

Tax Inspections

Inspect – do not suspect

A report on own-initiative
investigation results



Key Points

- Ukraine's National Revenue Strategy until 2030 defines **restoring taxpayers' confidence in tax authorities as one of its top priorities, on which progress in carrying out further reforms depends.**
- Business and professional community mostly perceive tax inspections as a punitive fiscal tool of the state, and, according to the Council's findings, assess their trust in regional tax authorities in context of audits at the level of **13%**, and **19%** as regards the State Tax Service (STS) Head Office.
- Annually, **99+%** of tax revenues are generated through voluntary tax payments; while the share of proceeds from additional reassessments and penalties has, since 2017, **never reached 1%** of total tax revenues.
- According to STS data, on average during 2017-2021 in 74% of cases tax inspections (except for desk audits) resulted in drawing up non-compliance reports, and in 2022-2023 this indicator **grew to 85%**.
- For the last seven years, overall actual and scheduled inspection trend results have been stable: **over 90%** of these audits end with drawing up a non-compliance report. As for unscheduled inspections, the trend is quite different: if in 2017, over half of unscheduled audits ended with drawing up a compliance statement, since 2018 there has been a gradual increase in non-compliance reports, **reaching a maximum proportion of 75% in 2023.**
- Based on analysis of the last seven years, the Council established that there were significant "gaps" between the accruals amounts, agreements and actual revenues to the budget year by year. In this period, not taking into account 2020 and 2022, when there was a moratorium on conducting inspections, **the annual reassessment/penalties amount increased from UAH 34 bn in 2017 to UAH 90 bn in 2021 and UAH 75 bn in 2023.** Despite such an increase in surcharges during the same period of time, agreed and actual payments to the budget were significantly smaller. Thus, the proportion of agreed payments in 2017-2023 ranged from 23% (2021) to 64% (2017), while actual payments to the budget ranged from 4% (2023) up to 16% (in 2017). Thus, a clear pattern can be traced: over the years, only a tiny share of the amounts additionally charged based on tax audit findings is converted into real revenues to the budget.
- While the National Revenue Strategy is focused on searching for more efficient and effective tax debt management methods, particularly to narrow the "gap" between agreed and paid obligations, a big problem exists one step ahead – the inspection results agreement level compared to the level of reassessments and penalties. This indicator has ceased to be defined as one of the KPIs for STS after 2020 (before it had been set at the level of 30-35%, and a strategic target was determined at the level of 75%; in 2023 it was 33%, i.e. less than half of the strategic target). However, it is the agreement level that concerns business the most, since it essentially shows the number of substantiated reassessments, i.e., those later confirmed in administrative or judicial appeals.
- Delay in validating reassessments affects money value over time. In particular, this concerns budgetary VAT refund amounts, which can be suspended in the budget for years. If the state can compensate for the depreciation of money value over time through additional charges in the form of a fine, the "mirror norm" regarding payment to businesses of interest on overdue budget refund amounts has been suspended for the period of martial law. It shows **a significant imbalance of power that does not contribute to building of relations of trust and generates corruption risks.**
- Based on tax audit complaints processed by the Business Ombudsman Council and analysis of the outcomes of administrative and judicial appeals, we have concluded that: during 2017-2023, out of 1,430 complaints, the Council accepted

and reviewed 1,152 complaints (81%): 408 complaints (35%) were closed by the Council as a result of a successful administrative appeal at the STS level; the rest of these cases were closed as a result of administrative appeal failure. The Council's complainants then went on to court in 644 cases, i.e. in **~87% of cases closed without success**, and the share of cases where the court completely or largely ruled in favor of business, is ~85%. Thus, as can be seen from the Council's statistics, court-confirmed administrative appeal outcomes account for **only ~15%**. In the Council's view, this points to a fairly low judicial success rate, given the administrative and business resources expended at all stages of these lengthy proceedings.

- During 2017-2023, business was reassessed **UAH 346.2 bn** in additional monetary obligations. Over this same period, there was a total of **UAH 358.3 bn** of reassessments being contested in court. Without resorting to analysis of the reasons for contested rulings exceeding reassessments themselves, these figures are an obvious manifestation of mass non-acceptance of tax audit findings by businesses.
- The Ministry of Finance in its budgetary program passports annually sets out as a quantitative KPI the share of disputes resolved by courts of all levels to the benefit of the STS. In recent years it was set at the level of **~44%** in quantitative and **~56%** in value terms. Though tax authorities, as a rule, fulfill this KPI, especially as regards value terms, this indicator highlights the central role of the courts in tax matters, and shows that the state sees **losing at least half of court cases** as sustainably acceptable.
- The judicial appeal pathway in the city of Kyiv and Kyiv Oblast -home to nearly half of Ukraine's tax-paying companies – is blocked: after the dissolution of the discredited Kyiv City Administrative District Court in December 2022, cases of taxpayers from the national capital are reviewed by the Kyiv Oblast District Administrative Court, which previously only handled cases from

