ISSUE
NO. 2
2013

RUSSIAN LAW

THEORY AND PRACTICE

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Authors: In sending a manuscript to Publishing House "Jurist", the author may express nonconsent to the publication of an English-language version.

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Journal
of the Russian Academy of Legal Sciences

RUSSIAN LAW:
THEORY AND PRACTICE

Issue No. 2, 2013

Published twice yearly
under the editorship of V.S. Belykh

ON APPLICATION OF ARTICLE 169 OF THE RF CIVIL CODE IN TAX RELATIONSHIPS[1]

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On 10 April, 2008, the Plenum of the Supreme Commercial Court of the RF adopted Ruling No. 22 "On Some Issues of Practice of Considering Disputes Related to the Application of Art. 169 of the Russian Federation Civil Code" (hereinafter — Ruling No. 22).

This article provides that everything received under invalid transactions intentionally concluded for a purpose knowingly contrary to the fundamental principles of law and order or morality shall be recovered to the revenue of the Russian Federation.

The primary meaning of Ruling No. 22 is to explain that Art. 169 of the Civil Code of the RF shall not be applied to tax relationships (Paragraph 6(4)).

Besides, it gives a number of explanations with regard to the procedure of applying this article to the relationships not related to execution of tax control.

The explanation regarding the exclusion of tax relationships from the scope of Art. 169 of the RF Civil Code cannot be recognized as legally valid.

First, it contradicts legal views of the RF Constitutional Court, in accordance with which "tax evasion is a purpose knowingly contrary to the fundamentals of law and order or morality" and "tax agencies have the right ... to bring to arbitrazh (commercial) courts the demands ensuring tax revenue, including claims on deeming transactions to be invalid and on recovering assets received under theese transactions to the revenue of the state" (for example, see Paragraph 2(3) and Paragraph 3(1) of Court Ruling of June 8, 2004, No. 226-O "On Refusal to Accept for Consideration the Complaint of 'Ufimskii Oil Refinery' Open Joint-Stock Company against Violation of Constitutional Rights and Freedoms by Art. 169 of the Civil Code of the Russian Federation and Art. 7(11(3)) of Law of the Russian Federation "On Tax Agencies of the Russian Federation"). It should be noted that in the second case, bringing claims on deeming the transactions to be invalid and recovering assets

[1] The article is written with informational support of Company "Consultant Plus".

received under the transactions to the revenue of the Russian Federation is directly qualified as the demands ensuring tax revenue.

In accordance with Art. 29(3) of Federal Constitutional Law "On the Constitutional Court of the Russian Federation", decisions of the RF Constitutional Court shall express the legal view of the judges which corresponds to the Constitution and is free from political bias. On the basis of Art. 6 of the Federal Constitutional Law "On the Constitutional Court of the Russian Federation", the decisions of the RF Constitutional Court (decisions, opinions, rulings) and, accordingly, the legal views contained therein are binding.

Second, this explanation contradicts the current legislation.

Art. 7 (11) of the RF Law "On the Tax Agencies of the Russian Federation" provides for the right of the tax agencies to bring claims not only on deeming the transactions to be invalid, but also on simultaneous recovering of assets received under these transactions to the revenue of the state, i.e. with application of consequences envisaged by Art. 169 of the RF Civil Code.

The Tax Code of the RF does not provide for such a power. However, Art. 6 of the RF Law "On the Tax Agencies of the Russian Federation" notes that the control over compliance with the legislation on taxes and charges, over correctness of calculation, completeness and timeliness of payments of taxes and charges to the budgets is also a fundamental task of the tax agencies, for implementation of which they are authorized as listed in Art. 7 of the said Law.

This circumstance was ignored by the Plenum of the Supreme Commercial Court of the RF (see Paragraph 6(2) of Ruling No. 22). At the same time, the Court, in all likelihood, was of the view that for the purposes of tax control, the competency of the tax agencies is provided for by the Tax Code of the RF, and the competencies thereof, stipulated only by the Law of the RF "On the Tax Agencies of the Russian Federation" (as the said law in this part contradicts the Tax Code of the RF) are intended to fulfil other tasks listed therein.

