ARTICLES

TAX COMPLIANCE IN THE RUSSIAN FEDERATION, THE UNITED KINGDOM OF GREAT BRITAIN AND NORTHERN IRELAND, AND THE UNITED STATES OF AMERICA: FORCING AND ENCOURAGING LAWFUL CONDUCT OF TAXPAYERS

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The article is devoted to the consideration of the system for the tax authorities to assess tax risks and to prevent tax law violations. The work focuses on how the tax authorities affect the conduct of taxpayers through "soft law," disclose information about their approach towards understanding tax risks and enforce a system of measures to ensure compliance. Tax compliance is analysed in the article as good-faith and lawful conduct of a taxpayer, which is formed under the influence of a system of, at the same time, preventive and incentive measures. This article considers tax compliance issues in Russia, the United Kingdom and the USA, not so much as a consequence of the voluntary actions of the taxpayer, but as a consequence of the conditions that are set for a taxpayer by the administrative action of tax authorities. To do this, the approaches of the tax authorities to defining the criteria for tax risks and the procedure for assessing them are analysed, as is the effect of these approaches on the subsequent implementation of tax control measures, while the system of enforcement measures and incentives for taxpayers to comply with tax legislation are examined. Tax compliance is the most desirable regime

for the state, but in the entire history of taxation no jurisdiction has been able to achieve full tax collection solely based on a persuasive method. At the same time, owing to the limited resources of tax administrations, in practice there is no real opportunity to examine absolutely every taxpayer. For specifically this reason, a risk-based approach to carrying out tax control with a reasonable combination of both incentive measures and the enforcement of compliance with tax legislation is becoming increasingly relevant. The authors consider the implementation of a risk-based approach and its effect on tax compliance, on the choice of tax control measures, and on depth and scope in terms thereof, using the example of the experience of Russia, the United Kingdom and the USA. The article also pays special attention to an analysis of incentive measures and the enforcement of tax compliance in these jurisdictions.

Keywords: tax compliance; tax risk assessment; FTS; HMRC; IRS; DIF; risk-based tax audit; office audit; field audit; tax penalty; criminal liability.

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Introduction

Both certainty of the legal status of taxpayers and their compliance with tax legislation have always been problems that have manifested themselves and at the same time have had to be solved.[1] All tax administrations worldwide have constantly

[1] *See Гидирим В.А.* Основы международного корпоративного налогообложения [Vladimir A. Gidirim, *The Fundamentals of International Corporate Taxation*] 706–819 (Moscow: Litres, 2018); *Пепеляев С.Г.* Об универсальном значении статей 3 и 17 НК РФ // Налоговед. 2018. № 9. С. 4–5 [Sergey G. Pepeliaev, *On the Universal Significance of Articles 3 and 17 of the Russian Tax Code*, 9 Nalogoved 4 (2018)];

struggled to reconcile two different policies: ensuring that taxpayers' rights are complied with, on the one hand, and not permitting abuses by taxpayers of their legal rights, in order to evade tax payments, on the other hand.

To achieve these purposes both in the legislation on taxes and levies and in the adjacent branches of legislation, as well as in the practice of court and administrative decisions, there should be provision for a mechanism of legal regulation that is understandable to all who enforce the law and that is efficient in its implementation. Only this guarantees that the balance is met of public and private interests in tax law and that the trust of civil society in the institutions of the state and the law is maintained.

It is important to understand that, for states, the most desirable thing is a situation of universal and voluntary due performance of tax obligations by all those involved in tax relationships. However, it is possible to ensure such a situation by way of an effective mechanism of tax regulation. For this, a set of measures is necessary and prudent comprising both administrative enforcement for non-compliance with tax legislation and administrative incentives to comply with tax legislation, taking account of the legislature's will and its intentions.

The functioning of such a mechanism is possible only as long as a system is implemented for the correct and timely identification of violations of tax legislation and of tax abuses. In connection with this, a risk-oriented approach to determining whether tax control measures should be carried out reasonably becomes particularly significant. Tax authorities use risk-based techniques to concentrate their supervisory activities on taxpayers with a relatively higher risk profile, while those who have low risk are generally protected from frequent tax audits.[2] In the context of such an approach, it is important to establish what will be considered to constitute a tax risk and the criteria for assessing it.

Therefore, the problems of tax compliance move to the foreground as a system of preventing violations of tax legislation and tax abuses, on the one hand, and a system of assessing tax risks as well as managing them, on the other hand. At the same time, tax risks are considered in the context of tax control, but not administrative enforcement, as facts that testify to circumstances bound in with a violation of tax legislation or an abuse of legal rights in the sphere of taxation and serving as a ground for a decision to be taken to conduct tax control measures.

Аракелов С.А. Антиуклонительные нормы в международной практике. Новые законодательные инструменты по борьбе против уклонения от уплаты налогов в России // Закон. 2018. № 5. С. 109–115 [Sergey A. Arakelov, *Anti-Evasion Rules in International Practice. New Legislative Instruments in the Struggle Against the Evasion of Tax Payments in Russia*, 5 Law 109 (2018)]; *Пепеляев С.Г.* Ст. 54.1 НК РФ – шаг к необходимости введения налогового комплаенса? // Законодательство. 2018. № 8. С. 5–9 [Sergey G. Pepeliaev, *Article 54.1 of the Russian Tax Code – a Step Towards the Need to Introduce Tax Compliance?*, 8 Legislation 5 (2018)].

[2] *See* Dennis de Widt & Lynne Oats, *Risk Assessment in a Co-operative Compliance Context: A Dutch–UK Comparison*, 2 British Tax Review 230 (2017).

Such an understanding of tax compliance allows for a consideration of both approaches by the tax authorities to assessing tax risks aimed at identifying violations of tax legislation and equivalent abuses of legal rights in the sphere of taxation, as well as approaches of taxpayers whose aim is to optimise taxation by lawful means.

Tax compliance is regarded as, at the same time, a system of preventive and incentive measures of administrative enforcement ensuring that taxpayers comply with the rules of legislation on taxes and levies, and other tax-related legal and regulatory acts, as well as that taxpayers perform the lawful demands of parties to tax control when a controlling authority is properly exercising its commission, and that there is no abuse of its legal right on the part of a taxpayer.

The approach to tax compliance and tax risks in different jurisdictions is not uniform and has particular features. Therefore, it seems logical to consider in more detail the issues of tax compliance and a risk-oriented approach in tax control using the example of states taken separately.

The authors examine the Russian jurisdiction as their own national jurisdiction, assimilating experience of legal regulation and court and administrative decisions in the practice of the Anglo-Saxon legal family, primarily the United States and the United Kingdom, in implementing tax compliance in tax control.

The choice of the United Kingdom for a comparison is tied in with the fact that the British tax control system is undergoing substantial reform due to this state's current membership of the European Union (the "EU") and the need to comply with the legal and regulatory acts of this political and legal association having regard to the policy of its bodies;[3] its involvement in initiatives of the Organisation for Economic Co-operation and Development (the "OECD"); the need to achieve the goal of maximising income for the public purse, which was publicly enacted in 2015 by Her Majesty's Treasury (the "Treasury"), which performs the functions of the United Kingdom's ministry of finance, with the United Kingdom's tax authority having to turn this goal into reality before 2020.[4] All the above factors are due to the high level of development of the institution of tax control and the use of the most consummate mechanisms for exercising such control, as well as civil society and democratic institutions ensure, in comparison with other countries, a high level of transparency of approaches that the tax authority applies, and a high level of protection of the rights and lawful interests of private persons.

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[3] Moreover, it is assumed that, when the United Kingdom ceases membership of the European Union, rules of European law that were previously applied in the United Kingdom will be introduced into domestic legislation, which will ensure stability in legal regulation. For more detail, *see* Department for Exiting the European Union, Legislating for the United Kingdom's Withdrawal from the European Union, Policy Paper (2017) (Jan. 20, 2019), available at https://www.gov.uk/government/publications/the-repeal-bill-white-paper/legislating-for-the-united-kingdoms-withdrawal-from-the-european-union.

[4] HM Treasury, Spending Review and Autumn Statement 2015, Cm 9162 (November 2015) (Jan. 20, 2019), available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/479749/52229_Blue_Book_PU1865_Web_Accessible.pdf.

For its part, the USA is a state with one of the strongest and most effective tax administrations in the world, and pays particular attention to achieving voluntary compliance.[5] The USA is a home to many initiatives in the struggle with abuses in the area of tax, such as rules about the taxation of the profit of controlled foreign companies, transfer pricing rules, and others.[6]

Since 1969, this jurisdiction has been applying a risk-oriented approach to tax control based on an automated computer system. Attention towards the American jurisdiction was reinforced in 2010 with the adoption of FATCA, which de facto extended the jurisdiction of the USA's Internal Revenue Service (the "IRS") with its approaches to tax compliance outside the USA, and provisions concerning the withholding of 30% on any passthrough payment[7] for non-compliance with the requirements of the law have ensured a proper enforcement mechanism worldwide.

1. Public Authorities Ensuring Tax Compliance

The orientation of tax control solely towards the identification of tax risks associated with the violation of tax legislation and with abuse is accompanied by the emergence of extremely wide discretion of tax authorities in assessing such risks.

This situation is explained by the specific features of arranging tax control, the legal status of bodies carrying out tax control and their place in the system and structure of public administrative bodies, as well as the purposes and objectives of tax control, which have a direct influence on the priorities of tax compliance.

Tax control in Russia is conducted by unified, centralized systems, that are subordinate to the Ministry of Finance of the Russian Federation, of tax authorities with respect to the taxes and levies that are provided for in the Tax Code of the Russian Federation (the "Russian Tax Code"), and of customs authorities with respect to customs payments.

Further, in part, tax control in Russia is vested in bodies which manage state schemes that are publicly funded: the Pension Fund with respect to contributions for mandatory medical insurance for the non-working population; and the Social Insurance Fund with respect to contributions for mandatory social insurance against workplace accidents and industrial diseases.

All of the above bodies are subordinate to the Government of the Russian Federation, whether directly or indirectly. The Ministry of Finance of the Russian Federation is subordinate to and controlled by the Government of the Russian Federation, while

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5 Jack Manhire, *What Does Voluntary Tax Compliance Mean?: A Government Perspective*, 164(1) University of Pennsylvania Law Review Online 11 (2015).

6 In particular, attempts to debt-to-equity ratio, which has substantial significance in the concept of thin capitalisation, were undertaken in the USA in 1946. *See Thin Capitalization and Tax Avoidance*, 55(7) Columbia Law Review 1054 (1955); *John Kelley Co. v. Commissioner*, 326 U.S. 521 (1946).

7 26 U.S.C. § 1471.

the Federal Tax Service and the Federal Customs Service and their local bodies are subordinate to and controlled by the Ministry of Finance of the Russian Federation.[8]

The system of bodies carrying out tax control can be characterized as federal, centralized and organized built on a hierarchy of federal executive bodies, which does not ensure tax control that is independent of the Government of the Russian Federation and the Ministry of Finance of the Russian Federation.

The function of tax authorities, customs authorities, and bodies that manage state non-budgetary funds in terms of control over whether a calculation is correct, and whether taxes and levies have been paid in full and on time in the context of Articles 3, 32(1)(4) and legal rules of other statutory acts is determined based on the concept of the rule of law. The constitutional law base of this concept is set out in Articles 18, 45 and 57 of the Constitution of the Russian Federation. The above bodies combine the control function with the function of administering the payments they control by way of forming the income of the government. This enables the purpose of tax control – the lawfulness of taxation – to become distorted, since the goal of ensuring that tax income comes in for the government often takes priority.

Combining the above functions is difficult if they are to be discharged effectively, especially for the tax control function to be exercised properly. What is more, the described functions are supplemented by the fact that the tax authorities' powers include considering and reviewing cases concerning violations of tax law and other fields of legislation on mandatory payments, the application of administrative enforcement measures for such violations, and considering and settling tax disputes and disputes relating to the payment and administration of other mandatory payments.

In actual fact, tax and other authorities administering mandatory payments also perform functions that involve devising tax policy and drawing up sub-legislative regulations, and the regulatory interpretation of rules in tax legislation and other branches of legislation on mandatory payments.

In the situation that has developed, taking account of the systemic economic crisis and the budget deficit in Russia, the most effective approach from the viewpoint of administering tax risks in Russia is only a pro-government approach to tax compliance.

In the United Kingdom, the body exercising tax control on the national level is a non-ministerial Department of Her Majesty's Government, which is officially

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[8] *See* Налоговый кодекс Российской Федерации [the Russian Tax Code], Закон Российской Федерации «О налоговых органах Российской Федерации» [the Law of the Russian Federation "On the Tax Authorities of the Russian Federation"], Таможенный кодекс Евразийского экономического союза [the Customs Code of the Eurasian Economic Union], Федеральный закон «О таможенном регулировании в Российской Федерации» [the Federal Law "On Customs Regulation in the Russian Federation"], Федеральный закон «Об обязательном социальном страховании от несчастных случаев на производстве и профессиональных заболеваниях» [the Federal Law "On Mandatory Social Insurance Against Workplace Accidents and Industrial Diseases"], Федеральный закон «Об обязательном медицинском страховании в Российской Федерации» [the Federal Law "On Mandatory Medical Insurance in the Russian Federation"] (Jan. 20, 2019), available at http://www.pravo.gov.ru.

referred to as Her Majesty's Revenue and Customs and commonly abbreviated to "HMRC" or "HM Revenue & Customs."

Section 5 of the Commissioners for Revenue and Customs Act 2005[9] states that such body is vested with the functions of two predecessor authorities – the Commissioners of Customs & Excise and the Commissioners of Inland Revenue. Such functions are:

1) The collection and management of revenue for which the Commissioners of Inland Revenue were responsible;

2) The collection and management of revenue for which the Commissioners of Customs and Excise were responsible; and

3) The payment and management of tax credits for which the Commissioners of Inland Revenue were responsible.

It should be emphasized that Acts of Parliament refer solely to the functions of a tax authority, while at the same time its direct purposes for the sake of which such functions are exercised are not mentioned in primary legislation.

At the same time, the Spending review and autumn statement 2015, which the Treasury put before the United Kingdom Parliament based on updated forecasts and clarifying the medium- and long-term priorities of the Government's fiscal policy enshrined in clauses 10.2 and 11.18 the priorities of HMRC for the period of 2015–2020. Among other things, in the document referred to above, the purpose[10] is enshrined of maximizing the amount of tax payable to the public purse and the crackdown on tax avoidance and tax evasion (the main priority is to encourage tax compliance).

The status of a non-ministerial department is due to the special position of the authority in question in the system of executive state authorities in the United Kingdom. It falls outside the hierarchy of being subordinate to a particular ministry.[11] As stated on the official website of the Government of the United Kingdom, the above position of the HMRC in the British system of executive authorities eliminates direct control on the part of any ministry over the operational activity of HMRC and ensures that tax administration is "fair and impartial."[12]

The Treasury cannot control the activity of HMRC and has only restricted supervisory and coordinating powers, since it exercises "strategic oversight of the tax system,"[13] and the associated legal regulation and devising of government policy in this area.

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9 Commissioners for Revenue and Customs Act 2005 (Jan. 20, 2019), available at https://www.legislation.gov.uk/ukpga/2005/11/contents.