the surrounding region. For over a year, this court, with only 27 working judges, is trying to cope with its own "regional" caseload, as well as that from the capital, making up for 49 dismissed judges. For the year 2023, the case consideration rate at the Kyiv Oblast District Administrative Court was **43%**, showing a growing backlog of pending cases.

- The Council regularly encounters episodes **of the state's inconsistent actions in the tax field**. This legal unpredictability is especially painfully perceived by business, which has already had to cope with unprecedented levels of situational uncertainty, escalating from pandemic restrictions to the impact of full-scale war.
- **Tens of thousands of annually generated non-compliance findings, aggressively formalist and often poorly-documented – most of them struck down after years in the courts cause administrative, law enforcement, legal and judicial churn, without noticeably supplementing Ukraine's tax revenues.** This approach places undue administrative and legal defence burdens on Ukrainian business, tying up management time and working capital that could be put to more productive use in powering the war effort and recovery. Worst of all, it continues to eat away at the trust between taxpayers and tax collectors that the National Revenue Strategy aims to restore.
- **Over the last seven years, despite the liquidation of the State Fiscal Service, its replacement by the State Tax Service, and a series of permanent and interim management changes and inconsistent attempts to set KPIs, the key problems related to tax inspections have not changed. If anything, they have deepened, and are not in keeping with a goal of national economic mobilisation. Thus, the Business Ombudsman Council's previous recommendations in this sphere remain largely relevant.**

- **This report also contains our new ideas for improvement:**
- **New policy direction** from empowered STS management to ensure application of rule of law principles and practices in terms of proportionality, **reasonableness, and fairness** of tax audit outcomes
- Implementation of the **Consult First** principle, the main purpose of which is to enable communication with taxpayers to correct **errors before imposing a reassessment or a fine**
- Enhancement of STS legal departments' role in tax audits for a comprehensive analysis by regional STS authorities of auditors' preliminary conclusions and to take into account their subsequent judicial perspectives
- **Reduction of the caseload in administrative courts**, especially in Kyiv City after the liquidation of its court, i.e. through the introduction of **alternative dispute resolution methods**. To assist, the BOC is currently upgrading and certifying its own mediation capabilities
- Development of **targeted, ambitious KPIs** to measure and strengthen the **ultimate effectiveness of tax audits**, (including after the court review), and ensure continuous feedback from business owners
- *In the third year of full-scale war, **tax inspections are still conducted with a presumption of ill** will where every taxpayer is treated as a potential, indeed probable, violator. Our common goal should be **transition to a presumption of 'good will'** – reflected in those 99+% of voluntary payments where the main focus is on how to provide quality tax compliance support, helping the law-abiding majority of legitimate taxpayers to find and fix their errors, while focusing aggressive enforcement efforts on bad actors of the grey and black economy.*



Introduction

Since its inception, the most popular category of complaints received by the Business Ombudsman Council (**Council**) has been tax-related complaints. Every year, their share fluctuates around 60%¹ of the total number of complaints received.

The Council has already highlighted certain legislative and procedural deficiencies and violations in the tax field in a number of reports:



Systemic report
“Problems with Administering Business Taxes in Ukraine” (2015)



Systemic report
“Administering Taxes Paid by Business” (2020)



Own-initiative investigation
“SMKOR as a VAT Administration Tool” (2023)

The widely publicized [Ukraine's National Revenue Strategy until 2030 \(National Strategy\)](#), published in late 2023 defines **restoring taxpayers' confidence in tax authorities as one of its top priorities**, on which progress in carrying out further reforms depends. Meanwhile, the factor identified by the state as the one mainly undermining trust in tax authorities is corruption caused by significant discretionary powers in place among the State Tax Service of Ukraine (STS) employees.

Taking into account that the Council's second most popular category of tax complaints after SMKOR is tax audits, which showed a growing trend even during 2023, in 2024 the Council decided to focus on the investigation of structural problems in this area. Moreover, it is during tax audits that the discretion of tax officials and direct communication of both parties at various audit stages and coordination of its findings are largely manifested. In other words, the course of

tax audits, at each of its stages, can significantly influence strengthening or weakening confidence in tax authorities, especially after the break the parties had during the quarantine and war. Having conducted a survey in early 2024² of an unlimited number of respondents³, the Council established that **business and professional community mostly perceive tax inspections as a fiscal and punitive tool of the state** and assess their level of trust in regional tax authorities in the context of conducting audits at the level of only 13.3%, and in the State Tax Service Head Office – 18.9%.

