Tax Risks and Tax Planning

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Abstract — The role of tax administration in maximizing budget revenues at different levels is described. A significant proportion of tax payments consists of the settlement of arrears, as well as fines and penalties. These may be due to accountants’ errors or to deliberate tax evasion. The present work emphasizes the mutual interest of taxpayers and tax collectors in tools for tax planning that balance an acceptable tax burden for businesses with an appropriate fiscal income for the state.

Keywords: tax risks, tax administration, tax burden, tax sanctions, tax exemptions, tax audits

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In most cases, the relationships of businesses and the state are mediated through taxes. Tax reform may be regarded as a permanent feature of national life. Historically, Russian tax laws in their current form have been under development since the 1990s. The state has been increasing the transparency of the business environment and strengthening tax administration.

Today, thanks to the digitization of accounting and auditing, tax administration in Russia has made notable progress. The development of risk management has considerably lowered the costs of auditing, while improving the quality. Correspondingly, fines and penalties have been growing, and the state has won many tax disputes.

The average income per tax audit has increased from 33.5 to 54.4 million rubles between 2019 and 2021, and continues to grow [1].

Note that, along with more stringent monitoring, the tax administration has expanded tax exemptions and preferences for individual categories of taxpayers, under specific conditions [2]. They have been expanded with particular vigor during the coronavirus pandemic, permitting many organizations to maintain financial stability and solvency.

Despite changes in the global economy that have changed market relations and transformed business activity, the main trends in Russian tax policies remain the same [3].

1. Suppression of the shadow economy. New administrative measures include the introduction of digital technologies and the creation of an integrated information space for tax regulation.

2. Expansion of inspections, with the introduction of new interim measures (seizure of property and freezing of accounts). Today, such measures are only employed after the decision that further investigation and auditing is necessary, in accordance with Article 101, paragraph 10, of the Russian Tax Code [4].

3. The right of the tax authority to collect funds from the taxpayer’s debtors. If the debtors resist, bailiffs may be summoned.

4. The right of the tax authority to seize certain of the taxpayer’s accounts and to draw funds from them against the payment of taxes.

5. Expansion of the reach of tax authorities beyond limited boundaries: no specific tax authority need be cited in regulating payment procedures and requesting documents.

These trends are evident in the conduct of tax audits according to Article 54.1 of the Russian Tax Code [4].

1. Verification whether transactions are truthfully represented or information regarding economic activity and the objects of taxation is distorted.

2. Tests for tampering with the budget and claiming unjustified tax benefits.

3. Identification of malicious intent: tax evasion, obtaining unjustified tax benefits, or knowledge of such behavior when concluding a transaction with a company conforming to the specifications in paragraph 6 of Letter N BV-4-7/3060@ (March 10, 2021) [5].

4. Verification of due diligence in the selection of a counterparty. That is the conventional standard for reasonable choice of a counterparty. The requirements
include scrutiny of their business reputation, ability to fulfill obligations, and solvency.

These procedures force enterprises to select their tax policies more responsibly, since the consequence of errors may be substantial financial losses, calling into question the continued existence of the business and the personal liberties of management [6].

The tax authorities have the right to request documents in only three cases, according to Article 93 of the Russian Tax Code [4]: during a desk audit; during a check of a counterparty; and in collecting documents (information) regarding the taxpayer or information about specific transactions outside the scope of tax audits.

In a desk audit, the list of situations in which the tax authorities have the right to request documents is limited (Article 88 of the Tax Code) [4].

A taxpayer may also be invited to the tax office for an oral interview. Such invitations often follow failure to report taxes for two years or more; a low tax burden compared to the industry average; outstanding taxes and fines; employee salaries lower than the regional average in the industry; or relations with problematic counterparties.

Effective management of tax risks entails a comprehensive approach to the management of tax obligations. The goal is to discover and assess tax risks so as to decrease their likelihood or minimize the consequences of tax exposure.

Management of tax risks may be regarded as a cyclic process with the following steps:

1. Identification of tax risks. A useful tool here is the guidance for planning field audits in [7]: this document defines the criteria used by tax authorities in selecting targets for audits.

2. Analysis of tax risks so as to permit more effective tax management within a specific project, organization, or territory and at the state level.

3. Ranking of tax risks by importance and identification of risk management measures. Their significance is determined on the basis of their magnitude, and appropriate management responses are developed [8].

4. Implementation of risk management, with one-time analysis of the effectiveness of the financial responses.

5. Analysis of the results of risk management and improvements as necessary. This is the final step in independent risk assessment and permits the identification of deficiencies in the risk management system.

Unless it is aimed at finding unjustified benefits, tax planning within an organization is entirely legitimate. Tax benefits will depend on government policy (at the regional and municipal levels) and also on compliance with the specified terms.

In recent years, tax benefits have proliferated in response to the challenges of the coronavirus pandemic. Government also target tax benefits so as to promote specific activities. For example, since 2021, organizations involved with information technology (IT) have been granted economic stimuli, with relief not only from individual taxes but in the form of tax packages. Since 2022, public catering has been offered tax benefits.

Small enterprises may opt for four special tax programs [9].

1. Simplified taxation. This popular option (governed by Chapter 26.2 of the Russian Tax Code) permits payment of a single tax in place of VAT, property taxes, and income tax. Deductions from taxable income may be made for insurance coverage and sick leaves.