10 HM Treasury, Spending Review and Autumn Statement 2015, *supra* note 4.

11 Cabinet Office, Classification of Public Bodies: Guidance for Departments, Public Bodies Handbook – Part 1, at 15 (Jan. 20, 2019), available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/519571/Classification-of-Public_Bodies-Guidance-for-Departments.pdf.

12 Our governance, HM Revenue & Customs (Jan. 20, 2019), available at https://www.gov.uk/government/organisations/hm-revenue-customs/about/our-governance.

13 About us, HM Treasury (Jan. 20, 2019), available at https://www.gov.uk/government/organisations/hm-treasury/about.

In accordance with Section 11 of the Commissioners for Revenue and Customs Act 2005, the Commissioners, in exercising their functions, act within the framework of directions of a general nature from the Treasury,[14] an example of these being the Treasury's Spending review and autumn statement, which enshrined a profiscal policy for the activity of HMRC.

In Scotland and in Wales, tax control with respect to whether devolved taxes[15] have been correctly calculated and paid is exercised by a non-ministerial department of the Government of Scotland responsible for revenues[16] (known as Revenue Scotland), and a non-ministerial department of the Government of Wales responsible for revenues[17] (known as The Welsh Revenue Authority).

Moreover, control powers within the framework of administering municipal tax (Council Tax)[18] are vested in local government (municipal councils); however, these powers are extremely restricted by virtue of a simplified taxation mechanism.[19]

Thus, HMRC as the tax authority in the United Kingdom has, by virtue of its status as a non-ministerial department, extensive autonomy from the body drawing up state policy in relation to the public finances and taxes, the Treasury; this is in contrast to the Russian Federation, where the Federal Tax Service is a subordinate body of the Ministry of Finance.

Moreover, the British system of tax control bodies is gradually evolving so as to become more decentralized, which reflects the process of public power being established at the regional level in Scotland and Wales.

In the USA, tax control is carried out on three levels – the federal, state and local levels – by the corresponding public executive bodies: the Internal Revenue Service (the "IRS"), and the tax administrations of states and municipalities.

With respect to the status of the IRS, it is important to note as follows. The U.S. Treasury, acting through the Secretary of the Treasury in accordance with § 7801 of the Internal Revenue Code (the "IRC"), is granted all powers relating to compliance

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14 Commissioners for Revenue and Customs Act 2005, *supra* note 9.

15 Devolution is a process of creating self-government in regions of the United Kingdom, and is accompanied with the delegation of powers by centralised executive state authorities of the United Kingdom to regional authorities. The powers thus delegated touch on various areas of public life.

16 Revenue Scotland and Tax Powers Act 2014 (Jan. 20, 2019), available at https://www.legislation.gov.uk/asp/2014/16/contents.

17 Tax Collection and Management (Wales) Act 2016 (Jan. 20, 2019), available at http://www.legislation.gov.uk/anaw/2016/6/contents.

18 The Council Tax (Administration and Enforcement) Regulations 1992 (Jan. 20, 2019), available at https://www.legislation.gov.uk/uksi/1992/613/contents/made.

19 The municipal council sends a bill to the taxpayer based on the category of real estate to which the relevant property is assigned, based on information from the Valuation Office Agency (VOA). An example of the substance of the control powers is that before granting a student benefit to the owner of a real estate property, the municipal council requests and checks documents confirming the person's right to the relevant benefit.

with laws on taxation and control over their implementation under the supervision of the Secretary of the Treasury.

At the same time, the actual functions of the U.S. Treasury in the area of taxation are restricted to devising policy and general administration in this area. The powers vested in the U.S. Treasury in the area of tax relationships, including functions in the area of tax control, are directly exercised by the IRS, which is a bureau of and is subordinate to the Department of the Treasury.

The IRS has been created to perform the obligations vested in the U.S. Secretary of the Treasury according to § 7801 of the IRC. § 7803 of the IRC provides that the Commissioner of Internal Revenue shall be appointed by the President by and with the advice and consent of the Senate to organize the implementation and application of laws on taxation.

From the standpoint of the overall functioning of the IRS and also the implementation and application of a risk-oriented approach, it is important to single out, in particular, four Divisions of the IRS: Wage and Investment, Large Business and International, Small Business/Self-Employed, Tax-Exempt and Government Entities. Also deserving of particular attention are such principal offices as the Chief Counsel, Appeals Office and Taxpayer Advocate Service, which report directly to the Commissioner of Internal Revenue. Moreover, the structure of the IRS' central administration also contains a Criminal Investigation department, as well as a Whistleblower Office.

The IRS also has a presence in the USA through the functioning of four regional offices and of TACs (Taxpayer Assistance Centers).[20]

The IRS handles the administration of federal taxes, while at the same time states and municipalities in the USA may introduce and administer their own taxes and may also undertake control measures.

The reason lies in the fact that, in the USA, no single list of federal, regional and municipal taxes has been established (whereas this has been done, for example, in Russia). This means in practice that states and municipalities can establish taxes[21] for the purposes of accumulating public finance at the corresponding level.

Each state has its own tax administration, responsible for collecting the taxes established in the state in question. The structure of such an administration is in many ways similar to the structure of the IRS set out above.

For example, in the state of Washington, the Department of Revenue administers *sales and use taxes, property tax, cigarette, aircraft, public utility and other taxes*.[22] This administration also presupposes the carrying out of tax control measures.[23]

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[20] IRS Official Website Information (Jan. 20, 2019), available at https://www.countyoffice.org/irs-offices/.

[21] *Толстопятенко Г.П., Федотова И.Г.* Налоговое право США. Терминология [Gennady P. Tolstopyatenko & Irina G. Fedotova, US Tax Regulations & Tax Terminology] 15 (Moscow: Publishing center "Ankil," 1996).

[22] Washington State Department of Revenue Official Website (Jan. 20, 2019), available at https://dor.wa.gov/find-taxes-rates/other-taxes.

[23] In 2017, for example, 6,000 audits were carried out; the level of voluntary compliance was 97.5%. *See* Revenue at a Glance (FY 2017) (Jan. 20, 2019), available at https://dor.wa.gov/about.

In each municipal unit, there also exists a service that is responsible for collecting local taxes and levies. For example, the city of Chicago has its Department of Finance.[24] The structure of this Department contains, among other things, a Tax Division, which is responsible for collection, for conducting audits and for administering all municipal taxes and levies. In the city of Miami, there is also a Department of Finance. The structure of this Department contains a Treasury Management Department, which, among other things, is responsible for administering *payments for business tax receipts*.[25]

Tax administration at state level and local tax authorities fall outside the IRS system. Since, in actual fact, local tax authorities perform similar functions to those of the IRS to ensure compliance, and they also, among other things, conduct tax control measures, further discussion will focus on the powers of the IRS when it administers federal taxes.

Thus, tax control functions in the USA are decentralized and are carried out by federal, state and local government. The IRS, as a bureau of the U.S. Treasury in structural terms, handles the administration of federal taxes only. States and municipalities form their own tax authorities, which undertake the administration of regional and local taxes respectively, including the holding of tax control measures.

In the legislation, the rules of 26 U.S. Code Subtitle F Chapter 80 Subchapter A (entitled Application of Internal Revenue Laws) are devoted to the functions and powers of the Commissioner of Internal Revenue.

§ 7801 of the IRC, in particular, states that the administration and enforcement of Title 26 (i.e. IRC) shall be performed by or under the supervision of the Secretary of the Treasury.[26] At the same time, § 7803 of the IRC establishes the fundamentals of the legal status of the Commissioner of Internal Revenue, noting that the Commissioner shall have such duties and powers as the Secretary of the Treasury may prescribe, including the power to administer, manage, conduct, direct, and supervise the execution and application of the internal revenue laws or related statutes and tax conventions to which the United States is a party.[27]

The powers, mission and role of the IRS are also contained in the Internal Revenue Manual (the "IRM"),[28] which is an official compendium of internal guidelines for personnel of the IRS and which clearly states the mission of the IRS and instructs its employees on how to carry out the IRS' functions. The mission of the IRS is to provide America's taxpayers with top quality service by helping them understand and meet

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[24] Tax Collection and Enforcement, City of Chicago (Jan. 20, 2019), available at https://www.cityofchicago.org/city/en/depts/fin/provdrs/tax_division.html.

[25] Get a Business Tax Reciept (BTR), City of Miami (Jan. 20, 2019), available at http://www.miamigov.com/finance/BusinessTax.html.

[26] 26 U.S.C. § 7801 – Authority of Department of the Treasury.

[27] 26 U.S.C. § 7803 – Commissioner of Internal Revenue; Other Officials.

[28] Internal Revenue Manual (Jan. 20, 2019), available at https://www.irs.gov/irm.

their tax responsibilities and by applying the tax law with integrity and fairness to all. The IRS' role is to help the large majority of compliant taxpayers with the tax law, while ensuring that the minority who are unwilling to comply pay their fair share.

Wide-scale changes concerning the IRS' goals and its legal status were introduced in 1998, after the Internal Revenue Service Restructuring and Reform Act was passed. The amendments were, in fact, aimed at the IRS changing its concept of relationships with taxpayers, ceasing to be too overzealous in collecting taxes, and becoming more focused on customer service with a view to increasing compliance. However, researchers have cast doubt over whether the 1998 law has had an effect on compliance.[29]

To understand the purposes and objectives of the IRS, it is also important to have recourse to the IRS Strategic Plan[30] for the fiscal years 2018–2022. Based on an analysis of this document, one may judge that the IRS is striving to ensure that each taxpayer pays what he/she/it is obliged to – no more and no less. The key objectives of the IRS in this context are: to create the conditions for taxpayers to understand their tax obligations and the opportunity for them to perform such obligations; to use the IRS' administration and enforcement protect the unity of the tax system by way of increasing compliance; and others. Thus, the tax authorities do not directly declare the fiscal purpose as taking priority in their work, although they are undoubtedly guided by the interests of the state and the public purse, in particular, at all stages of tax control.[31]

The comparison of the priorities in tax control in the jurisdictions under consideration allows for the conclusion that, instead of risk-oriented tax control over the lawfulness of taxation, in other words, whether the calculation of mandatory payments is correct and whether they have been paid in full and on time, the situation unfolds of a conflict between the interests of tax control authorities, which are principally aiming to ensure that tax income is realized for the public purse, and the interests of taxpayers, who are counting on the certainty and stability of the tax system.

Besides, such a situation is typical not only for the jurisdictions under consideration, but also for other countries in the world,[32] which are joining forces to fight the erosion of the tax base and the transfer of profits to avoid taxation.[33] In such a situation, the main purpose of tax compliance becomes the accomplishment of tax income for the public purse, and not the lawfulness of taxation; this immediately makes compliance ineffective.

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29 Leandra Lederman, *Tax Compliance and the Reformed IRS*, 51 University of Kansas Law Review 971, 973–974 (2003).

30 Strategic Goals Overview, IRS (Jan. 20, 2019), available at https://www.irs.gov/about-irs/understanding-the-plan/strategic-goals-overview.

31 Statistics from audits show that the IRS strives to audit major taxpayers more, since the likelihood and scope of potential additional tax assessments are extremely high (*see* subsequent sections).

32 *See* Rolf Eckhoff, *Vom konfrontativen zum kooperativen Steuerstaat*, 2 StuW 107 (1996).

33 For more detail on this issue, *see* http://www.oecd.org.

However, in countries with a developed civil society and strong democratic institutions, tax administrations are more focused on ensuring a reasonable combination of enforcement measures and encouraging tax compliance. It is specifically in this way that, ultimately, the mission is defined of both HM Revenue & Customs in the UK and the Internal Revenue Service in the USA. A fiscal purpose is certainly present in the work of the tax authorities and this will be examined in the sections below. At the same time, in the tax legislation of the UK and the USA, as distinct from Russian tax legislation, the accent is placed on achieving voluntary compliance for the purpose of ensuring that all taxpayers have correctly calculated their taxes and have paid them on time and in full, and the proper implementation of the legal status of taxpayers should be guaranteed.

2. Risk Assessment Conducted by Tax Authorities

A risk-oriented approach to selecting persons with respect to whom tax control measures will be carried out applies in the Russian Federation and also in the United Kingdom and the USA. Such an approach is used owing to the need to increase the effectiveness of tax control and to encourage tax compliance.

An analysis of the approach that authorities apply to tax control is made more difficult by the fact that, in each system of justice, a risk-oriented approach presupposes that there will not be full openness in terms of the criteria laying at the base of the mechanism for determining a taxpayer's risk. Detailed disclosure of full information about risk assessment is undesirable for the public interest to be met, because taxpayers simulate compliance within the mechanism of assessing risks and may hide from control facts of violations of tax legislation.[34]

At the same time, the system of risk criteria and the procedure for assessing them should be sufficiently transparent for taxpayers to be able to use it as a guide and as a basis for them to ensure compliance. Through the disclosure of information about a risk assessment, a tax authority exercises soft-touch regulation of taxpayers' conduct. Taxpayers generally want to ensure that their tax planning is legal, efficient and appropriate, that it does not create reputational risks and that reporting and compliance requirements are satisfied.[35]

Thus, the system of risk criteria, the procedure for assessing them, the level of their openness and transparency for a taxpayer, the opportunity for the latter to be involved in the process of assessing risks – these are the results of the struggle between private and public interests and the long road to finding a balance between them, which comes into being in every state in a special and unique way.

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[34] *Risk-Based Tax Audits: Approaches and Country Experiences* (M.S. Khwaja et al. (eds.), Washington, D.C.: World Bank, 2011) (Jan. 20, 2019), also available at http://documents.vsemirnyjbank.org/curated/ru/490491468159916971/Risk-based-tax-audits-approaches-and-country-experiences.

[35] *See* Judith Freedman et al., *Corporate Tax Risk and Tax Avoidance: New Approaches*, 1 British Tax Review 74, 75 (2009).

2.1. System of Tax Risk Criteria

Let us examine more detailed criteria used by the tax authorities of the three states to assess risks.

In Russia, there is no proper level of detailed elaboration and legal regulation of the fundamentals of a risk-oriented approach in tax control. This conclusion can be reached from an analysis of the criteria of tax risks in the Russian Federal Tax Service's Order No. MM-3-06/333@ dated 30 May 2007 "On Approving the Concept of the System of Planning Field Tax Audits"[36] and explanations of the issues arising when such criteria are applied, which are contained in letters of the Russian Federal Tax Service and are de facto regulatory in nature.

Tax risks and the criteria for assessing them are established at the sub-legislative level by tax administration, in which are vested both law enforcement and control functions in terms of assessing such risks. This is despite the fact that tax risks and the criteria for assessing them are decisive for a taxpayer's legal status and what Russian law refers to as the essential elements of taxes (i.e. the key components of taxes for which the law provides).

At the same time, provision is made in Article 57 of the Constitution of the Russian Federation for the obligation to pay only lawfully established taxes and levies. Further, to establish a tax by law means determining in, specifically, a legislative act on taxes and levies all material elements of a tax obligation and the mechanism for enforcing it. In the case at hand, the legislature does not even, in the Russian Tax Code, delegate powers to determine the list of tax risks and the criteria for assessing them to administrative agencies exercising executive power. Accordingly, the legal fundamentals of the system of tax risk criteria and the procedure for assessing them should be contained in the Russian Tax Code, yet in the current Russian tax legislation there is no reference to a risk-oriented approach and the application of it.