However, it is impossible to agree with this approach for the *following reasons*:

a) this approach does not correspond to the abovementioned legal views of the RF Constitutional Court . In this connection, it is unclear why on some issues (for example, on the issue of fair practices of taxpayers) the legal views of the RF Constitutional Court are accepted for execution by arbitrazh (commercial) courts, but in other cases they are ignored. At the same time, in the first and in the second cases, they proceed from one and the same ruling of the RF Constitutional Court (see, correspondingly, Paragraph 3(2 and 3) of Ruling No. 138-O "On the Petition of the Russian Federation Ministry of Taxes and Charges Regarding Explanation of the

Russian Federation Constitutional Court Ruling, dated October 12, 1998, on the Case of Verifying the Constitutionality of Art. 11(3) of the Russian Federation Law "On the Fundamentals of the Tax System of the Russian Federation" dated June, 25, 2001);

b) it is not clearly stipulated by the law, as, for example, practically all the rights of the tax agencies, which are envisaged by Art. 7 of the Russian Federation Law "On the Tax Agencies of the Russian Federation", are related to tax control. This system of competencies is uniform and not divided on the basis of tasks and functions of tax agencies;

c) the application of this approach to the powers, on the contrary, envisaged only by the Tax Code of the Russian Federation, may cause problems. For example, it may turn out that the autority of tax agencies to submit petitions on annulment or suspension of licenses to perform certain types of activities (Art. 31(1(13)) of the RF Tax Code), issued to natural persons and legal entities, can be implemented only for violations of tax legislation by these persons. At the same time, this measure primarily ensures the compliance with licensing requirements.

As to the cases of execution by a taxpayer of other void transactions not related to those contradicting the fundamentals of law and order, including fictitious and sham transactions, the tax agencies are not required to receive a preliminary court decision regarding invalidity thereof (Art. 166(1) and 170 of the RF Civil Code). The issue of legitimacy of their changing legal classification of taxpayers' transactions shall be resolved when recovering additionally charged taxes by judicial procedure (Art. 45(2(3(3))) of the Tax Code of the RF).

Ignoring the said provisions, the Plenum of the Supreme Commercial Court of the RF created a logical contradiction: Paragraph6(5) of Ruling No.22 explains that a tax agency itself may bring a claim on deeming a taxpayer's transactions to be invalid, and Paragraph7(4) of Ruling No.22 has already clarified that a tax agency may change the classification of the transaction by law, including classifying them into fictitious or sham transactions.

Third, the interpretation by the Plenum of the Supreme Commercial Court of the RF of the concept of *fundamental principles of law and order* disparages public interests. This was manifested by the fact that tax evasion, related to the interests of an unlimited group of persons, was not considered as contradicting the fundamental principles of law and order. At the same time, for example, transactions, aimed at manufacturing and selling counterfeit securities, which, in the majority of cases, affect the interests of particular persons, on the contrary, are considered as such (see Paragraph1(2) of Ruling No.22).

The situation should be the opposite. The fundamentals of law and order are always connected with protection of interests of an unlimited range of persons (public interests).

Fourth, the main argument of the Plenum of the RF Supreme Commercial Court,, apart from the fact that it contradicts the abovementioned legal views of the RF Constitutional Court, is simply absurd. Let us uote: "the requirement of the tax agency ...substantiated by the fact that the said transaction was executed for the purposes of tax evasion,.. is not a measure aimed at ensuring tax recovery" (Paragraph6(4) of Ruling No.22). In other words, it turns out that combating tax evasion has nothing to do with tax collection!

In view of the abovementioned, the tax agencies, if they want to revive the institution of transactions contrary to the fundamentals of law and order or morality in tax relationships, have every ground to raise before the RF Constitutional Court the issue of finding Art. 169 of the RF Civil Code unconstitutional in the sense attached to it by the established practice of applying the law.

In fact, the legislation provides for the following procedure of application of Art. 169 of the RF Civil Code in tax relationships: in the event of detecting the facts of execution by taxpayers of fictitious or sham transactions for the purposes of tax evasion, the tax agencies may file to the courts of law the demands on recovering additionally charged tax arrears and imposing relevant sanctions and also recovering, to the revenue of the Russian Federation, of all assets received in these transactions.

These demands shall be consolidated into a single procedure as they have a similar body of evidence (Art. 130 (1) of the Arbitrazh Procedure Code of the RF).