The Council is convinced that in dark times mutual trust of business in the state, not being a legal category, becomes a cornerstone driving further development⁴.

In this report, the Council will analyze causes and origins of problem of business trust in the state represented by tax authorities in the course of conducting tax audits, and also try to share ideas for their solution.

¹ Here and throughout the text, the base period for the analysis is defined as the period of 2017-2023. The calculation of statistics for 2022 does not consider a special period during which the Council provided business support in Helpline mode.

² The Council published [a Survey form](#) on February 08, 2024 with a submission deadline of March 01, 2024.

³ The questionnaire was filled out mainly by accountants (28%), founders (22%), lawyers (20%), directors (16%) and others (14%).

⁴ In this context, the results [of the study on business state and needs in wartime](#) conducted by Diia. Business are also interesting. Unpredictability of the development of the situation in Ukraine and the domestic market is currently the biggest obstacle to business recovery – 58.3%. Unforeseen actions of the state go second (50.7%). The TOP-7 factors also include obstacles from regulatory and/or fiscal authorities – 25.4%.

Problem #1

(un)fair rules of the game

For many years, the Council regularly encountered cases of the state's inconsistent actions in the tax field. Such behavior is extremely negatively perceived by society, as it immediately affects material interests of a large number of individuals and considerably complicates business planning. In recent years, business has perceived such unpredictability especially painfully, when it is already forced to deal with a high level of uncertainty caused by introduction of quarantine to prevent the spread of COVID-19 first, and later by the military aggression of the Russian Federation against Ukraine.

Instead, entrepreneurs expect understanding and a more loyal attitude to each individual taxpayer situation in current conditions.

Example #1

Conducting inspections based on a government resolution contrary to the effect of the "covid" moratorium

The Resolution of the Cabinet of Ministers of Ukraine (**CMU**) dated 02.03.2021 "On Shortening the Limitation Validity Period in Terms of the Moratorium on Certain Types of Audits" entered into force in February 2021, tax officials thereafter began to actively use its provisions to initiate tax audits. The business immediately raised the question of why such a resolution had been adopted and what the STS authorities were guided by when they applied resolution provisions rather than the direct norm of the Tax Code of Ukraine (**TCU**), which introduced a general moratorium on conducting inspections and had a higher legal force⁵.

It seemed that the debate would be put to an end by the Supreme Court⁶, which upheld the business position and stated that conducting audits during the "covid" moratorium was illegal. However, tax authorities still continued conducting inspections based on the said resolution and, in case of admission to the inspection⁷, added monetary liabilities not canceled administratively as a result of such procedural violations.

Thus, for a long time, the Council observed how, on the one hand, tax officials spent resources on conducting audits and defending their findings during court appeals, and, on the other hand, how well-established case-law emerged on the formal annulment of the results of such audits only because of illegality of their appointment and conducted based on the aforementioned CMU resolution.

⁵ Para 52-2 of subsection 10 of chapter XX "Transitional Provisions" of the TCU.

⁶ The first decision of the Supreme Court on this case was adopted on February 22, 2022 in case No. 420/12859/21.

⁷ The Grand Chamber of the Supreme Court in its decision dated September 8, 2021 in case No. 816/228/17 formed the legal position that if a supervisory body was allowed to conduct an inspection based on an order empowering to conduct it, then this order as an act of individual action was applied, and therefore its appeal was not a proper and effective way of protecting the right of a taxpayer, since cancellation of the order cannot result in a restoration of the violated right. Also, the Supreme Court in the decision of 21.02.2020 in case No. 826/17123/18 formulated a legal conclusion that regardless of the decision on (no) admission to the audit made by a taxpayer, subsequently contesting consequences of the audit conducted by the controlling body in the form of tax notifications-decisions and other decisions, a taxpayer is not deprived of the opportunity to refer to the violation by the controlling body of the requirements of the law regarding the conduct of such an audit, if he or she believes that they lead to the illegality of such tax notifications-decisions.



Example #2 Red tape with hostilities territories list introduction

In March-April 2022, amendments to the TCU, according to which during the martial law period and for some time after its end, payers received the right to be temporarily exempted from the land assessment, environmental and real estate tax⁸, became effective. For this purpose, the CMU had to approve the territories list where hostilities are (were) taking place, or temporarily occupied territories (**territories list**).