Tax risks and criteria for assessing them are established at the sub-legislative level by the tax administration, in which both law enforcement and control functions in relation to assessing such risks are also vested, despite the fact that tax risks and criteria for assessing them are decisive for determination of the taxpayer's legal status. At the same time, legal certainty is lacking when a list of tax risks and the criteria for assessing them are established.

This particular factor narrows the application of a risk-oriented approach in tax control, substituting for it a wide latitude for officials of the tax authorities or administrative discretion for them which does not have predictable legal boundaries. In the Russian Federal Tax Service's Order "On Approving the Concept of the System of Planning Field Tax Audits," there are only twelve publicly available criteria of all

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[36] Приказ ФНС России от 30 мая 2007 г. № ММ-3-06/333@ «Об утверждении Концепции системы планирования выездных налоговых проверок» [Russian Federal Tax Service's Order No. MM-3-06/333@ dated 30 May 2007 "On Approving the Concept of the System of Planning Field Tax Audits"] (Jan. 20, 2019), available at http://www.consultant.ru/document/cons_doc_LAW_55729/.

tax risks, designated as the "key" criteria for selecting taxpayers for the purpose of conducting a field tax audit with respect to them; this indirectly evidences that there is a list of tax risks and criteria for assessing them that is closed to public access.

The management of the Russian Federal Tax Service confirms this conclusion; most notably the Deputy Head of the Russian Federal Tax Service, D.V. Egorov mentioned 84 criteria based on which a taxpayer's risk is assessed in his report to the Federation Council of the Federal Assembly of the Russian Federation (i.e. one of two chambers of Russia's parliament) on the work of the automated tax control software for VAT known in Russian as ASC "VAT-2."[37]

Despite the codification of tax control rules in the Russian Tax Code, which are actually applied are the open lists of tax risks and uncertain criteria for assessing them established by the Federal Tax Service's Order and clarified by numerous letters of the Federal Tax Service, both normative and individual interpretation, grounded in among other things judicial decisions relating to tax disputes and legal positions of the Constitutional Court of the Russian Federation interpreted by the management of the Federal Tax Service with an unchanging anti-evasion and pro-government approach.

There is no certainty and stability in this issue in principle. The implementation by tax control authorities of automated information systems for aggregating information to assess tax risks only exacerbates the situation, because algorithms for the selection of information by these systems when a risk-orientated approach is implemented in tax control are not formalized and not promulgated. This is done for the reason that the systems are constantly improved by day-to-day use and generally designed for official use only, with the exception of the "Business Risks: Check Yourself and Your Counterparty" section on the Federal Tax Service's official website, which is open for the public to use.

In the United Kingdom, the fundamentals of a risk-oriented approach were set out in 2007 in the Internal Manual on Tax Compliance Risk Management.[38]

Moreover, the mechanism of the application of a risk-oriented approach is disclosed in several documents containing soft law: Managing Serious Defaulters Programme[39] and Code of Practice 9, COP9 dated 30 June 2014.[40]

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[37] *See Егоров Д.В.* О практике ФНС России при внедрении риск-ориентированного подхода при осуществлении контрольно-надзорной деятельности [Daniil V. Egorov, *On the Russian Federal Tax Service's Practice When Implementing a Risk-Oriented Approach in the Carrying Out of Control and Supervisory Activity: Report*] 13 (Jan. 20, 2019), available at http://www.council.gov.ru/media/files/41d589309a50b0750aaa.pdf.

[38] Tax Compliance Risk Management, HM Revenue & Customs (Jan. 20, 2019), available at https://www.gov.uk/hmrc-internal-manuals/tax-compliance-risk-management/tcrm2200.

[39] Managing Serious Defaulters programme, Guidance, HM Revenue & Customs (Jan. 20, 2019), available at https://www.gov.uk/guidance/managing-serious-defaulters-msd-programme.

[40] HM Revenue & Customs, Code of Practice 9: HM Revenue & Customs Investigations Where We Suspect Tax Fraud, HMRC 06/14 (Jan. 20, 2019), available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/494808/COP9_06_14.pdf.

Information from returns, from the registers at Companies House and other sources (including, for example, information from airlines about a person's plane flights abroad) is aggregated with the assistance of Connect software.[41]

In order to simplify the process of managing risks for taxpayers HMRC, in its Internal Guidance, presents a system of criteria of tax risks that it considers when applying a risk assessment system.

HMRC's employees analyze criteria of two types:

1) Inherent criteria that stem from the economic conditions of the activity of the person subject to control, for example: foreign membership in a company; a multiplicity of transactions with transfer prices; the complexity of the structure of the group to which the company belongs and the presence of subsidiary companies;

2) Criteria that directly characterize tax compliance of the person subject to control, for example: the timely provision of full and accurate information in response to HMRC's requests; the filing of returns on time and with accurate information; a lack of involvement in structuring operations whose tax consequences contradict the objectives of legislation on taxes and levies.

A risk-oriented approach cannot function effectively without an analysis of inherent criteria that allow for a suggestion as to whether there is potentially a violation and the possible adverse consequences of such violation.

At the same time, the criteria should not have a significance that is independent of compliance. The same approach would have adverse consequences in the form of those responsible for exercising control becoming involved in the economic activity of taxpayers, which can be observed in the law enforcement practice of the Russian tax authorities. For example, based on the Russian concept of a risk-oriented approach, a person who is subject to control can face a field tax audit if an inspectorate considers that the salary level of its employees is not sufficient,[42] even if such person ensures compliance.

To avoid the same shortcoming, the British tax authority has stated that inherent criteria are important only so that the tax authority is able to determine precisely which actions a specific taxpayer should undertake and which it should forego if it is striving for low risk.

Having ensured compliance, a taxpayer eliminates risk both with respect to criteria directly linked to compliance, and with respect to inherent criteria that have no independent significance.

Thus, the status of a low-risk taxpayer is determined by actions that a person takes through its own will and not by factors which such person cannot influence; these actions should be undertaken within the scope of a tax relationship and not in the area of economic activity.

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41 *See* Mark McLaughlin, *HMRC Investigations Handbook 2016/17* 326 (London: Bloomsbury Professional, 2017).

42 *See* the Russian Federal Tax Service's Order "On Approving the Concept of the System of Planning Field Tax Audits," *supra* note 36.

It is also worth emphasizing the greater openness of the system of tax risk criteria in the United Kingdom as contrasted with that in the Russian Federation.

Thus, in practice[43] employees of HMRC when determining risk analyze the facts of a person's involvement in tax avoidance schemes; they assess whether returns are filed on time and a breakdown of explanations accompanying any facts that could potentially be revealed to the tax authority as a sign of tax violations having been committed. Despite the fact that the public list of factors considered to be a risk by the tax authority is not exhaustive, the criteria that the tax authority takes into account are closely related to the public ones.

At the same time, the levels of openness and transparency of information about HMRC's risk-oriented approach are different for two groups of taxpayers, which is predicated on the specific features of national tax policy.

For large-scale enterprises, a more transparent control regime is created, and the Internal Manual is aimed specifically at assessing such enterprises. For small and medium-sized enterprises, this legal construct remains undetermined and, without having access to risk criteria, such enterprises are also compelled to take their bearings from the concept drawn up for large-scale taxpayers.

In the USA, Section 4.10.3.2 of the IRM is devoted to risk analysis. Risk analysis is the process of comparing the potential benefits to be derived from examining a return or issue to the resources required to perform the examination.

A risk assessment applies throughout all control measures, including the audit itself and what is known as the pre-audit phase. The IRS, when conducting control events, calls on the inspectors to pay attention to such factors as fraud potential, materiality, hours required to audit, and others.

The IRS also recommends being guided during an audit by the 80/20 concept (with respect to setting priorities by and spending sources of IRS officials) and the Mid-Audit Decision Point Rule, which means that in the middle of the audit, a decision should be made on whether to audit the remaining matters and issues.

The advantages of risk analysis consist of increased productivity; improved audit planning process; reduced cycle time; increased audit coverage; and reduced taxpayer burden.

Thus, the IRS bases its activity relating to control and ensuring compliance on a risk-oriented approach.

The IRS accepts an overwhelming majority of tax returns in the form in which they are submitted, since to check all returns by hand is impossible and there is no sense in doing so, because most taxpayers perform their tax obligations voluntarily and in good faith.

However, there are always some who do not comply with tax legislation. In view of this, it is important to understand how potential tax offenders can be most

[43] *See* McLaughlin 2017, at 326–327.

effectively identified. For these purposes, it is important to determine the risk factors that would be indicated in those returns which the tax authority might check to the greatest effect, i.e. would lead to the most substantial amounts of additional tax assessment.

The IRS has rejected manual screening of returns as the first and main method of processing returns.[44] In place of this, the IRS has been applying the Discriminant Inventory Function System since 1969. The Discriminant Inventory Function (DIF) System is the major audit selection method of the Internal Revenue Service. DIF is a mathematically based system which, through a computer, assigns weights to entries on tax returns and produces a final score for each return. The greater the score, the greater the examination potential within each examination class, so the probability of being audited increases with a higher final score.[45]

In fact, the DIF System is built in such a way that data from a tax return are to be compared with certain average figures that are characteristic for an overwhelming number of taxpayers in the corresponding category. If a significant discrepancy is identified, a tax audit can be carried out.

Despite the fact that the IRS should disclose the criteria and procedure it uses to select returns for audit,[46] DIF Documentation is strictly confidential and is not disclosed to taxpayers.[47]

In this connection, it is impossible to state with confidence which factors underpin the functioning of this system and specifically which average figures are taken into consideration. Data of the DIF System are supplemented using random selections of tax returns in the context of the National Research Program, which has been in effect since 2002 and replaced the Taxpayer Compliance Measurement Program,[48] i.e. the taxpayer may be selected for an audit by chance, in the absence of any signs of a violation on his/her/its part.

Before the DIF System was implemented, around half of audits did not lead to any changes in the tax return; after the DIF System was implemented, only one fifth of audited returns remained unchanged.[49]

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44 *Risk-Based Tax Audits*, *supra* note 34.

45 Boris I. Bittker et al., *Federal Income Taxation of Individuals* (3rd ed., New York: Warren, Gorham & Lamont, 2003), Part 47.01. Examination and Audit of Returns.

46 *Federal Tax Coordinator* (2nd ed., New York: Tax Research Institute of America, 1977), T. 1060. Selection of Returns to Be Audited.

47 Even the score assigned to the tax return according to the results of the audit is not disclosed to taxpayers.

48 Amber Torrey, *The Discriminant Analysis Used by the IRS to Predict Profitable Individual Tax Return Audits*, Honors Projects in Mathematics, Paper 1 (2008) (Jan. 20, 2019), available at https://digitalcommons.bryant.edu/honors_mathematics/1/.

49 Robert E. Brown & Mark J. Mazur, *The National Research Program: Measuring Taxpayer Compliance Comprehensively*, 51(5) University of Kansas Law Review 1255 (2003).

Tax authorities are not restricted to the DIF System and the random selection of returns for audit, though taxpayers have undertaken attempts to challenge this approach, citing it as unjustified and arbitrary.[50] At the same time, courts adhere to the opinion that the holding of an audit and additional assessment of tax in one case, and the non-holding of an audit in another case, does not violate the principle of the due process clause, if the audit was appointed with an absence of discrimination against the taxpayer (with no account taken of gender, race, personal views and similar).[51]

To understand the risk-oriented approach, the following documents are significant:

1) Internal Revenue Manual (the IRS' official compendium of internal directions for its employees);

2) Documents containing "soft law." This refers to published materials of the IRS,[52] and to reports that the Government Accountability Office prepares from time to time.[53] In particular, the report on the activity of the Large Business and International Division contains information that, at present, the "Large Business and International Division does not have a process to monitor the final decisions about which tax returns will be audited;"

3) Published materials of academic lawyers, which also contain information about what catches the attention of the IRS in practice when it decides to hold control measures.

Based on an analysis of the documents referred to above, the risk factors can be separated out, and conditionally divided into the following groups: those which the taxpayer cannot affect, and those which it can affect.

The first group of risks relates to a discrepancy between the data of a return and the data from information returns,[54] or a related party of a taxpayer with which the former entered into transactions in the corresponding period being subject to an audit (it is possible to influence the reduction of such risk by way of

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50 In one case, taxpayers challenged the lawfulness of an audit that had been conducted, on the grounds that they were selected for an audit not based on the results of a random selection or the DIF System which, in their opinion, contradicted Amendment IV to the United States Constitution. *See Bhagwan D. Raheja and Krishna K. Raheja v. Commissioner of Internal Revenue*, 725 F.2d 64 (7th Cir. 1984).

51 *Teague v. Alexander*, 662 F2d 79, 83 (D.C. Cir. 1981); *Penn-Field Indus., Inc. v. CIR*, 74 T.C. 720, 724 (1980); *Karme v. CIR*, 673 F2d 1062 (9th Cir. 1982).

52 *See, e.g.*, Department of the Treasury, IRS, Publication 556 (Rev. September 2013), Cat. No. 15104N (Jan. 20, 2019), available at https://www.irs.gov/forms-pubs/about-publication-556.

53 U.S. Government Accountability Office (GAO), IRS Return Selection: Improved Planning, Internal Controls, and Data Would Enhance Large Business Division Efforts to Implement New Compliance Approach (March 2017) (Jan. 20, 2019), available at https://www.gao.gov/assets/690/683721.pdf; U.S. GAO, Return Selection: Wage and Investment Division Should Define Audit Objectives and Refine Other Internal Controls (December 2015) (Jan. 20, 2019), available at https://www.gao.gov/assets/680/674313.pdf; U.S. GAO, IRS Return Selection: Certain Internal Controls for Audits in the Small Business and Self-Employed Division Should Be Strengthened (December 2015) (Jan. 20, 2019), available at https://www.gao.gov/assets/680/674228.pdf.

54 26 U.S.C., Subtitle F, Chapter 61, Subchapter A, Part III.

showing due circumspection when selecting a counterparty).[55] The IRS also analyses information from the mass media[56] and information from other sources, including communications about evasion.[57]

Large business is in a particular risk zone from the standpoint of the potential for tax control measures to be carried out under the Coordinated Examination Program. The statistics for the 2017 fiscal year are such that, if on average the risk of an audit being conducted is less than 1%, a company that has declared more than USD 10 million is audited in 4% of cases; with income between USD 50 million and USD 100 million, the likelihood is as great as 10%. If a large business declares more than USD 20 billion, its likelihood of being audited is 58.4%. At the same time, with respect to such companies in 2017, there were 331 field audits and 29 correspondence audits. This risk is defined in economic terms and does not depend at all on the taxpayer.

To the second risk category, one may assign the following: an application for significant deductions or a refund, or the amendment to a return already filed. Another risk trigger will be a request for a clarification or a ruling from the IRS, a request to enter into a closing agreement, and also an offer in compromise.[58] The presence of substantial arrears in previous tax periods is also a risk for a taxpayer. Previously, the IRS even asserted in an official document that a return may be selected for audit based on data about a prior history of substantial deficiency or fraudulent action.