Moreover, these sanctions have the same administrative legal nature. The recovery to the revenue of the Russian Federation of all assets received under a transaction is an administrative sanction, as in order to apply the sanction the guilty intent has to be establshed. Guilty negligence is not taken into consideration. This is a unique case in the civil legislation when only one form of guilt has to be established for imposing liability[2].

The said sanctions also differ on the grounds for application. Sanctions provided for by the tax legislation are imposed for the underpayment of taxes and all assets received under a transaction are recovered to the revenue of the Russian Federation

[2] For details of the concept of guilt in civil law please see in A.Ya. Kurbatov. Subsidiarnaya otvetstvennost' direktorov v sluchae nesostoyatel'nosti (bankrotstve) kreditnykh organizatzii vozglavlyayemykh imi [Subsidiary Responsibility of the Directors in the Event of Insolvency (Bankruptcy) of Credit Institutions Headed by Them]. Informational Legal System "Consultant Plus", Section "Commentaries of the Legislation".

for the intended execution of transactions contrary to the fundamentals of law and order or morality.

According to the opinion of the Plenum of the RF Supreme Commercial Court, in the second case, the dispute is of civil law nature (see Paragraph 7(1) of Ruling No.22). And this relates to the recovery of funds by the state agency effectuating control functions for the revenue of the budget!

The legal nature of the demands should be taken into consideration, because in judicial practice, special attention is drawn to the procedural aspects (in this particular case — to categories of cases). However, in such cases, the fact that procedural norms determine the procedure of applying material norms and cannot distort their essence should be of primary importance. If the norms of material law provide for the necessity of simultaneous consideration of particular demands, commercial courts must implement this procedure.

The Plenum of the Supreme Commercial Court of the RF gives an opposite explanation: the demands on application of tax sanctions shall not be considered in the disputes on deeming the transactions to be invalid (see Paragraph5(1) of Ruling No.22).

And vice versa, the demands of different legal nature, in the opinion of the the Plenum of the RF Supreme Commercial Court , must be considered in one legal dispute. **Thus**, in the cases of guilty intent of only one party to the transaction contradicting the fundamental principles of law and order or morality, the Plenum explains that the commercial court, concurrently with recovery of funds to the revenue of the Russian Federation, shall be obliged to conduct a unilateral restitution (see Paragraph 3(2) of Ruling No.22). And this is a purely civil law requirement with a different creditor. Apart from procedural difficulties, this approach creates no other consequences. It turns out that either one party to the transaction (defendant) has to file a relevant claim to the other defendant, or the commercial court court, on its own initiative (Art. 166 (2(2)) of the Civil Code of the RF), shall recover funds from one defendant for the benefit of the other!

Besides, sham and concealed transactions cannot be separated as they are united by a single purpose. At the same time, the Plenum of the RF Supreme Commercial Court specifies that only a concealed transaction can be classified under Art. 169 of the Civil Code (Paragraph2(2) of Ruling No.22). However, a sham transaction can also pursue the purpose contrary to the fundamentals of law and order. This construction is frequently found in tax relationships. Instead of performing legitimate transactions, the taxation of which is the parties find unsatisfactory , they conclude other transactions for the purpose of tax evasion. In this case, the transactions

which they have concluded must be considered both sham and contrary to the fundamentals of law and order. The recovery of assets to the revenue of the Russian Federation, should this happen, shall be applied to sham transactions, and taxes and sanctions must be imposed on the basis of the transactions which have been concealed.

The said distortions of the legally established procedure of filing a claim to deem transactions to be invalid and to recover all assets received under such transactions to the revenue of the Russian Federation, are the consequences of incorrect legal classification by the Plenum of the RF Supreme Commercial Court of the existing legal relationships and illegitimate exclusion of tax relationships from the scope of Art. 169 of the RF Civil Code . At the same time, tax relationships are the relationships where there have been real attempts to apply this article and, most importantly, where there is a compelling need in such application. The recovery to the state budget of all assets received under a transaction contrary to the fundamentals of law and order allows to separate, from the viewpoint of liability, the untimely or incomplete payment of taxes and the cases of intentional tax evasion, using seemingly legal ways, which is a major violation of public order.