However, for almost a year, the situation remained not finally settled, because from the very beginning of the war, the territories list was maintained by the Ministry of Reintegration, not the CMU. During this time, many entrepreneurs approached the Council, particularly from Kharkiv, Kherson, Chernihiv, Kyiv Oblast and the city of Kyiv itself – all of them, when applying the exemption directly provided for in the TCU, risked receiving fines due to the lack of the territories list approved by the CMU, and subsequently such tax notifications-decisions really started appearing.

Only in December 2022, the CMU finally issued a Resolution⁹ authorizing the Ministry of Reintegration to maintain the territories list¹⁰. However, until April 2023, STS in its consultations, having enlisted the support of the Ministry of Finance, continued to not recognize the possibility of using the list of the Ministry of Reintegration for taxation purposes, because according to the rules of the TCU, it is the CMU that must independently form the territories list and not entrust it to one of the ministries.

Finally, in the spring of 2023, the Verkhovna Rada adopted amendments to the TCU¹¹, which officially confirmed that the territories list was not directly determined by the CMU, but was formed in accordance with the procedure established by it. This legalized actions in the eyes of STS that the Government took back in December 2022, instructing the Ministry of Reintegration to create the territories list, including for tax purposes. In addition, the aforementioned law retrospectively adjusted conditions for applying tax benefits for 2022-2023, in particular, it provided for cancelling decisions regarding monetary obligations already charged to taxpayers, which the STS authorities had time to make based on desk audits findings.

⁸ Sub-para 69.14, paras 69.16 and 69.22 of clause 69 of Subsection 10 of Chapter XX “Transitional Provisions” of the TCU.

⁹ CMU Resolution dated 06.12.2022 No. 1364 “Some Issues of Forming a List of Territories Where Hostilities Are (Were) Taking Place or Temporarily Occupied by the russian federation.”

¹⁰ The list of territories where hostilities are (were) taking place or temporarily occupied by the russian federation is approved by Order No. 309 of the Ministry of Reintegration of Temporarily Occupied Territories of Ukraine dated December 22, 2022.

¹¹ The Law of Ukraine “On Amendments to the Tax Code of Ukraine and Other Legal Acts of Ukraine Regarding Exemption from Payment of Environmental Tax, Land Fee and Immovable Property Tax, Other Than a Land Plot, for Destroyed or Damaged Immovable Property” dated April 11, 2023 No. 3050

Example #3 Failure to provide a transition period for registering tax invoices drawn up before the war

During “covid” quarantine, in addition to the moratorium on inspections, there was also a moratorium on applying fines, including fines for missing the deadlines for registering tax invoices/ adjustment calculations (TIs/ACs) in the Unified Register of Tax Invoices (**URTI**)¹². VAT payers, being confident they were protected by such a moratorium, did not care that after a full-scale invasion, the STS restricted access to the URTI, and businesses, accordingly, were unable to register TIs/ACs. It is obvious that at that time entrepreneurs had completely different concerns and cared more about survival issues than TIs/ACs registration.

However, already on May 27, 2022, when the next amendments to TCU¹³ became effective and TIs/ACs registration resumed, business quite suddenly began to be held liable for untimely registration of those TIs/ACs, the registration deadline for which was until February 2022. It turned out that, when introducing the relevant amendments, the legislator did not provide a transitional period for the said TIs/ACs, even minimally enough for their registration without applying fines. Instead, the legislator set such a transitional period for TIs/ACs drawn up from February to May 2022.

Investigating this situation, the Supreme Court¹⁴ pointed out to the actual establishment of different responsibilities for taking actions that were essentially the same and noted that the law introducing the relevant amendments was officially published on May 26, 2022 – i.e., in fact, VAT payers had only one day to familiarize themselves with its content and understand its consequences. Therefore, it stated that application of fines for untimely registration of TIs/ACs, drawn up by February 2022, laid an excessive burden on the VAT payer and was a violation of the fundamental principles of the rule of law and good governance.

As can be seen from the above examples, the state’s setting up unpredictable “rules of the game” directly affects the STS as a law enforcement body. In the future, it often results in generating standard decisions, systematically canceled later. It not only means a loss of time and money, but also a chance to build confidence between participants in tax relations.

