and/or additional tax assessment carried out within the framework of regular procedures of tax control under the *Tax Code* can be supported, although by the following considerations:

— Evasion as such is not specifically defined by the *Criminal Code* and, therefore, this term shall be understood in its ordinary meaning. The dictionary defines evasion basically as a process aimed at circumventing, not executing, liabilities. While Article 67 of the *Constitution of Ukraine* establishes liability for everybody to pay taxes and duties under the procedures and in the amounts provided by legislation. Thus, tax evasion may be understood as action aimed at circumventing the liability to pay taxes under the procedure and in the amounts provided by law.

Yet, if an additional tax assessment based on the tax audit conducted under the auspices of the *Tax Code* is finally legally confirmed after a duly passed administrative appeal/judicial procedures, and then paid by the taxpayer as envisaged by the *Tax Code* for such cases of disputable amounts, the respective tax amount (liability) shall be viewed as still paid under the procedures envisaged by tax legislation. No damage in such case as the *Tax Code* also envisages a penalty as respective compensatory payment for delay in collection of the funds by the state. Therefore, there shall not be even a thought regarding a crime of tax evasion in the event of tax assessment based on routine procedures envisaged by the *Tax Code*.

To sum up, some actions are worth taking so as to prevent increasing pressure on taxpayers through unnecessary criminal investigations launched without a proper base. That is, it's improper to shift to a criminal investigation track on 'suspicion' of possible tax evasion based on a tax audit act carried out under procedures envisaged by the *Tax Code* as such, and/or in parallel with the procedures again under the *Tax Code* implemented by the taxpayer in order to finally resolve a dispute. If a dispute is resolved against the taxpayer and the tax assessment is paid with penalties then, with this event, the matter will be considered as finally resolved; no further step to criminal procedures will be taken. If criminal procedures are in fact implemented in parallel with the tax dispute resolution procedures under the *Tax Code*, such action may be qualified rather as an illegitimate attempt to exert illegal pressure on the taxpayer in a disputable situation, and thus cause difficulties in conducting entrepreneurial activity (which in itself may

already be considered a crime by any state officer doing so).

WHAT CAN BE DONE?

Respective submissions by taxpayers in such situation as described above can be made, with a request to launch a criminal investigation already against state officers (investigators/prosecutors) pursuing such abusive policy of "pressurizing" taxpayers in disputable situations. Hopefully the efforts of taxpayers will be strong enough to move towards building judicial practice that launching a criminal investigation or not closing them immediately under reason of absence of a crime, is in itself a crime of the state officer in question.

A more "instant" result can be achieved if, for instance, the Prosecutor-General's Office would be ready to hear and realize this approach (e.g., upon a relevant submission from the business ombudsmen's office which shall be aware of such cases) and share respective vision by formal communications right down to local offices. Under the law, attorneys of the Prosecutor-General's Office shall supervise and control that investigation bodies act in accordance with the law. So, it would be appropriate if the discussed inappropriate and even harmful current practice of turning tax disputes on the criminal investigation track is stopped by the agreed actions of Prosecutor-General's Office attorneys throughout Ukraine.

The situation can be resolved with due political will even within existing legislative frameworks, merely by proper execution or implementation of the relevant steps and practices.

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