Thus, multiple factors may increase a person's risk. However, this does not entail an audit being automatically conducted because also significant is the extent to which carrying out an audit in the specific circumstances at hand will correspond to the interests of the state.

In other words, even it is identified that a person has a risk (for example, a high DIF Score), within the classification procedure and analysis of the return from the standpoint of potential, priority may be given to another return with a greater risk (an even higher DIF Score) in cases where the IRS has limited resources and it proves impossible to audit all risk-bearing returns.

When assessing the merits of a particular tax return position, the Treasury Regulations,[59] IRS Circular 230[60] and professional standards of certified accountants[61]

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55 *Federal Tax Coordinator*, *supra* note 46, T. 1061. Selection of Returns to Be Audited.

56 Allen D. Madison, *The Futility of Tax Protester Arguments*, 36(2) Thomas Jefferson Law Review 253 (2014); *United States v. Schiff*, 612 F.2d 73, 78–81 (2d Cir. 1979).

57 An informer under the Whistleblower Program receives from 15 to 30% of the amount of arrears recovered, in the form of recompense, while an informer under § 7623 IRC receives recompense at the discretion of the Secretary of the U.S. Treasury. *See also* Allen D. Madison, *The IRS's Tax Determination Authority*, 71 Tax Law 143 (2017).

58 *Federal Tax Coordinator*, *supra* note 46, T. 1065. Chances of a Return Being Audited.

59 26 C.F.R. § 1.6694-2, Treas. Reg. § 1.6694-2.

60 Circular 230 Tax Professionals, IRS (Jan. 20, 2019), available at https://www.irs.gov/tax-professionals/circular-230-tax-professionals.

61 American Institute of Certified Public Accountants (AICPA), Tax Executive Committee, Statement on Standards for Tax Services No. 1, Tax Return Positions (2009) (Jan. 20, 2019), available at https://www.

strictly prohibit tax return preparers from taking Internal Revenue Service (Service) audit risk into account. For this reason, many tax return preparers, as a matter of principle, refuse to discuss the merits of a particular return (or clause of a return).

As noted previously, the DIF System and the mathematical formulas underpinning it are confidential and should be disclosed to an IRS officer only when necessary. DIF formulas are intended for internal use only and should not be discussed with unauthorized personnel.[62] The American courts have noted in a series of cases that the disclosure of DIF documentation could undermine the unity of the U.S. tax system and its regulatory function, since taxpayers would learn to manipulate the DIF score, thus avoiding audits. On specifically this ground, information concerning the work of the DIF System is not supplied within the scope of the right to information under the Freedom of Information Act[63] ("techniques and procedures for law enforcement investigations or prosecutions, or guidelines for law enforcement investigations or prosecutions" are not subject to disclosure "if such disclosure could reasonably be expected to risk circumvention of the law"[64]). § 6103 of the IRC establishes that, at the discretion of the Secretary of the U.S. Treasury, it is permitted not to disclose not only the criteria applied to select returns for audit but also data used for determining such criteria, if the Secretary determines that such disclosure will seriously impair assessment, collection, or enforcement.

However, even so, there is information that is publicly available and will allow a taxpayer to understand what IRS inspectors will pay attention to. In particular, Audit Techniques Guides[65] for small business are available on the IRS' website. These are guidelines for the IRS' officials when carrying out audits, and are grouped according to two features – either by industry, or by particular, special questions. A taxpayer may acquaint itself with the guidelines before an audit and thus will know what will catch the attention of the inspector.

In the USA, a person may only manage risks to a certain degree, because (1) not all risks are able to be estimated and managed on the part of a taxpayer; and (2) in principle, a taxpayer is not aware of all risk factors. In practice, taxpayers make attempts to manage tax risks, forming, for example, an audit committee or tax departments and vesting them with the function of identifying, assessing and managing an enterprise's tax risks.[66]

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aicpa.org/content/dam/aicpa/interestareas/tax/resources/standardsethics/statementsonstandardsfortaxservices/downloadabledocuments/ssts-effective-january-1-2010.pdf.

62 Michael B. Lang & Jay A. Soled, *Disclosing Audit Risk to Taxpayers*, 36(3) Virginia Tax Review 423 (2017).

63 *Buckner v. IRS*, 25 F. Supp. 2d 893, 898 (N.D. Ind. 1998); *Gillin v. IRS*, 980 F.2d 819, 822 (1st Cir. 1992); *Lamb v. IRS*, 871 F. Supp. 301, 304 (E.D. Mich., 1994).

64 5 U.S.C. § 552 – Public Information; Agency Rules, Opinions, Orders, Records, and Proceedings.

65 IRS Official Website Information (Jan. 20, 2019), available at https://www.irs.gov/businesses/small-businesses-self-employed/audit-techniques-guides-atgs.

66 Thomas Frank Larson, *Corporate Tax Risks: A Call for Greater Audit Committee Involvement*, 13 U.C. Davis Business Law Journal 39 (2012).

2.2. Risk Assessment Procedure

In Russia, tax authorities assess tax risks continually based on: data from the AIS "Nalog-3" system; data from the taxpayer's accounting system during tax monitoring; information when requested without tax audits being conducted; commissions for legalizing the tax base (i.e. commissions for tax avoidance schemes disclosure); each office audit of a tax return; and a field tax audit. The stages of applying a risk-oriented approach are not formally separated out.

For the purposes of tax control over the correctness of the calculation and the payment of taxes and levies in full and on time, the tax authorities use, in their activity, the automated information system "Nalog-3," known in Russian as "AIS "Nalog-3" ("Nalog" being the Russian for "tax"). This is a unified information system of the tax authorities, in which, in particular, data is accumulated concerning: the registration of what are termed in Russian "acts affecting civil status" (births, marriages, deaths, etc.); the state registration of legal entities and individual entrepreneurs; the state registration of rights to property; marking of goods; an analysis of banking activity; data from cash register technology; data from control work; data from the ASK VAT-2 system; and so on.

The systematization of the above information based on the automatization of it using modern information technologies ensures the identification of tax risks associated with both violations of tax registration and the abuse of tax law throughout the country.

Part of the data from AIS "Nalog-3" is publicly available Federal Tax Service's official website in order to ensure that due circumspection and reasonable care are exercised in the selection of a counterparty. This service is called: "Business risks: check yourself and your counterparty."

The tax authorities are trying to modify their approach to tax control by shifting focus from demonstration of due circumspection in choosing a counterparty to identification of the ultimate beneficial owners of an unjust tax benefit derived from various tax fraud schemes (when, in fact, the tax authorities impute their intrinsic function to exercise tax control onto business entities entering into civil law relations with other such entities).

For these purposes, the tax authorities intend to improve the administrative procedure for the state registration of legal entities, to use to the maximum the results of internal control of financial institutions to identify persons who are problematic from the standpoint of financial and legal risks[67] and to promptly obtain

[67] *See* Методические рекомендации о повышении внимания кредитных организаций к отдельным операциям клиентов (утв. Банком России 13 апреля 2016 г. № 10-МР) // Вестник Банка России. 2016. № 40 [Methodological Recommendations on Increasing the Attention Paid by Credit Institutions to Specific Operations of Their Clients (approved by the Bank of Russia on 13 April 2016 under No. 10-MR), 40 Bulletin of the Bank of Russia (2016)]; Методические рекомендации о подходах к управлению кредитными организациями риском легализации (отмывания) доходов, полученных преступным путем, и финансирования терроризма (утв. Банком России 21 июля 2017 г. № 18-МР) // Вестник

the information they need from the banking system and from other financial market participants for the targeted application of administrative enforcement, and also to apply the method of comparing flows of goods and money.

Taking account of the development of blockchain technology and the collaboration of the Federal Tax Service and the Central Bank of the Russian Federation (also commonly referred to as the "Bank of Russia") on this issue, such tax administration efforts have led to the creation of a more effectively functioning system, AIS "Nalog-3," which will be at the base of a targeted risk-oriented approach to identifying persons who are problematic from a taxation standpoint. This refers to so-called "platforms" to obtain an unjustified tax benefit or to infringe the boundaries of the exercise of taxpayers' legal rights when calculating the tax base and/or an amount of tax (Article 54.1 of the Russian Tax Code). Their identification is aimed at the timely adoption of administrative enforcement measures specifically with respect to such persons.

Thus, the "ASK VAT-2" system singles out technical subjects, whose activity is connected solely with obtaining an unjustified tax benefit or infringing the boundaries of the exercise of taxpayers' legal rights when calculating the tax base and/or an amount of tax, substantive subjects, whose activity is of a business nature, and transit subjects, who ensure the connection between the first and second subjects.

Based on such classification of subjects in the integrated IT system of the tax authorities' databases, the issue is decided of the targeted application to them of administrative enforcement measures both for a violation of tax legislation and for an abuse of a tax law right. What is being referred to here is applying the whole set of administrative enforcement measures: preventive, preclusive, provisional, punitive and restorative measures.[68]

In connection with the struggle against erosion of the tax base on a global (international) level, which is necessary to overcome bad-faith competition between offshore zones and onshore jurisdictions, states are obliged to move gradually away from the practice of entering into bilateral tax treaties, one of the aims of which is not to permit tax abuses by way of the unlawful application by taxpayers of the benefits

Банка России. 2017. № 63 [Methodological Recommendations on Approaches to the Management by Credit Institutions of the Risk of the Legalization (Laundering) of Income Obtained Through Criminality, and the Financing of Terrorism (approved by the Bank of Russia on 21 July 2017 under No. 18-MR), 63 Bulletin of the Bank of Russia (2017)]; Методические рекомендации о повышении внимания кредитных организаций к отдельным операциям клиентов (утв. Банком России 2 февраля 2017 г. № 4-МР) // Вестник Банка России. 2017. № 15 [Methodological Recommendations on Increasing the Attention Paid by Credit Institutions to Specific Operations of Their Clients (approved by the Bank of Russia on 2 February 2017 under No. 4-MR), 15 Bulletin of the Bank of Russia (2017)].

[68] For more detail on this issue, *see Овчарова Е.В.* Основания классификации и система мер административного принуждения за нарушения налогового законодательства // Вестник МГУ. Серия «Право». 2018. № 4. С. 21–43 [Elena V. Ovcharova, *The Grounds for the Classification of and System of Administrative Enforcement Measures for a Violation of Tax Legislation*, 4 Bulletin of the Moscow State University. Series "Law" 21 (2018)].

for which international tax treaties between states provide, and to move towards the signature and ratification of multilateral tax treaties in which the crackdown on tax avoidance through international tax planning is becoming the main purpose.

Here, it is the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting[69] that is in issue, as well as international treaties ensuring the effective exchange of tax information on an international level and reciprocal assistance with respect to tax matters on a global (international) scale.

Thus, the Convention on Mutual Administrative Assistance in Tax Matters of 25 January 1988 (the "Convention") was signed by the Russian Federation in Cannes, France, on 3 November 2011 and ratified by the Russian Federation by Federal Law No. 325-FZ dated 4 November 2014 "On Ratifying the Convention on Mutual Administrative Assistance in Tax Matters,"[70] which came into force in the Russian Federation starting from 1 July 2015 and began to be applied starting from 1 January 2016. The above Convention provides, along with the international exchange of tax information at the request of an interested state and the spontaneous exchange of tax information, for the automatic exchange of tax information.

Special significance is accorded to the latter. In this connection, the Multilateral Competent Authority Agreement on Automatic Exchange of Financial Account Information dated 29 October 2014 was drawn up.[71] In its development, consultations were held with representatives of the Russian Federal Tax Service (the "FTS of Russia"). The implementation of such global conventions presupposes the FTS of Russia's active involvement in the drawing up and implementation of the OECD's Common Reporting Standard ("CRS") and Common Transmission System ("CTS"), with the assistance of which a protected, single channel for the exchange of information can function.[72]

To ensure that the Russian Federation performs the international obligations it has undertaken for the automatic exchange of financial information with foreign states (territories) in the framework of the above international treaties, a system

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[69] *See* Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting, published by the OECD on 24 November 2016 and open for signature from 31 December 2016 (Jan. 20, 2019), available at https://www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-BEPS.pdf.

[70] Федеральный закон от 4 ноября 2014 г. № 325-ФЗ «О ратификации Конвенции о взаимной административной помощи по налоговым делам» [Federal Law No. 325-FZ dated 4 November 2014. On Ratifying the Convention on Mutual Administrative Assistance in Tax Matters] (Jan. 20, 2019), available at http://www.pravo.gov.ru.

[71] *See* Multilateral Competent Authority Agreement on Automatic Exchange of Financial Account Information (CRS MCAA) (Jan. 20, 2019), available at https://www.oecd.org/tax/exchange-of-tax-information/multilateral-competent-authority-agreement.pdf.

[72] *See Вольвач Д.В., Кадет А.В.* Кто владеет информацией, владеет и налоговой базой // Налоговед. 2016. № 6. С. 15–25 [Dmitry V. Volvach & Aleksandra V. Kadet, *He Who Possesses Information Also Possesses the Tax Base*, 6 Nalogoved 15 (2016)].

has been introduced of notifications of involvement in an international group of companies, with information about countries being presented, as special forms of international tax reporting for an international group of companies: global documentation, national documentation and a country report.[73]

By Order No. MMV-7-17/123@ of the FTS of Russia dated 6 March 2018, the format was approved for the country report of an international group of companies regarding the states (territories) of which members of the international group of companies are tax residents, while the procedure for such report to be filled in and submitted electronically was also approved.[74]

If, before 30 September 2018 with reference to the Russian Federation, exchange took place at the request of an interested party or spontaneously by way of the supply of information to a party that might be interested, then since 30 September 2018 Russia has fully joined in with the system of the automatic exchange of financial information[75].

This system implies that the FTS of Russia will have access in real time to financial information about Russian tax and currency residents that is accumulating in the global automated information database for the purposes of international information exchange under the Convention on Mutual Administrative Assistance in Tax Matters and the Multilateral Competent Authority Agreement on Automatic Exchange of Financial Account Information concluded in accordance with such Convention.

The automatic international exchange of financial information, in which around 80 to 100 jurisdictions participate, ensures that the principle of transparency is implemented in financial control on a global scale.

So that any taxpayer has the opportunity to determine the boundaries of the state's tax jurisdiction with respect to such taxpayer with the assistance of the institution of tax residency, starting from 16 January 2018 on the official internet

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[73] *See* Федеральный закон от 27 ноября 2017 г. № 340-ФЗ «О внесении изменений в часть первую Налогового кодекса Российской Федерации в связи с реализацией международного автоматического обмена информацией и документацией по международным группам компаний» [Federal Law No. 340-FZ dated 27 November 2017. On Amending the First Part of the Russian Tax Code in Connection with the Implementation of the Automatic International Exchange of Information and Documentation for International Groups of Companies] (Jan. 20, 2019), available at http://www.pravo.gov.ru.