It is also evidenced by the STS data¹⁵, according to which, over the past seven years, **top three reasons for dropping decisions on additional payments in the administrative procedure** include precisely those aimed to block inconsistency of the state’s steps and harmonize law enforcement practice, namely:

- 1 taking into account during the administrative appeal procedure the Supreme Court practice, official explanations of the Ministry of Finance and the STS, which did not exist at the time of inspections
- 2 legislative gaps, inconsistencies or conflicts in the current legislation and bylaws
- 3 amendments to legislation that occurred or were occurring after the compilation of inspection materials and decision-making by controlling bodies

¹² Para 52-1 of Subsection 10 of Chapter XX “Transitional Provisions” of the TCU.

¹³ Para 3 of sub-clause 69.1 and para 17 of sub-clause 69.2 of clause 69 of Subsection 10 of Chapter XX “Transitional Provisions” of the TCU as amended by the Law of Ukraine “On Amending the Tax Code of Ukraine and Other Laws of Ukraine Regarding Peculiarities of Administration of Taxes, Fees and a Single Contribution During the Martial Law, State of Emergency Period” dated December 5, 2022 No. 2260-IX.

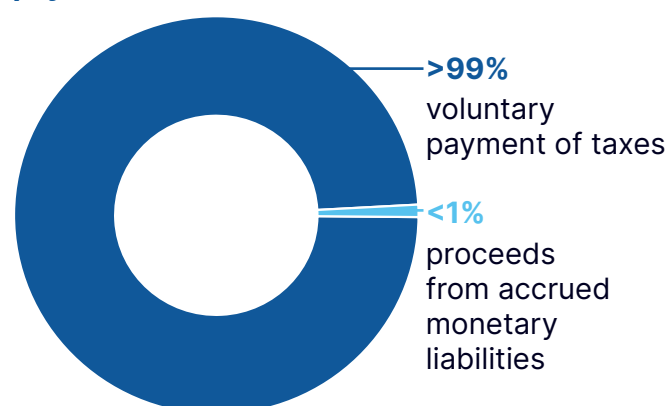
¹⁴ Rulings of the Supreme Court dated February 7, 2024 in case No. 380/7070/23 and in case No. 420/10441/23, as well as dated February 22, 2024 in case No. 420/19335/22.

¹⁵ The Council received the said information in response to its request to the STS.

It is clear that the challenges of war require prompt response, since the situation is developing very dynamically and new circumstances that need to be resolved are constantly emerging. However, **any dramatic changes should be accompanied with a transitional period and not in words but in deeds comply with the legal certainty principle**, so that payers affected by them have the opportunity to distinguish between legitimate and illegal behavior. After all, control over compliance with tax legislation requirements is carried out primarily to create equal competitive market conditions, increase the voluntary tax payment level and improve tax culture.

After all, the prevailing opinion in the business community today is a debatable opinion that at the level of state policy, the purpose of tax audits is to cover the budget deficit.

Looking for approaches to assess the overall effect for the budget from additional reassessments, the Council compared the amount of additionally accrued monetary liabilities that actually came to the budget and the total amount of tax revenues of the Consolidated and State budgets in the respective periods. Thus, according to the diagram below, **after 2017, the share of revenues from accrued monetary liabilities never reached 1% of the total amount of tax revenues. That is, annually 99+% of tax revenues are generated through voluntary payment of taxes¹⁶.**



Year	The amount of tax receipts and fees, payments whose implementation control is entrusted to STS bodies in the Consolidated Budget (thousand hryvnias)	The amount of tax receipts and fees, payments, the control of which is entrusted to STS bodies in the State Budget (thousand hryvnias)	The amount of monetary liabilities that actually came to the budget from economic entities based on accrued monetary liabilities (thousand hryvnias)	The ratio of revenues from accrued monetary liabilities to tax revenues of the Consolidated Budget %	The ration of income from accrued monetary liabilities to tax income State budget %
2017	519,185,262.20	335,335,161.0	5,362,694	1.03	1.6
2018	623,298,175.90	9,134,778.1	3,416,123	0.55	0.85
2019	732,905,162.2	466,929,008.70	3,865,946	0.53	0.82
2020	848,021,566.5	567, 0,659.10	2,266,352	0.27	0.4
2021	993,241,051.8	652,076,370.90	4,995,591	0.50	0.76
2022	1,091,417,757.4	698,719,512.90	1,815,469	0.17	0.26
2023	1,213,581,871.9	783,599,3.50	3,072,328	0.25	0.4

Despite this, the Council itself is a frequent witness of excessively fiscalized approaches of the state during tax audits: in some situations, the “bomb” is laid at the level of law-making, in other cases – it appears in the course of law enforcement.