2. Patent taxation (covered by Chapter 26.5 of the Russian Tax Code). This option is only suitable for individual entrepreneurs.

3. Unitary agricultural tax (covered by Chapter 26.1 of the Russian Tax Code). This applies to agricultural entrepreneurs.

4. Tax on professional income [10]. This is an experimental program for individuals and freelance entrepreneurs.

Besides switching to one of these programs, another approach to tax planning is to divide obligations between interdependent companies by forming independent economic entities. This is not to be confused with illegal splitting of a business for purposes of tax evasion. Dividing financial flows between individual companies is legal and may decrease the tax burden if the goals, management priorities, pool of partners, assets, employees, and territories of the companies are not the same.

However, each company is unique. Consequently, no general criteria exist for classifying the subdivision of a business as legal or illegal. We have already mentioned the tax benefits offered to IT companies. Since IT departments are found in all large organizations, the idea of spinning them off as separate companies has been proposed. The Federal Tax Service has already ruled that no tax risks are associated with such splitting [11].

Tax-planning options at the local level include the creation of reserves for dubious debts, which may be counted as expenses when computing income taxes; depreciation premiums, which allow up to 30% of the purchase price of fixed assets to be taken as a one-time deduction; an investment deduction allowing certain extractive enterprises to take total expenditures on fixed assets as a deduction against income tax; and deduction of losses in previous years. Certain limits apply to the deductions for losses: for instance, the total deduction can be no more than 50% of the total taxable income.

Thus, the basic means of addressing tax risks are as follows.
1. Regular internal audits to verify the reliability of the accounts.
2. Due diligence in selecting counterparties.
3. Effective document management and distribution of responsibilities among staff.

INTERNAL AUDITS

Audits are required to detect and correct errors. Accounting errors may be fatal to companies. Audits allow management to survey all the existing risks and reserves, with relevant figures and reasoning, taking account of laws and current judicial practice. The auditors' report confirms that all the necessary actions are being taken to comply with laws, rules, and standards of commercial behavior, and that the accounting practices are reliable; and that the laws regarding counterparties are observed.

At present, some auditing companies provide not only a report but expanded legal and financial guarantees of business, ensuring protection against tax claims; insurance against losses may be available, if required. If the authorities’ tax claims cannot be completely rebutted, all fines and penalties will be reimbursed.

DUE DILIGENCE

Each company is responsible for due diligence. The Federal Tax Service has set a certain standard of prudence in concluding transactions with counterparties. In this context, the following steps should be taken in scrutinizing counterparties.

1. Selection of a counterparty and request for all relevant documents and financial records.
2. Consultation of open sources (official web sites of the Federal Tax Service, the Federal Bailiff Service, the Federal Notary Chamber, etc.).
3. Consultation of specialized databases and additional sources: a certificate of workforce size to confirm the availability of labor resources, copies of lease agreements, property certificates, etc.
4. Market analysis and examination of similar commercial offers.
5. Creation of a dossier on the counterparty and assessment of the party’s business reputation.

A further safeguard is to include a tax clause in the contract [12]. This would indemnify the company against any losses incurred through the counterparty's fault.

DOCUMENT MANAGEMENT

Careful document management reduces the risk of tax surcharges. Distribution of responsibility and power within the enterprise passes the responsibility for specific transactions from upper management to named individuals. The degree to which each individual has affected the outcome and conditions of the transaction is a key consideration here. The responsibility of each participant in the transaction must be fixed in internal job descriptions and other documents.

Management’s exposure to risk may also be decreased if internal company documents include clear statements of the circumstances and reasoning associated with each important decision—regarding the Covid-19 pandemic, for example.

Document management also entails monitoring of tax administrators’ primary concerns and implementing the following responses: (1) proof of the business goal of economic relationships; (2) proof that no tax benefit exists; (3) demonstration of the expediency of the production process and also commercial and final activity; (4) demonstration that all noted relationships actually exist and document management is subject to strict discipline.

Applying this check list to any company will avoid tax audits, disputes, and unnecessary expenditures.

As we have noted, the tax authorities offer specific benefits, such as the four special programs for small business and programs to support enterprises in specific regions and territories. Essentially, tax benefits serve to promote the economic development of the country and to create competitive market conditions. However, some enterprises try to misuse tax benefits in pursuit of competitive advantage. In most cases, a company will seek tax benefits by representing itself as a set of independent small enterprises. What are the legal limits of this maneuver? How can its economic expediency and business goals be proven?

On the one hand, enterprises legitimately use special conditions and tax programs, with economic benefit for the nation as a whole. On the other, the state seeks to curb abuses of those tax provisions.

To identify such abuses, the Federal Tax Service carefully analyzes the filings of taxpayers that create the appearance of several independent taxable entities in order to gain or preserve access to special tax programs that provide fiscal benefits. At the same time, the authorities strive to avoid unreasonable demands on businesses that have no felonious intent, since the choice of a business culture is the exclusive right of independent economic entities [13].

Successful economic development entails the organic collaboration of business and the state. That depends on clear rules and areas of responsibility. On a regular basis, enterprises should conduct audits and assess their own activity in terms of tax risks. For its part, the state, while tightening tax enforcement, will also offer more opportunities for managing tax obligations. Such a balance will foster the stable development of economic and legal relations within the country; reduce tension in the relations between tax author-
ities and tax payers; and create a favorable business climate.

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