[74] *See* Приказ ФНС России от 6 марта 2018 Г. № ММВ-7-17/123@ «Об утверждении формата странового отчета международной группы компаний по государствам (территориям), налоговыми резидентами которых являются участники международной группы компаний, порядка его заполнения и представления в электронной форме» (зарегистрировано в Минюсте России 7 мая 2018 г. № 50994) [Order of the FTS of Russia No. MMV-7-17/123@ dated 6 March 2018. On Approving the Format for the Country Report of an International Group of Companies According to the States (Territories) of Which Members of the International Group of Companies are Tax Residents and [Approving] the Procedure for [Such Report] to Be filled in and Submitted Electronically (registered with the Russian Ministry of Justice on 7 May 2018 under No. 50994)] (Jan. 20, 2019), available at http://www.pravo.gov.ru.

[75] However, automatic exchange has been carried out with certain jurisdictions since 2017. *See* more detailed information about this on the OECD's official internet website (Jan. 20, 2019), available at http://www.oecd.org/tax/automatic-exchange/international-framework-for-the-crs/exchange-relationships.

website of the FTS of Russia at *https://www.nalog.ru*, an electronic service of the FTS of Russia was launched under the name "Confirm the Status of a Tax Resident of the Russian Federation." This has considerably simplified the procedure for a taxpayer to confirm its tax status. Tax residency is decisive in both intra-state and international tax relationships. Competent authorities of foreign states will also receive access to information about tax residency of the Russian Federation in accordance with the international tax treaties examined above.

In Russia, when tax authorities assess tax risks, account is taken primarily of the actual circumstances of taxpayers' economic activities, their economic sense and detailed documentation, i.e. for the purposes of managing tax risks, formality and detail are important and tax accounting documents should be supplied to the tax authority in as full a volume as possible. Further, the taxpayer is neither always aware of the assessment of tax risks by tax authorities, nor is it present when the assessment procedure takes place. AIS "Nalog-3" allows tax risks also to be assessed without the interested party being involved in this.

A taxpayer and its lawful and authorized representatives may also in fact take part in the risk assessment procedure in the framework of a meeting of the commission to legalize the tax base, the base of social security contributions and other commissions of the tax authorities and also when they consider issues about the supply of well-grounded opinions in the context of tax monitoring.

Tax monitoring[76] refers to a special service for major taxpayers founded on the implementation of the newest information technologies for taxpayers and tax authorities to interact using telecommunications channels that ensure the opportunity for the tax authorities to have free access to taxpayers' tax accounting systems in order to identify substantial tax risks. The taxpayers in question generate large amounts of taxes for the state budget, but taking into account the risk-oriented approach, tax authorities administering them actually control companies' systems of tax compliance and identify shortcomings in its functioning.

Therefore, with the gradual expansion of tax monitoring based on the implementation of modern information technologies in tax control, one can speak of the fact that a system of tax compliance, based on an automated information system of tax accounting, is on its way to replace the tax audit as the traditional method of tax control over whether tax has been correctly calculated and paid in full and on time.

At the same time, the opportunity is already being granted to taxpayers to interact with tax authorities for the purposes of tax compliance in the framework of tax monitoring and/or using the information resource "Business Risks: Check Yourself and Your Counterparty," which is open to taxpayers on the official internet website of the FTS of Russia at *https://www.nalog.ru* and also using the open-access part of the AIS "Nalog-3" system, by way of supplying answers to requests for documents

[76] *See* Section V.2 "Tax Control in the Form of Tax Monitoring" of the Russian Tax Code.

made outside the scope of audits, visiting commission to legalize the tax base, the base of social security contributions and other commissions whose formation has not been legalized, effectively interacting with inspectors when tax control measures or monitoring are carried out, when filing objections or additions to them, when submitting appeals and by being involved in considering tax control files.

In the United Kingdom, the selection of a person for a risk assessment to be carried out is made primarily based on the "Connect" data system, in which information from all sources available to HMRC is aggregated.[77] A ground for risk to be assessed or reassessed can be the onset of the deadline for the next risk assessment (3 years for a low-risk payer,[78] and no more than 1 year for a person not assigned to that category), the identification of violations during control measures, the receipt of information from another person about a violation that has been committed, and also such a change in the behavior of a person as to allow the tax authority to presuppose non-compliance (deviation from HMRC's recommendations).

It should be noted that the differentiation of the periods for which risk is presumed with respect to a taxpayer serves as a stimulus for compliance. Having attained a status that presupposes more intensive control measures, a taxpayer can change its approach to interacting with the tax authority and reduce the risk during a new assessment procedure. A low risk allows the intensiveness of control measures to be reduced for a greater period.

During the risk assessment, HMRC checks whether the person's conduct corresponds to the conduct of a low-risk taxpayer – whether the person submits by itself information about business transactions in real time, whether the person does not commit tax offences and tax crimes, to what level of quality and detail he/she/it completes returns and clarifications of them. Inherent risk factors (the size of the taxpayer, whether it has related parties and so on) affect the assessment of a person's conduct: the higher these factors are, the stricter the requirements will be for the person's conduct.

It is advisable for a taxpayer to give all necessary clarifications and send by itself information concerning its business operations and how they are accounted for, and to give explanations about the performance of its tax obligation. The carrying out of such actions in the absence of control measures is regarded as the conduct of a person that is striving to ensure compliance, and is rewarded by the establishment of a low risk factor.

In its internal manual, HMRC notes that

> even for customers who are currently Low Risk, CRMs will need to maintain sufficient contact with the customer to ensure that they have this knowledge and understanding.

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77 *See* McLaughlin 2017, at 325.

78 *See* de Widt & Oats 2017, at 237.

At the same time

> If the customer has a low level of inherent risk then it may be sufficient for the CRM to simply base the assessment on their periodic discussions with the customer and ongoing monitoring activity.[79]

It should be emphasized that HMRC has a wide discretion in carrying out a risk assessment, because the Commissioners for Revenue and Customs Act 2005 provides that the Commissioners of HRMC have the right to do anything which they think necessary or expedient in connection with or anything which they think conducive to the exercise of their functions.[80] Taking account of this rule, the main restriction on the discretion of the tax authority is the proportionality principle.

According to Article 8 of the European Convention on Human Rights, public authorities are not permitted to interfere with the exercise of the right to respect for private and family life except when such interference is in accordance with the law and is necessary in a democratic society in the interests of national security, public safety or the economic well-being of the country.[81]

In accordance with this rule of the Convention, implemented in national legislation by the Human Rights Act 1998,[82] interference in private life must be undertaken in accordance with the law and be due to the economic well-being of the United Kingdom.[83]

The rule in this article extends also to private information, covering issues of doing business and professional activity both for physical and legal persons.[84]

By virtue of the above principle, the tax authority must ensure proportionality in its actions with that information it possesses about a specific taxpayer – for example based on an assessment of the tax risk of a specific person.[85] In other words, the proportionality principle permits the justified establishment of a special construct of the balance of interests for each specific taxpayer.

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79 Tax Compliance Risk Management, HM Revenue & Customs (Jan. 20, 2019), available at https://www.gov.uk/hmrc-internal-manuals/tax-compliance-risk-management/tcrm3370.

80 Commissioners for Revenue and Customs Act 2005, *supra* note 9.

81 European Convention on Human Rights (Jan. 20, 2019), available at https://www.echr.coe.int/Documents/Convention_ENG.pdf.

82 Human Rights Act 1998 (Jan. 20, 2019), available at https://www.legislation.gov.uk/ukpga/1998/42/contents.

83 Compliance Handbook, HMRC Internal Manual, HM Revenue & Customs (Jan. 20, 2019), available at https://www.gov.uk/hmrc-internal-manuals/compliance-handbook/ch21340.

84 *Id.*

85 Tax Compliance Risk Management, HM Revenue & Customs (Jan. 20, 2019), available at https://www.gov.uk/hmrc-internal-manuals/tax-compliance-risk-management/tcrm2200.

In the USA, a risk assessment is carried out on an ongoing basis according to the DIF System, specifically: all filed returns undergo a computer check, with a score reflecting audit potential being assigned. If the issue concerns risk factors, then in such event the risks are assessed on a case-by-case basis. For example, if information is obtained from an informer about potential tax evasion, the information is initially checked in terms of its accuracy using the resources of the IRS without documents being requested from the taxpayer and without an audit being conducted; then, the risks and the potential prospects for additional assessments are weighed, with control measures being carried out after that.

The risk assessment is conducted according to the following procedure: at the beginning, a pool of returns that might possibly be checked is put together – returns reach this point based on their DIF score. Next, what is known as classification takes place, which involves IRS officials studying a return, paying attention to Large Unusual and Questionable Items.[86] Then a list of the returns subject to audit is compiled, and it is subsequently passed to tax inspectors for audits to be conducted.[87]

In the tax law of the USA, there are tools and methods for the minimization (mitigation) of tax risks and increase in tax transparency.

One such tool is the *pre-filing agreement*, by deploying which a taxpayer may ask that an audit be held before the tax return is filed; when so doing, it must pay duty amounting to USD 218,600. An equivalent of the Russian tax monitoring, the *Compliance Assurance Process*, also facilitates increased tax transparency (for more detail, see the next section).

More than that, a taxpayer can submit requests to receive *rulings* for the purpose of minimizing (mitigating) its tax risks.

The IRS and a taxpayer may enter into a *closing agreement* under § 7121 of the IRC regarding the tax consequences of a particular event (for example, a transaction). After the agreement has been approved, it becomes legally binding, final and conclusive.

In the USA, the tax authority may assess risks on its own, without the relevant person being invited. A person may be present when the risk is assessed in the context of an office audit to give explanations. In addition, the question whether subsequent control measures are needed is decided based on risk assessment.

In formal terms, violations on the part of the tax authorities concerning a risk assessment procedure are not widespread or typical; however, it needs to be taken into consideration that tax authorities have wide discretionary powers, including those with respect to selecting taxpayers for exercising control measures, including an audit.

Definite insurance for taxpayers is the factor that, since 1998, the IRS has changed its strategy for building relationships with taxpayers. Priority has been given to customer

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86 IRM 4.10.2.3.1.

87 *See, e.g.*, U.S. GAO, IRS Return Selection, *supra* note 53, at 8.

service for the purposes of increasing voluntary compliance, and therefore in practice, tax authorities try to be guided by the principle of reasonableness, for example in carrying out tax control measures (for more detail, see the next section).

Generally, in the USA, the identified tax risk remains live for three or six years[88] from the date on which the return is filed, according to the statute of limitations effective in American criminal law.

The taxpayer should also carefully select the person who will prepare its tax return in order to reduce (or at least, not allow an increase in) its tax risks. The IRS devotes great attention to tax preparers and frequently issues advice to taxpayers on how to choose a tax preparer correctly.[89]

The mere existence of an audit committee or tax department does not in itself affect the reduction of the taxpayer's risk, because it is also important to make sure that these bodies in corporations perform their work effectively.

In summarizing, we note that the most serious problems of legal regulation in the wide-scale implementation of modern information technologies in tax control for the purpose of creating an effective system of preventing violations of tax legislation are the problems of exercising the constitutional rights of man and an individual in the same meaning and content as they are understood and disclosed in the humanitarian philosophy of law.

This philosophy of law supposes that specifically man, his rights and freedoms are of the highest value determining the existence and functioning of all institutions of the state and the law. Such approach lies at the base of the concept of the rule of law that is enshrined in the Constitution of the Russian Federation as currently in effect; the consolidation and protection of the positions of this principle correspond to high human values.[90]

In conditions in which modern digital information technologies are being implemented in risk-oriented tax control, it is important to ensure a mechanism of legal regulation that will not allow the humanitarian philosophy of law to be cancelled out and will not lead to an actual rejection of the concept of the rule of law, as the Chairman of the Constitutional Court of the Russian Federation, Professor V.D. Zorkin, doctor of laws, insisted when he spoke at the St Petersburg International Legal Forum.[91]

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88 Criminal Tax Manual (Jan. 20, 2019), available at https://www.justice.gov/tax/criminal-tax-manual-700-statute-limitations.

89 IRS Official Website Information (Jan. 20, 2019), available at https://www.irs.gov/tax-professionals/choosing-a-tax-professional.

90 *See Алексеев С.С.* Право: Азбука. Теория. Философия: Опыт комплексного исследования [Sergey S. Alekseev, *Law: The Alphabet. Theory. Philosophy: Experience of Integrated Research*] 558, 520–563 (Moscow: Statut, 1999).

91 *See Зорькин В.Д.* Право в цифровом мире // Российская газета. 2018. 30 мая. С. 1, 4 [Valery D. Zorkin, *Law in the Digital World*, Rossiiskaya gazeta, 30 May 2018, at 1, 4].

Therefore, it is worth paying special attention to the following negative trends in the mechanism of legal regulation when modern information technologies are implemented in risk-oriented tax control. Such negative trends await to be overcome, since they are at odds with the values of the humanitarian philosophy of law and the concept of the rule of law:

Firstly, for this field specifically, insufficient certainty of legal rules is characteristic. A frame legal regulation takes place at the level of the law, with the rules subsequently being fleshed out in documents that are not regulatory acts and that are often adopted for official use only and are not officially published.

All this is accompanied by a wide discretion reflected in court and administrative decisions, which presupposes that opportunities will be implemented to adjust and improve the work of information systems on an ongoing basis;

Secondly, when a risk-oriented approach is applied in tax control, a responsiveness is observed in the development of information technologies and such development outruns the formation of a legal control mechanism that is fit for its purpose. This disconnect between the two trends is conditioned by objective factors of acceleration in technological development, on the one hand, and the conservatism of the legal system and the bureaucratization of the legal control method on the other hand.

As a result, a situation is evolving in which the guarantees provided for by constitutional and other statutory legal instruments are totally ignored, and at the same time non-legalized methods and forms of tax control are being applied.

For the purposes of implementing the main principles of tax and levies, proportionality and the effective maintenance of the balance between public and private interests in tax legislation, risk-oriented tax control must be formalized.

In tax legislation, it is necessary to provide for a closed list of tax risks, clear criteria for assessing them, and a gradation according to the level of the threat to protected social relationships.

Further still, the procedures and the frequency for risk assessment must be set out in detail, depending on the gradation of risks and the stages of the risk-oriented approach should be regulated by tax legislation. On the above plane, the risk-oriented approach in tax control that has evolved in the United Kingdom possesses a greater level of openness and transparency.

At the same time, legalization should also take place of the formats for the use and certification by accredited subjects of the software used to assess tax risks, the rules for assigning tax risks to taxpayers and changing the level of such risks, and specific measures that should and/or can be undertaken by a taxpayer in the context of managing tax risks.

3. Tax Control Based on a Risk-Oriented Approach

Methods of tax control should be established taking account of how risk-oriented it is. At the same time, the lower the level of risk is, the less expenditure of both time and other resources should be spent on tax control measures, which, further, should ensure the implementation of the functions of preventing tax risks and identifying them promptly.

The organisational and legal guarantees to taxpayers of procedural economy of tax control resources should be secured to the extent that they improve tax compliance and having regard to the level of tax discipline that they achieve. Thus, the intensiveness of tax control measures, their scope, depth and duration depend on the level of tax risks and whether the taxpayer's situation with tax risks is improving or deteriorating.

Therefore, the classification of tax control methods taking account of how risk-oriented it is, as well as measures to encourage tax discipline, deserve special attention in this article.