¹⁶ For comparison, the Council did an additional calculation and found that if the whole amount of accrued monetary liabilities were paid to the budget, the share of such revenues could be up to 9.1% in the Consolidated and up to 13.8% in the State Budget per year, depending on the period.

Example #1 Recognizing business transactions as unreal based on statistical data

The industry peculiarity of documentary inspections of agricultural producers is that they are often based not on the actual indicators of an entrepreneur's activity and production factors available to it, but on statistical information. In particular, if the amount of the harvested crop is less than the statistical yield for the region, then during inspections assumptions are made about the sale of products to unidentified persons and taxes are charged based on the difference between the harvested crop and the statistical yield on the basis of the probability of selling products on the "black" market for cash (and if the harvest is more than average statistical indicators – it is assumed that the producer could buy the products "hands-on" for cash). At the same time, in practice, during tax audits, such assumptions are often not carefully checked, and therefore later canceled in the administrative or judicial appeal procedure.

Example #2 Fixed disproportionate consequences for minor violations during factual inspections

For actual inspections, situations where fines are applied for formal violations that do not lead to budget losses are typical. For example, the Council is aware of cases where discrepancies in one letter of the address of an excise warehouse were interpreted by tax officials as the absence of registration of such warehouse at all and applied a fixed fine rate in the amount of UAH 1 mn, which additionally entailed non-recognition of the registration of flow meters at these gas stations and imposing a fine for each of them. That is, detection of a deficiency in the application for the registration of an excise warehouse could be identified by tax officials with the detection of an illegal gas station, and any arguments about the need to observe the principle of proportionality were rejected.

Another example is the scope of settlement operations registrars, which is distinguished by the length of periods for which sanctions are imposed. Thus, if, in the opinion of the supervisory authority, indication of mandatory details in fiscal slips is improper, the fine may reach almost 100% of the annual revenue (while these funds were fiscalized, accordingly, taxes were paid on them). From the Council's experience, such unfortunate situations could have been avoided if the tax office, having seen this violation in its information base, would have informed the payer at an early stage of the need to adjust the details instead of choosing a "cumulative" approach.

Usually, when the respective violations reach the judicial appeal stage, administrative courts arrive to the conclusion that the corresponding decisions do not meet the criteria-principles of the decisions of the subjects of power established in the procedural law.

Example #3 Ignoring the objective change in economic conditions as a result of the war

The lack of proper perception of martial law conditions on the part of the STS authorities was noted by the Council in numerous cases of challenging fines for untimely registration of TIs/ACs, which occurred due to long blackouts caused by attacks on energy infrastructure. In these cases, the conflict of norms, which provided for different time limits for TIs/ACs registration, were interpreted in favor of the tax authority; certificates of the Chamber of Commerce and Industry about force majeure were not taken into account; the law on mitigating liability, which entrepreneurs had hoped for, was not directly empowered with retroactive effect, so fines could not be avoided.

In 2023, inspections on compliance with the deadlines for currency settlements were also intensified – their number and additional charges as a result of them increased by several times. At the same time, the blockade of sea ports resulted in failure of goods to be

imported into the customs territory of Ukraine on time, so entrepreneurs tried to sell them abroad. Sometimes, due to considerable losses, goods had to be sold at a price lower than the purchase one. However, non-return of the full value of goods originally paid for them was considered a violation by the tax office during inspections and a penalty on the difference between the amounts was charged, although such a violation could not be physically eliminated, since goods had already been sold out, and the dedicated procedure indicated sufficiency of the fact of the sale of goods in full to close the currency control, regardless of the amount.

Another example is perceiving war zones: the Council has witnessed refusals to refund the VAT due to the fact that the main asset was located in these territories. According to tax officials, if there is a risk of destruction of leased agricultural machinery cultivating the land in Kharkiv Oblast, or production facilities purchased in Kherson Oblast, then there was no right to budget VAT refund amounts generated from them. However, the current norms of the TCU do not link this right with the risk of destruction of the object of taxation or its location in the territories where hostilities are taking place. The TCU clearly indicates there is no right to budget refund if there is an actual fact of destruction of the object of taxation¹⁷, and not a hypothetical risk (since it exists throughout the territory of Ukraine).

There are also other practices of auditors that the Council has to deal with. So, since the norms of the TCU and the legislation, control over compliance with which is entrusted to tax authorities, are framework, they do not directly regulate every individual situation in economic activity. It enables auditors to interpret the actual circumstances of the activity in a way to allow them to add monetary obligations, which contradicts the presumption of legality of the taxpayer's decisions¹⁸. Auditors often use this approach during VAT audits, where they come to conclusions about the use of certain goods, works or services outside of economic activity or about the unreality of economic transactions. However, such practices may also occur during other types of inspections.

Of course, there is a norm in the tax legislation backing up each situation described above. The only question is whether it will be applied in good faith, fairly and proportionately, in fact, in the way an entrepreneur expects.

Problem #2

where there is an inspection, there is a surcharge

The final cancellation of the moratorium on inspections since December 2023 was met with concern by the business community. To find out its reasons, the Council held several rounds of meetings with business representatives, business associations and industry experts, and also conducted a survey in which 90 respondents participated.

¹⁷ Clause 69.29 of Subsection 10 of Chapter XX "Transitional Provisions" of the TCU

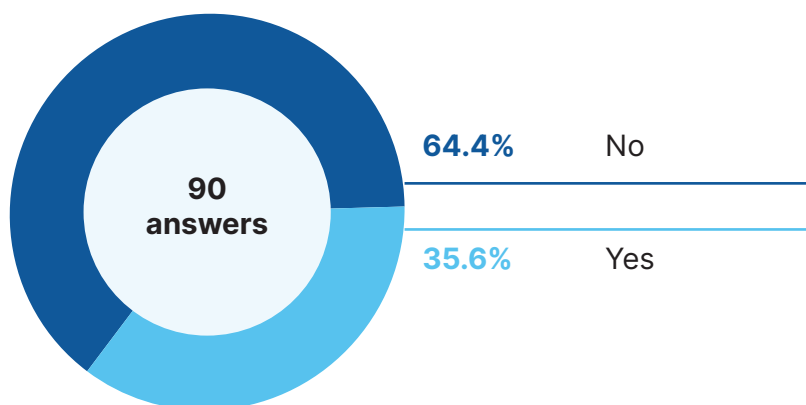
¹⁸ Sub-clause 4.1.4 of clause 4.1 of Article 4 of the TCU.

During discussions, entrepreneurs are mostly focused on the fact that, according to the way they feel, tax audits do not pursue the goal of discipline, but are an attempt to find violations for surcharges at any cost to “justify” the reasonableness of the initiated audit. And in case of no violations found, business representatives reported that from their own experience they received requests from inspectors to independently point out at least some minor violations to accrue additional charges, since it is impossible to complete the inspection without additional charges or fines.

In order to find out how widespread this practice is, the Council asked relevant questions in the questionnaire for an unlimited number of people.

35.6% of respondents reported that over the past seven years, they have encountered situations when the tax inspector, not finding any violations during the inspection, asked to point them out on his or her own to make at least some additional reassessment. The requests were based on management orders, the need to fulfill the so-called “additional reassessments plan”¹⁹, which auditors’ bonuses depend on, and the impossibility of completing the audit without a non-compliance report, since STS will schedule another inspection and consequences will be even harsher. As respondents reported, such situations occurred during all types of tax audits²⁰.

Over the past 7 years, have you experienced situations when the tax inspector, not finding any violations during the inspection, asked you to report any violations yourself in order to at least make a minimal overpayment?



What kind of inspection was it?

32 answers

Unscheduled

19 | 59.4%

Scheduled

18 | 56.3%

Desk

10 | 31.3%

Actual

7 | 21.9%

¹⁹ In the course of the investigation, the Council failed to establish facts that would confirm the existence of such a plan.

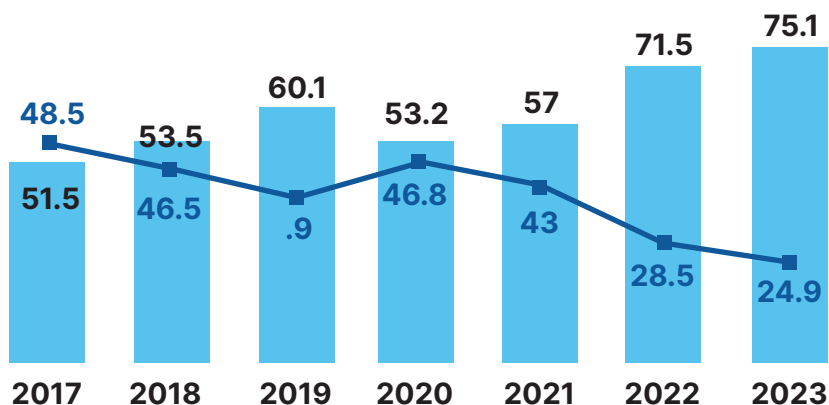
²⁰ Respondents had the opportunity to choose several answer options.