To implement a risk-oriented approach to tax control in Russia, the priority is an office audit of tax reporting documents, and if tax risks are identified during the office audit, a field tax audit is appointed; audits are also typified by subject matter, bearing in mind the high level of tax risks in definite areas of tax control and with specialised multi-district inspectorates being singled out for off-site control over whether VAT has been correctly calculated and whether it has been paid in full or in time, and for setting prices for tax purposes; for tax control with respect to major taxpayers whose contributions are decisive in forming the state budget, specialised multi-region and multi-district inspectorates are created at the federal and regional levels respectively.[92]

Tax monitoring in Russia[93] is applied on a voluntary basis, we are referring to a special service for major taxpayers with a high level of tax compliance, the service being based on the implementation of the most up-to-date information technologies for the interaction of taxpayers and the tax authorities using telecommunications channels ensuring the opportunity the tax authorities, when administering such taxpayers in order to identify material tax risks, to have free access to the tax accounting system of taxpayers. The taxpayers in question are of high importance for the state budget, but taking into account the risk-oriented approach, tax authorities are able to actually control systems of tax compliance developed by such taxpayers and timely identify shortcomings in their functioning.

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92 *See* the Russian Federal Tax Service's Order "On Approving the Concept of the System of Planning Field Tax Audits," *supra* note 36; Приказ Минфина России от 17 июля 2014 г. № 61н «Об утверждении Типовых положений о территориальных органах Федеральной налоговой службы» [The Russian Ministry of Finance's Order No. 61n dated 17 July 2014. On Approving Model Regulations of the Regional Bodies of the Federal Tax Service] (Jan. 20, 2019), available at http://www.consultant.ru.

93 *See* Section V.2 "Tax Control in the Form of Tax Monitoring" of the Russian Tax Code.

In the United Kingdom, the whole aggregate of control measures that HMRC carries out is divided into three types:

1) a Tax Compliance Check;[94]

2) a Civil Investigation of Fraud;[95]

3) a Criminal Investigation of Fraud.

To check tax compliance, the differentiation used in the Russian Federation between the regime of an office audit and a field tax audit does not exist, and nor does the division itself into these types of audit. In the context of a check, the tax authority has the opportunity to request documents and to visit a taxpayer's premises.

A check of tax compliance can be restricted to a telephone call[96] to a taxpayer, in the context of which an employee of the tax authority, based on a questionnaire, poses questions to a person. The answers to such questions allow it to be confirmed whether business operations have been correctly accounted for over the past several months for tax purposes. A check of tax compliance can, however, consist of a visit to the taxpayer's premises where reasonably required for the purpose of checking the person's tax position[97] and the inspection and even seizure of its documents.

In the tax authority's internal manual, it is stated that to check a person's tax position[98] for several taxes, a regime is used of combining several checks of tax compliance.[99] In other words, a check for all taxes is, in formal terms, an aggregate of separate measures and not a single measure. Accordingly, for a check of each of several taxes, there should be a corresponding ground identified by employees of the tax service.

The principle of proportionality, aimed primarily at protecting persons who are subject to control from an excess burden of control, allows for a restriction of the tax authority's wide discretion, despite the latter having, in formal terms, the right to transform any check from a telephone call to enforced tax monitoring involving a visit to the taxpayer's premises. The division of checks by subject matter is also predicated on this principle – if there is a risk for corporation tax, a person's tax position should be subject to a check to the extent concerning such risk if there is no justifiable supposition that there are risks for other taxes.

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94 HM Revenue & Customs, General Information About Compliance Checks, Compliance Checks Series – CC/FS1a, HMRC 12/18 (Jan. 20, 2019), available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/675422/CC-FS1a_01_18.pdf.

95 HM Revenue & Customs, Code of Practice 9, *supra* note 40.

96 HM Revenue & Customs, General Information About Compliance Checks, *supra* note 94.

97 *See* Glen Loutzenhiser, *Tiley's Revenue Law* 95 (8th ed., Oxford: Hart Publishing, 2016).

98 A person's tax position includes several elements – in particular, the calculated amount of tax payable, expressed in monetary form, for a different tax period; the amount, expressed in monetary form, of sanctions for a violation of the legislation on taxes and levies; the amount of the taxes that the taxpayer has claimed for deduction or refund; and certain other aspects characterising the person's settlements with the government. For more detail, *see* Finance Act 2008 (Jan. 20, 2019), available at https://www.legislation.gov.uk/ukpga/2008/9/contents.

99 Compliance Handbook, HMRC Internal Manual, HM Revenue & Customs (Jan. 20, 2019), available at https://www.gov.uk/hmrc-internal-manuals/compliance-handbook/ch206500.

As a consequence of the violations committed by a person, the tax authority can, in specific cases, compulsorily extend to such person the tax monitoring regime provided for by the Managing Serious Defaulters Programme.[100]

It is important to note that in the United Kingdom, the monitoring regime is determined in a different way from what is understood as monitoring in the Russian Federation.

Tax monitoring in the British system is not a separate method of control but constitutes a regime under which the frequency of tax compliance checks increases, while the boundaries of the tax authorities' discretion expand in the context of control measures – in particular, the tax authority is entitled to conduct a check of a person's accounting for business operations as well as to make an unannounced visit to inspect assets,[101] and to carry out a compliance check in relation to several taxes.

On account of the establishment of this regime, the proportionality principle is implemented: persons falling within the category of serious defaulters are subject to more intensive control.

The tax monitoring regime may extend to physical persons, legal persons and unincorporated associations that are classified as serious defaulters. At the same time, monitoring that is established over a person may subsequently be extended to other persons related to the first person. For instance, it may be extended to partners, directors and officers of a company that was under this regime, after it has been liquidated; and may be extended to a legal entity if it has been created by persons who are under a monitoring regime. On average, a monitoring regime with respect to a person may be established for a period from two to five years.

In the USA, two groups of tax control measures can be singled out: tax examinations (known as *audits*); and other tax control measures that do not have the status of a tax audit (a *compliance check and compliance review*).

Audits are usually carried out further to the fact that a tax return has been filed; however, other legal factors can be singled out that are a reason for an audit to be carried out (for example, when the contrary situation is at hand and a return is not filed).

Audits should be carried out at the time and in the place selected by the IRS, to which end such time and place should be reasonable under the circumstances.[102]

The IRC forbids the carrying out of an audit of a taxpayer where this is unnecessary,[103] and moreover, under the general rule, the same single tax period can be examined on only one occasion for a particular tax. When carrying out an audit, in

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100 Managing Serious Defaulters programme, *supra* note 39.

101 *Id.*

102 26 U.S.C. § 7605(a); Reg. § 301.7605-1(a).

103 26 U.S.C. § 7605(b) ("No taxpayer shall be subjected to unnecessary examination or investigations").

determining the *scope and depth* of it, the tax authorities carry out a risk-analysis (briefly discussed in the previous section about a risk-oriented approach).

Thus, the scope and depth of the audit's subject matter and whether it is necessary to carry out a particular control measure is determined taking account of the most effective (i.e. proportionate) investment of the IRS' resources in order to accumulate as much tax income as possible. In connection with this, the 50% rule (Mid-Audit Decision Point Rule) needs to be borne in mind; this means that, in the middle of any audit, it is required to check whether there is a need to continue. If to continue the audit will not be in line with the government's interest (for instance, owing to the low amount of potential additional assessment), the official carrying out the audit is entitled to put a stop to it, having, in doing so, documented his or her decision and the relevant reasons. In handing down this decision, the officer is relying on his or her professional judgement.

Depending on the place where the audit is held, audits are divided into *office* audits and *field* audits.[104] In turn, an *office* audit can be carried out using two methods:[105] by correspondence (a *correspondence audit*) or in a personal meeting with the taxpayer at the tax authority's office (a *face-to-face (in person) audit*).

According to an alternative approach, a correspondence audit is a separate type of a tax audit.[106] A correspondence audit (a check of documentation) is the simplest type of audit, consisting of sending to the taxpayer a request for additional information and/or documents. It is often the case that, if a matter is not material and the IRS receives the necessary information by post, the audit is stopped at that stage. If the tax inspector has additional questions, they will propose that the taxpayer should appear at the tax authority's office to give explanations within the scope of an in person (face-to-face) audit.

A field audit is carried out at the taxpayer's premises, or more precisely where it carries out its accounting, but the IRS usually prefers to carry out audits at a person's home or place of business.[107] Field audits usually involve business returns, and are conducted in cases involving voluminous records, complex accounting methods, substantial and material inventories, unusual issues, or complex and time-consuming examination.[108]

Depending on the criterion of randomness, there are both *random and non-random* audits. The latter are carried out based on an assessment and the identification of risks.

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104 IRS Official Website Information (Jan. 20, 2019), available at https://www.irs.gov/businesses/small-businesses-self-employed/irs-audits#conduct.

105 *American Jurisprudence. Vol. 34* (2nd ed., Rochester, N.Y.: Lawyers Cooperative Publishing, 1972), 70005. Types of Audits; Place of Examination.

106 *Federal Tax Coordinator*, *supra* note 46, T-1090. Audit Types, Timing, Locations, and Transfers.

107 *American Jurisprudence*, *supra* note 105, 70008. Federal Taxation.

108 Bittker et al. 2003, Part 47.01 [2]. Office and Field Audits.

A *random audit* is very detailed, since the whole tax return is checked; however, the reason for the audit consists of the need to obtain statistics, i.e. officials of the IRS do not suspect the taxpayer of evasion or of other offences, but nevertheless they check the whole return painstakingly to obtain data so as to update the DIF program (i.e. the automated program to assess tax risks).

Generating tax revenue is not the direct purpose of random audits. Rather, random audits are conducted for research purposes and are used primarily to gather information.[109]

Viewpoints are voiced that, immediately after a random audit is carried out, the level of compliance can reduce. After random audits are conducted according to the results of which no violations were identified in the years following the audit, such taxpayers have declared less income compared with the year of the audit. Possibly, this is a question of the psychological factor: it seems to the taxpayer that there is a negligible probability of it, as a taxpayer of good repute, being audited each year. Specifically for this reason, a number of academics espouse the opinion that it is reasonable to conduct a repeat audit of a person after a random audit.[110]

It is important to distinguish an audit (examination) from other tax control measures, and in particular from a compliance check and compliance review.

A *compliance check* is a review that the IRS carries out to make sure that an organization is adhering to recordkeeping and information reporting requirements, or whether an organization's activities are consistent with their stated tax-exempt purpose. The check is a tool to help educate organisations about their reporting requirements and to increase voluntary compliance.[111]

A *compliance review* is a control measure within the scope of which the IRS can assure itself that the taxpayer is complying with the terms and conditions of a voluntary agreement entered into with the IRS. The IRS offers voluntary agreements that contain differing obligations for both parties.

As an equivalent of Russia's tax monitoring, in the USA the *Compliance Assurance Process* exists. This programme is intended for major taxpayers; an application to participate in it may be filed annually.

It is carried out in the context of joint work between the tax authority and a taxpayer throughout the entire year before a tax return is filed, in order to identify and resolve contentious issues as soon as they arise. The purpose of the programme is to reduce the taxpayer's burden and lessen uncertainty while assuring the IRS of the accuracy of tax returns prior to filing thereby reducing or eliminating the need

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[109] Sarah B. Lawsky, *Fairly Random: On Compensating Audited Taxpayers*, 41(1) Connecticut Law Review 161, 191–194 (2008).

[110] Emily Satterthwaite, *Can Audits Encourage Tax Evasion? An Experimental Assessment*, 20(1) Florida Tax Review 1 (2016).

[111] Department of the Treasury, IRS, Publication 3114 (Rev. 4-2011), Cat. No. 26034G (Jan. 20, 2019), available at https://www.irs.gov/pub/irs-pdf/p3114.pdf.

for post-filing examinations (the IRS gains access to accounting records, including returns, before the filing deadline).

Below we examine the mechanism in tax control for recording whether taxpayers do or do not present risks.

In Russia, the absence of proper organisation by taxpayers of internal tax compliance systems may entail the realisation of tax risks and the related so-called analytical methods of the tax authorities in the form of tax authorities' requests without tax control measures being carried out, taxpayers being summoned to a session of commissions of the tax authorities on the legalization of the tax base and the bases of social security contributions, and other commissions of the tax authorities.

It should be noted that the sending of similar requests and the creation of such commissions are practices for which tax legislation does not expressly provide; tax authorities apply them widely in tax relationships to obtain information about tax risks with a view to subsequently checking and assessing the corresponding risks.[112] According to information provided by the officers of the FTS of Russia, the proportion of tax obligations that were voluntarily clarified as a result of such analytical work of the tax authorities for the first nine months of 2016 came to 8%. For the first nine months of 2017, it was 20%, and for the first nine months of 2018, it was 25%, i.e. the proportion of tax proceeds for the public purse that are secured in this way is growing from year to year.[113]

The absence of an effectively functioning system of tax compliance in a company can entail the inclusion of the company in the tax authority's schedule for conducting a field tax audit.

The risk of a field tax audit being appointed based on tax risks identified during office audits is growing in connection with the AIS "Nalog-3" system – a new service allowing information technologies to be used to aggregate all information about taxpayers and to identify violations of tax law.

The statement of a taxpayer's settlements with the government that is prepared based on this information and the information aggregated in the section in AIS "Nalog-3""Business Risks: Check Yourself and Your Counterparty" may create serious restrictions for the taxpayer's legal status to be implemented when it takes part in tenders to enter into transactions, in public procurement, when they receive

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112 *See* Письмо ФНС России от 25 июля 2017 г. № ЕД-4-15/14490@ [Letter of the FTS of Russia No. ED-4-15/14490@ dated 25 July 2017] (Jan. 20, 2019), available at http://www.nalog.ru; *Соколов Д.В.* Исторический и правовой генезис межведомственных налоговых комиссий // Налоговед. 2017. № 11. С. 43–50 [Dmitry V. Sokolov, *The Historical and Legal Genesis of Inter-Agency Tax Commissions*, 11 Nalogoved 43 (2017)].

113 *See* Выступление Заместителя начальника контрольного управления ФНС России Константина Новоселова на конференции ИРСОТ «Налоговый контроль: Итоги-2018, ожидания-2019» [The speech of the Deputy Head of the FTS of Russia's Control Division, Konstantin Novoselov, at Conference of the Institution for the Development of Modern Educational Technologies "Tax Control: Results of 2018, Expectations for 2019"] (Jan. 20, 2019), available at https://www.ruseminar.ru.

licences or permits, and when business and other economic activity is undertaken in connection with the general concept of showing due circumspection in the selection and checking of counterparties.

On the whole, regardless of the absence in tax legislation of legal and organisational guarantees to encourage taxpayers to behave lawfully, tax compliance is a condition for the proper exercise of one's rights, which may be restricted owing to a lack of compliance or to compliance being improperly arranged. Thus, for major taxpayers compliance is a condition for a potential transfer to tax monitoring and the application of the tax monitoring regime.

Moreover, compliance is a necessary condition for a weakening of tax control by actually reducing the intensiveness of field tax audits with respect to a "statistically average" taxpayer that is not classed as a major taxpayer, and to the scope and depth of such audits in terms of subject matter, although a mechanism for alleviating control on condition of compliance is also not stated in detail in publicly available documents of the tax authority.

Finally, compliance is a condition for a shortening of the time limits for a VAT office audit in the context of export.[114]

It is important to stress that there is no direct dependence between the ensuring of tax compliance by taxpayers and the assessment of risks by the tax authorities, particularly if the question revolves around amounts of tax obligations that are significant for the public purse. A major taxpayer can almost continuously be subjected to field audits irrespective of the quality of compliance they ensure.

Thus, in Russia, when the tax authorities do not uncover tax risks that they determine taking their wide discretion into consideration and the list of which is actually open, but the criteria for assessing them are established in each specific case by the tax authorities themselves, the tax authorities are restricted to office audits and are not able to designate field tax audits of taxpayers; a risk-oriented approach and a satisfactory (according to the tax authorities' assessment) state of tax compliance are decisive criteria for office audits which are conducted under an accelerated procedure for a refund of VAT during export and also for a transfer of major taxpayers to tax monitoring by tax authorities at the initiative of such taxpayers and to preserve for them of such a legal regime of tax control.

No clear and organisational guarantees have evolved for a low risk and an improvement of tax discipline, either in Russian tax legislation or in practice.

In the United Kingdom, the tax authority takes into consideration changes in a person's conduct and reduces the person's risk if such conduct has improved. The relevant mechanism is enshrined in the internal manual and is based on the proportionality principle. At the same time, proportionality takes the form of less intensive control.

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[114] *See* Article 165(1.2) of the Russian Tax Code.

A low risk of a taxpayer presupposes a restriction of the tax control burden and protection from excess control measures as non-proportionate; the tax authority, as a rule, does not carry out a check of tax compliance for the period where the low risk is maintained or is restricted to a request for explanations without a visit to the taxpayer's premises. In relations with low-risk taxpayers, the tax authority proceeds on the presumption that information provided in a tax return is accurate.[115]

In the USA, guarantees of procedural economy follow from § 7605(b) of the IRC, which prohibits the carrying out of unnecessary audits and are also conditioned by the presence in the IRM of a direct statement that risk-analysis needs to be carried out when tax control measures are conducted. The IRS does not carry out an audit for the sake of an examination – where resources are restricted, the IRS is aimed at auditing only those taxpayers with respect to which, with a greater degree of probability, an audit will allow higher amounts of assessments in favour of the public finances.

For example, if an audit is initiated, it may be completed at the stage of a correspondence audit if the tax authority receives answers to all questions and understands that the taxpayer acts in good faith and is compliant.

It also needs to be borne in mind that, following the wordings of the IRM and taking a decision that to continue an audit is reasonable in the context of the 50% Rule (the Mid-Audit Decision Point Rule) (*see* above in the previous section), an inspector is guided not only by the taxpayer's risk level and sometimes not so much by that as by the fiscal interests of the government.

In other words, relying on his or her professional judgement and acting in the interests of the government, an official may come to the conclusion that the continuation of the audit is not reasonable owing to the insubstantial amount of potential additional assessments, even if a tax risk with the taxpayer is identified.

In the tax legislation of the USA, there are no clearly expressed and formalised organisational and legal guarantees in the event of a reduction of the tax risk. At the same time, the IRS in fact audits taxpayers based on a risk-oriented approach. The higher the risk (for example, the DIF Score), the higher the chance of being audited.

Based on the above, one can conclude that three approaches exist to risk orientation in tax control:

1) One based primarily on the gradation of tax risks according to the level of their significance for observing tax discipline in the United Kingdom, i.e. according to a quality-based characterisation of tax risks. Although the intensiveness of tax control remains dependent on the size of a business and other inherent risk, the significance of such factors is secondary with respect to ensuring compliance by a person. If a taxpayer ensures compliance, it protects itself from excessive control measures, even if the financial result of its business is significantly telling on revenues for the country's public finances;

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[115] Tax Compliance Risk Management, HM Revenue & Customs (Jan. 20, 2019), available at https://www.gov.uk/hmrc-internal-manuals/tax-compliance-risk-management/tcrm2430.

2) One taking into account equally both the level of tax risks and the amount of potential arrears in the USA, in other words both quality-based and quantity-based risks to a similar level; and

3) One, in Russia, that is a solely pro-government approach, when the tax authority aims at discovering any tax risks by any methods of tax control, irrespective of quality-based and quantity-based characteristics of tax risks, and tax monitoring is introduced in a taxpayer company that is a major contributor the state budget when the level of tax risks in its tax compliance system is reduced in practical terms to zero.

At the same time, if in the first two cases taxpayers have the opportunity at a certain level to affect the assessment of tax risks and the level of the intensiveness of risk-based tax control, then in the latter case there is no such opportunity for taxpayers.

4. The Methods of Ensuring Tax Compliance

The right to receive information about the interpretation of provisions by tax and financial authorities of tax legislation concerning tax risks is a condition for the implementation of the constitutional duty of a taxpayer to pay only legally established taxes and levies, as is the constitutional right of a taxpayer to state protection, which is ensured by the certainty of tax legislation and its observance subjects of tax administration.

Legislation on taxes and levies should make provision for both compulsory and incentive-based measures to ensure that taxpayers comply with tax legislation in order to implement the principle of the legality of taxation, to properly perform obligations to correctly calculate and to pay, in full and on time, lawfully established taxes and levies, as well as obligations relating to the tax administration of them.

In this regard, it seems necessary to consider the mechanism of the legal regulation of the system of measures to ensure tax compliance in each of the jurisdictions under consideration.

As mentioned above, in Russia, the absence of or improper organisation by taxpayers of tax compliance may entail the discovery of tax risks by tax authorities based on the results of their control and analytical work, and may also entail the cancellation of falsified tax returns and calculations.

It should be noted that although the forms of analytical work and the cancellation of tax returns and calculations are not properly legalized, they are widely used by tax authorities to obtain information about tax risks and the assessment of them, and to make decisions about conducting field tax audits and also to suppress tax violations.

If the outcome of a tax audit confirms violations of tax legislation, then the taxpayer may be subject to the administrative enforcement measures provided for in the Russian Tax Code – the recovery of taxes, penalties, a prohibition on the disposal of property, the seizure of property and the suspension of outgoing transactions on

accounts. If signs of tax crimes are detected, the taxpayer may face criminal liability and criminal law measures against individuals (taxpayers, officers and other persons of organisations that are taxpayers) that entail the possible recovery of damage caused by the tax crime to public finances of the country in question.

A universal administrative measure in the field of taxes and levies for non-compliance is to suspend expenditure transactions on the accounts of companies and individual entrepreneurs if they do not properly file a tax return or calculation, or if they do not confirm the receipt or acceptance of documents from a tax authority through telecommunications channels within 10 days after the deadline that has been established for the submission of a tax return or the calculation, or the confirmation of receipt or acceptance of documents through telecommunications channels.[116] This measure is now widely applied when falsified tax returns or calculations are cancelled.

The likelihood of a field tax audit being appointed based on tax risks identified during office audits, as well as the occurrence of other adverse consequences associated with restrictions in the implementation by a taxpayer of both its public law and private law status as a business entity, which is mentioned above, is increasing in connection with the implementation of the AIS "Nalog-3" system, that is, a new service that allows information technology to be used to automatically aggregate all information about taxpayers and to identify violations of tax legislation.

It is also necessary to take into account the institution of the suspension of a field tax audit provided for in the Russian Tax Code when a taxpayer counteracts the carrying out of tax control measures against he/she/it with an increase in the limitation period for liability under the Russian Tax Code for the period of such suspension of the audit as a measure to encourage the legitimate conduct of a taxpayer during a field tax audit.[117]

As a general rule, the imposition of legal liability does not give an exemption from the proper performance of an obligation and vice versa: in a decision to impose liability for a tax violation according to Russian Tax Code, as well as in the order issued by a competent authority in an administrative offence case seeking the elimination of the causes and conditions of the administrative offence under the Code of Administrative Offences of the Russian Federation, in general, the issue is resolved of the enforcement of a voluntarily unfulfilled obligation and the adoption of measures to eliminate the causes and conditions of the administrative offences respectively.

In the United Kingdom, the provisions concerning liability are spread among multiple, non-systematised (non-codified) legislative acts. Civil penalties and criminal fines apply to both individuals and legal entities, and such fines may amount to

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[116] *See* Article 76(3) of the Russian Tax Code.

[117] *See* Article 113(1.1) of the Russian Tax Code.

200% of the amount payable,[118] in addition to interest on the amount of tax paid late or not in full.

By virtue of the improper conduct of a taxpayer, an early reassessment of its tax risk can be carried out in relation to it, depriving such person of low-risk status and increasing the intensity of tax control measures.

Alongside financial penalties, non-compliance can entail a person being classified among the serious defaulters.[119] By virtue of a person being assigned to the class of serious defaulters, information that such taxpayer forwards to the tax authority becomes subject to a rigorous compliance check.[120]

It should be noted that the presumption of good faith does not have effect with respect to these persons. In "Your Charter" adopted by HMRC, it is stipulated that:

> We'll presume that you're telling us the truth, unless we have good reason to think otherwise.[121]

Information about serious defaulters can be published in the mass media.

Moreover, a high-frequency tax monitoring regime can be established with respect to a person, which entails on-site tax control measures being carried out up to several times per year. On average, tax monitoring is established for a five-year period.

In the USA, non-compliance with the rules of tax legislation entails the collection of tax and interest and the application of both criminal law and civil law sanctions. Liability for a violation of tax legislation is mostly governed by Chapter 75 of the IRC. The system of civil law penalties and criminal law fines has wide application. U.S. tax legislation enumerates more than 100 cases in which civil penalties are imposed. The IRS clearly states that penalties should facilitate voluntary compliance.[122] Both penalties and other adverse consequences of a tax offence are aimed at encouraging tax compliance, because *without them, it is doubtful taxpayers would ever voluntarily comply*.[123] In the USA, corporations can also face criminal liability (including for felonies, i.e., the most serious crimes), with the punishment being a criminal fine of a maximum amount of USD 500,000.[124]

For refusing a compliance check, a person can be subjected to an audit.[125]

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118 HM Revenue & Customs, Code of Practice 9, *supra* note 40.

119 Managing Serious Defaulters programme, *supra* note 39.

120 *Id.*

121 Your Charter, Corporate report, HM Revenue & Customs (Jan. 20, 2019), available at https://www.gov.uk/government/publications/your-charter/your-charter.

122 *See* IRM 1.2.20.1.1(1) ("Penalties are used to enhance voluntary compliance").

123 Allen D. Madison, *The Legal Consequences of Noncompliance with Federal Tax Laws*, 70(1) Tax Lawyer 367 (2016).

124 26 U.S.C. § 7201 – Attempt to Evade or Defeat Tax.

125 Department of the Treasury, Publication 3114, *supra* note 111.

In the United States, information about a person's prior criminal record is important when he or she is sentenced for a new crime, including a tax crime,[126] and also in cases of parole (applicable to individuals) if the penalty for a tax offence was imprisonment.

Information about previous violations of tax laws could, in the future, potentially cause the relevant taxpayer's return to be analysed in more detail.[127]

Despite the fact that taxpayers have a right to confidentiality with respect to information constituting a tax secret,[128] in certain cases of tax crimes, information about offenders is published. For example, on the IRS' website, information is published about persons convicted of using illegal tax schemes.[129] An adverse consequence of such publication, undoubtedly, is that reputational risks for the taxpayer in question arise or increase.

As well as establishing penalties that entail adverse consequences for taxpayers for non-compliance, mechanisms are also being created in the various jurisdictions aimed at encouraging tax compliance and ensuring that it is implemented. We denote such a mechanism as the aggregate of such a measure encouraging compliance.

Russian tax legislation has no legal mechanism to encourage compliance. At the same time, the proper conduct of a taxpayer is a condition for the full exercise of the statutory rights that are vested in it, which may be restricted owing to non-compliance. A properly organised tax compliance system for a major taxpayer is a prerequisite for it to be transferred to a tax monitoring regime and for it to stay under such regime. Tax compliance is also a prerequisite for easing tax control in terms of actually reducing the intensity of field tax audits, their scope and depth in terms of subject matter, as well as in terms of reducing the timeframe for an office audit of export VAT.[130]

On the whole, except for cases where a person is transferred to and is under tax monitoring, there is no direct correlation between taxpayers ensuring tax compliance and the tax authorities assessing risks. This is due to the pro-government approach in Russian tax administration.

As a potential way of encouraging lawful conduct by taxpayers, it is possible to consider only circumstances mitigating a person's liability; the list of such circumstances is open, according to Article 112 of the Russian Tax Code and Article 4.2 of the Code of Administrative Offences of the Russian Federation. Moreover, according to the Russian Tax Code, the finding of such circumstances by the tax authorities or the courts allows the penalty to be at least halved.

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126 Youngjae Lee, *Recidivism as Omission: A Relational Account*, 87 Texas Law Review 571 (2009).

127 *Federal Tax Coordinator*, *supra* note 46, T. 1065. Chances of a Return Being Audited.

128 We are talking about the tax return and return information. 26 U.S.C. § 6103 – Confidentiality and Disclosure of Returns and Return Information.

129 Examples of Abusive Tax Schemes – Fiscal Year 2017, IRS (Jan. 20, 2019), available at https://www.irs.gov/compliance/criminal-investigation/examples-of-abusive-tax-schemes-fiscal-year-2017.

130 *See* Article 165(1.2) of the Russian Tax Code.

The institution of an exemption from criminal liability for tax crimes when tax arrears are paid in full should also be noted;[131] courts impose criminal liability for tax crimes only when direct intent exists.

In Russia, fiscal and tax authorities explain tax legislation to taxpayers in written, oral and electronic form by the construction and interpretation of the provisions of tax legislation.

As for both oral and written explanations by tax authorities, and written explanations by fiscal authorities (the Ministry of Finance of the Russian Federation and similar bodies of constituent entities of the Russian Federation and municipalities) all of them considered as individual advice concerning the application of tax legislation are ineffective as a means of preventing violations and tax abuse for the following reasons.

Firstly, they are inconsistent with one another as a result of the fiscal and tax authorities having opposing positions, and this inconsistency is particularly manifested in the written explanations of the Ministry of Finance of the Russian Federation and the Federal Tax Service of Russia, in which these bodies often take directly opposing positions on the same tax issues, despite the Federal Tax Service being subordinate to the Ministry of Finance in terms of administrative hierarchy,[132] and, therefore, documents of the Federal Tax Service must comply with the documents of the Ministry of Finance, and if the former contradict the latter, the documents of the Federal Tax Service are subject to being cancelled by the Ministry of Finance.[133] In addition, attention should be paid to the function of the Ministry of Finance for the development of state policy and legal regulation in the field of taxes and levies, as well as the obligation for the tax authorities to provide, within their competence, written explanations of financial authorities by virtue of a direct provision of the Tax Code.[134]

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131 *See, e.g.*, the note to Article 198(3) and the note to Article 199(2) of the Criminal Code of the Russian Federation.

132 Указ Президента РФ от 9 марта 2004 г. № 314 «О системе и структуре федеральных органов исполнительной власти» с изменениями и дополнениями, внесенными Указом Президента РФ от 20 мая 2004 г. № 649 «Вопросы структуры федеральных органов исполнительной власти» [Decree of the President of the Russian Federation No. 314 dated 9 March 2004. On the System and Structure of Federal Executive Authorities, as amended and added to by Decree of the President of the Russian Federation No. 649 dated 20 May 2004 "Issues of the Structure of Federal Executive Authorities"]; Указ Президента РФ от 15 мая 2018 г. № 215 «О структуре федеральных органов исполнительной власти» [Decree of the President of the Russian Federation No. 215 dated 15 May 2018. On the Structure of Federal Executive Authorities] (Jan. 20, 2019), available at http://www.pravo.gov.ru.

133 Постановление Правительства РФ от 30 июня 2004 г. № 329 «О Министерстве финансов Российской Федерации» [Resolution of the Government of the Russian Federation No. 329 dated 30 June 2004. On the Ministry of Finance of the Russian Federation]; Постановление Правительства РФ от 30 сентября 2004 г. № 506 «Об утверждении Положения о Федеральной налоговой службе» [Resolution of the Government of the Russian Federation No. 506 dated 30 September 2004. On Approving the Regulations on the Federal Tax Service] (Jan. 20, 2019), available at http://www.pravo.gov.ru.

134 Article 32(1)(5) of the Russian Tax Code.

Secondly, such explanations are provided without any interference in the financial and business activities of the entities to which they are provided, i.e. without an analysis of either the operations whose tax consequences are clarified, or the tax consequences of them in relation to the specific circumstances of the economic activity of the entities to which clarifications are provided. These circumstances are investigated only in the context of tax audits, according to the results of which statements are issued about the violations of tax laws that have been identified and jurisdictional decisions are taken on whether to impose or decline to impose administrative liability for a violation of tax legislation. An analysis of the tax consequences of operations, based on a study by the tax authority during a tax audit of the specific circumstances of the audited taxpayer's economic activity, allows other conclusions to be reached than those that were made without such a study in written explanations of the financial and tax authorities at the request of the taxpayer. For the same reason, some written explanations of the financial and tax authorities on the application of tax legislation are not sufficiently well defined, specific and understandable so that the subject to which they are addressed has the ability to use such explanations in its financial and business activity.

Hope for a resolution of this issue was given by the legal position in Resolution No. 34-P of the Constitutional Court of the Russian Federation dated 28 November 2017 concerning the complaint of the Joint Stock Company "Fleet of the Novorossiysk Sea Trade Port,"[135] which in essence prohibited the Ministry of Finance from avoiding giving written clarifications on taxation issues, even if this requires special knowledge, taking into account opportunities for inter-agency collaboration.

When the tax authorities have a wide discretion in the fight against abuse of legal rights, the receipt of title documents and certificates from competent authorities, as well as the exercise of a right to receive information about taxation and levies in other forms for the purpose of preventing the commission of administrative offences under tax legislation, i.e. as a measure to prevent tax offences and abuses, this is insufficient without creating and keeping updated the condition of the system of documents confirming not only the formal status, but also the actual circumstances of the economic activities of the person subject to taxation, which will allow it to use tax preferences.

Unfortunately, only a limited number of the largest taxpayers have recourse to the most effective preventive methods with respect to violations and abuses in the field of tax, such as tax rulings and agreements with tax authorities, which involve the joint

[135] *See* Постановление Конституционного Суда РФ от 28 ноября 2017 г. № 34-П «По делу о проверке конституционности пункта 8 статьи 75, подпункта 3 пункта 1 статьи 111 и подпункта 23 пункта 2 статьи 149 Налогового кодекса Российской Федерации в связи с жалобой акционерного общества «Флот Новороссийского морского торгового порта»» [Resolution of the Constitutional Court of the Russian Federation No. 34-P dated 28 November 2017 concerning the complaint of the Joint Stock Company "Fleet of the Novorossiysk Sea Trade Port"] (Jan. 20, 2019), available at http://www.consultant.ru.

determination by tax authorities and taxpayers of the tax consequences of business operations before they are undertaken, with the results of such an assessment being reflected in a unilateral administrative document by the tax authority (a well-grounded opinion during tax monitoring) or a bilateral administrative document by the tax authority and the taxpayer (an agreement on pricing for tax purposes). Such lack of availability is due to both statutory and administrative restrictions on the use of the methods in question. These administrative documents are binding on both tax authorities and taxpayers, since they are guided both by taxpayers when determining the tax consequences of transactions consummated in accordance with such documents and by tax authorities when tax control measures are carried out.

In the United Kingdom, to encourage compliance in the context of tax audits, employees of HMRC assess what is known as the quality of disclosure,[136] or "telling, helping and giving,"[137] which, in particular, presupposes an assessment of the scope and content of information about violations committed by the taxpayer that is handed over by the audited person itself, as well as help to the tax authority in establishing and identifying violations.

The encouragement is secured by the fact that a component of accounting for the assessment of the quality of cooperation is implemented in the design of fines in such a way that the measure of liability for the non-payment of tax decreases depending on how fully and promptly a person reports the violations.

Thus, the penalty for the non-payment of tax regulates the conduct of the taxpayer during control so as to ensure the maximum effectiveness of control measures.

As Robert W. Maas correctly states with respect to the British system of sanctions for the violation of legislation on taxes and levies, "Civil penalties are designed to change a taxpayer's behaviour."[138]

Similar to the quality parameter of interaction within tax compliance audits, during the *civil investigation procedure of tax fraud*, the incentive component of penalties was implemented through a mechanism for coordinated *information disclosure (the Contractual Disclosure Facility, or CDF)*.[139]

This mechanism presupposes that a contractual arrangement arises between the persons exercising control and those subject to control. In accordance with these relationships, the taxpayer provides all the information about the actions that caused the tax payable to be reduced, while the tax authority guarantees a refusal to initiate a criminal investigation in relation to the facts stated by the person and reduces the penalty.

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136 HM Revenue & Customs, General Information About Compliance Checks, *supra* note 94.

137 Compliance Handbook, HMRC Internal Manual, HM Revenue & Customs (Jan. 20, 2019), available at https://www.gov.uk/hmrc-internal-manuals/compliance-handbook/ch73220.

138 *See* Robert W. Maas, *Guide to Taxpayer's Rights and HMRC Powers* 456 (London: Bloomsbury Professional, 2017).

139 HM Revenue & Customs, Code of Practice 9, *supra* note 40.

Moreover, Customer Relationship Managers from HMRC send recommendations to taxpayers that are classed as large businesses in order to improve their compliance. Changing its conduct based on recommendations sent to it, a taxpayer reduces its tax risk, which is revealed during a new risk assessment.

The USA has various capital amnesty programs to encourage tax compliance, for example, the Offshore Voluntary Disclosure Program ("OVDP"), which was in force until 28 September 2018. The essence of the programme was that the taxpayer could obtain a chance to legalize foreign assets with the minimum possible consequences and practically excluding the risks of criminal prosecution. The state also received taxes and default interest for several years, penalties that were smaller than when assets were declared under the general procedure, and obtained information about assets, banks, and other taxpayers.[140]

In the USA there is also the Streamlined Filing Compliance Procedures programme. It differs from OVDP, in particular, in that this programme applies only to those taxpayers who have filed returns for the three previous years and will be able to prove that the violation of the obligation to declare foreign assets was not the result of intent. This programme also provides benefits for taxpayers, which consist of a low probability of being audited, lower penalties, less paperwork, and, with the termination of OVDP, is the main instrument of a capital amnesty, as it has been implemented to date. However, this programme offers no safeguard against criminal liability.[141]

Additionally, the IRS strives to encourage compliance by improving the quality of its work, i.e. by providing customer service, as well as by the additional tool of using media information resources, for example, by making information public about cases concerning the criminal prosecution of celebrities.[142]

The IRS also devotes increased attention to voluntary compliance. In academic literature, there is a point of view that it is correct to call voluntary compliance cooperative compliance, since it implies not simply a taxpayer's desire to pay taxes, but rather the desire to interact with the IRS, including fulfilling its tax obligations in a timely manner and in full, so that the IRS would be inclined to audit such a taxpayer as rarely as possible.[143]

Even if the violation has already happened, and in this case, the IRS is attempting to give the person an incentive to comply. In particular, if the taxpayer committed a violation as a result of a good-faith misunderstanding of the meaning of a legal rule

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140 Shu-Yi Oei, *The Offshore Tax Enforcement Dragnet*, 67(4) Emory Law Journal 655 (2018).

141 Marnin Michaels & Anne Gibson, *Voluntary Disclosure for People with Good Stories: Did Waiting Make Sense?*, 27 Journal of International Taxation 55 (2016).

142 Elizabeth Branham, *Closing the Tax Gap: Encouraging Voluntary Compliance Through Mass-Media Publication of High-Profile Tax Issues*, 60(6) Hastings Law Journal 1507, 1524–1532 (2009).

143 Manhire 2015.

and therefore could not meet the prescribed standards of conduct, this circumstance should be taken into account when deciding whether to hold a person liable.[144]

In the public domain, there is no information as to whether the IRS is sending recommendations for how to increase compliance to the person concerned. However, in accordance with the Taxpayer Bill of Rights, a taxpayer has the Right to Be Informed.

This means that taxpayers have the right to know what they need to do to comply with the tax laws. They are entitled to clear explanations of the laws and IRS procedures in all tax forms, instructions, publications, notices, and correspondence. They have the right to be informed of IRS decisions about their tax accounts and to receive clear explanations of the outcomes.

Despite the various methods, forms and approaches to ensuring tax compliance in the countries under consideration, in all the jurisdictions we have reviewed, the main institution for the prevention of violations of tax legislation is the institution of legal liability, which provides for a holistic system of measures of state enforcement for a violation of tax laws and an abuse of tax law rights, as well as measures that encourage compliance with the regulations of tax legislation and the non-abuse of what tax laws allow.

The more developed the system of legal regulation of tax compliance in the country is, the less coercive and incentive measures of tax compliance coincide. Thus, in Russia they coincide almost completely, whereas in the USA and the UK, they coincide only in terms of the application of civil law sanctions.

But at the same time as this, the principle of procedural economy when applying tax control procedures is implemented in the jurisdictions under consideration, taking into account the established level of potential tax risks. Here we can talk about the differing degree of flexibility of the system in question and the certainty of the legal regulation of it in the countries being considered.

The most certain legal regulation of tax compliance for taxpayers, in our opinion, is that in the UK, which allows a taxpayer to manage its own tax risks and motivates it to reduce them. The system for the legal regulation of tax compliance in the USA can be regarded as less certain, but at the same time it makes provision for the relevant organisational and legal guarantees for taxpayers. As far as the Russian system of legal regulation of tax compliance is concerned, its certainty and the possibility of

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144 In the case *United States v. Murdock*, 290 U.S. 389 (1933), the court concluded that "Congress did not set the goal of recognizing as a Criminal anyone who, as a result of a good-faith but incorrect understanding of a rule of law relating to his duty to pay tax, file a declaration, keep relevant books of accounting, failed to meet the prescribed standards of conduct" (*cited by Осина Д.М.* Особенности уклонения от уплаты налогов по праву США // Актуальные проблемы сравнительного, зарубежного и российского административного, финансового и налогового права: Сборник научных трудов [Dina M. Osina, *Features of Tax Evasion Under U.S. Law* in *Topical Issues of Comparative, Foreign and Russian Administrative, Financial and Tax Law: Collection of Scientific Papers*] 261–272 (Moscow: MGIMO-University's Publishing House, 2018).

an objective assessment of tax risks cannot be spoken about at all, let alone the management by taxpayers of their tax risks.

Conclusion

One has the impression that at times public authority has no interest in creating a system with a risk-oriented approach in tax control that is both clearly understandable to taxpayers and other parties to tax relationships and effective for tax administration, owing to the concept that has taken root in legal consciousness of an all-powerful state that can, should it be "necessary" based on expediency, act "outside the field of the law." A risk-oriented approach in tax control, without the precise legal regulation of which tax compliance loses any sense often depends on subjective factors in both political conjuncture and economic trends.

Only a determination of clear legal criteria of tax risks and the formalization of approaches to assessing them from a position of the humanitarian philosophy of law and the concept of the rule of law in a codified act of national tax legislation at the federal level will create the legal and regulatory base of an effective mechanism for the legal regulation of tax compliance. The implementation of such a mechanism as a whole and in full will depend on legal policy and the legal consciousness of the public administration and judges, who set the trends in the law-enforcement system.

The existing trends of the tax authorities of being guided by the principles of reasonableness and justice when applying a risk-oriented approach in tax control lead to the levelling out of the core principles of the law: the priority of the rights and freedoms of man and an individual, lawfulness, openness (full disclosure), and humanism, which reduces the level of legal and organizational guarantees of the implementation of a person's legal status in the country. The consequences of such trends are described by G.F. Shershenevich in his public lecture, read on 10 March 1897, "On the Feeling of Lawfulness":[145]

> The drawbacks of the legislation, instead of showing up clearly in individual cases, attracting the attention of society, the press, and the administration, and causing the appropriate changes in the legislation, continue to exist and quietly cause unjust suffering. The harmful influence of this practice is further reflected in the fact that any confidence in society is lost, whatever law is in effect, whether it is written in legislation or the one that the courts apply. When there is such a trend, no one can know the current law. The most profound expert on the law cannot give any instructions to a person turning to him for advice, because everything depends on the opinion of the court.

[145] The text of the lecture is set out at the publication: *Шершеневич Г.Ф.* О чувстве законности / *Шершеневич Г.Ф.* Избранное [Gabriel F. Shershenevich, *On the Feeling of Lawfulness* in Gabriel F. Shershenevich, *A Selection*] 449–471 (P.V. Krasheninnikov (comp.), Moscow: Statut, 2016).

> The one who can give instructions is not the person who knows the laws, but the person who knows the judges, their views and orientation. In one court, practice of one decision is established and, in another court, practice of another decision is established. When one goes to another court, their point of view on many judicial issues also changes.
>
> There is no need to prove how much this practice undermines the legal order, how much it destroys the main basis of the latter – the feeling of the lawfulness of the population.

In this connection, there is a need to reassess the social role of law in the conditions of the development of an information technology society: does the role of the law remain regulating and its regulatory function continue to be the main one, or does it start to serve as society moves towards the information technology stage of development? At the same time, only the actual recognition and securing by the state of the supremacy of law with its regulatory role, which is manifested in the implementation of the regulatory function, in the context of implementing modern information technologies in all spheres of life, in particular in tax control, will allow a civil society to be formed and will ensure the exercise of human rights and the freedoms of man and an individual in the country.

In tax law, the maintenance of the balance of public and private interests and strengthening of the confidence of civil society in the institutions of the state and law is possible only if clear criteria are established and identified for assessing tax risks, taking into account a risk-oriented approach to tax control, as well as with unified approaches of both tax authorities and taxpayers to understanding these risks and managing them. All interested subjects of tax law and those involved in tax law relationships should be given the opportunity not only to objectively assess tax risks, but also to prevent them before tax law relationships arise, using, in order to do so, the administrative procedures of tax rulings, that is, obtaining well-grounded opinions of tax authorities, and concluding agreements with tax authorities concerning the tax consequences of the business operations undertaken by taxpayers.

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