For their part, business representatives reported during the meetings that they **almost never²¹ had to face situations when tax officials drew up non-compliance reports based on the audit findings.**

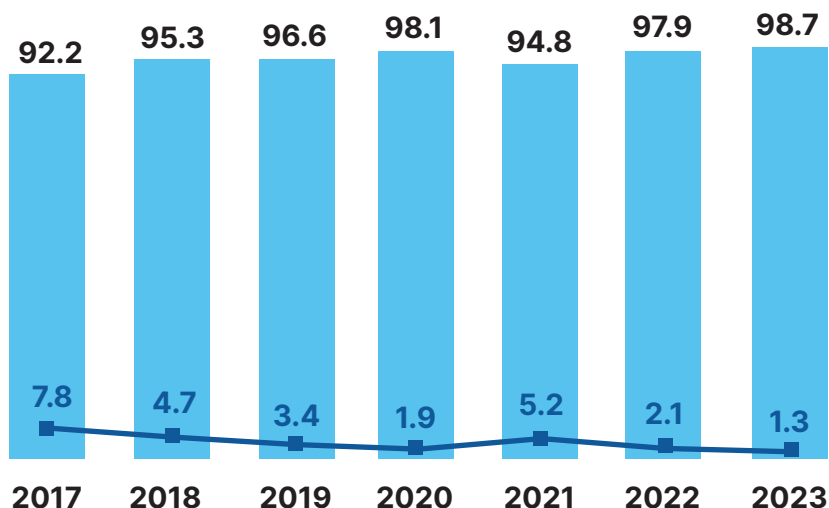
Such business sentiments are fully correlated with official statistical data. So, according to the information provided by STS, on average,

during 2017-2021, **in 74% of** inspection cases (except for desk audits) completed with drawing up non-compliance reports, and in 2022-2023, this indicator **grew to 85%**. The graphs below show trends of drawing up non-compliance reports or compliance statements typical for each type of such inspections.

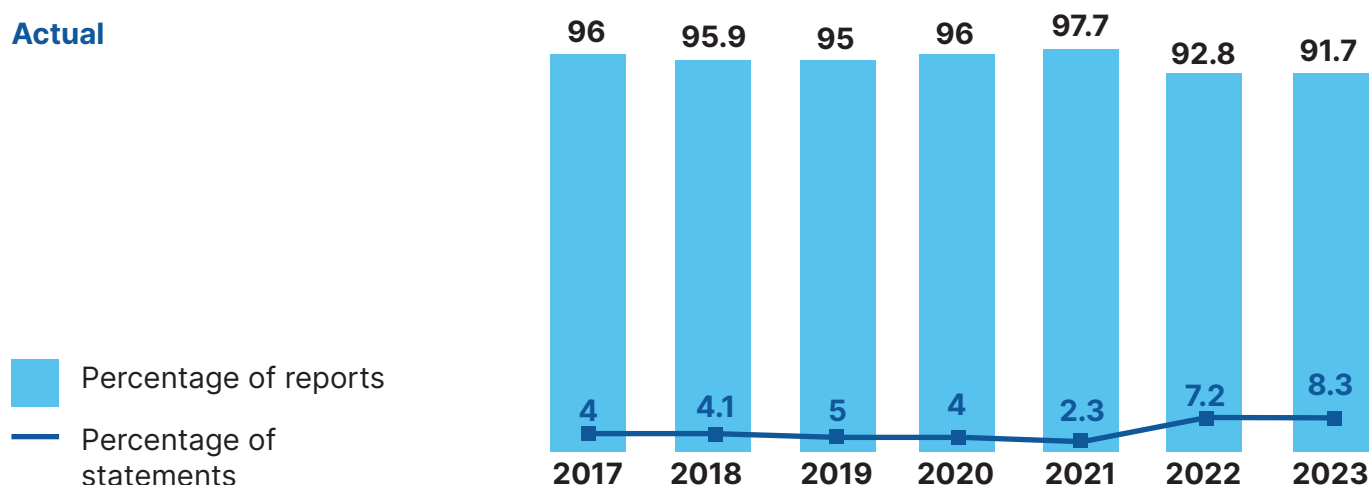
Documentary unscheduled



Documentary scheduled



Actual



²¹ According to the Council's survey results, business had the experience of receiving a compliance statement only in 20% of cases, in the rest 80% – a report was drawn up.

As can be seen from the graphs, over seven years, the general trend for actual and scheduled inspections is constant: **over 90% of these inspections end with drawing up a non-compliance report**. As for unscheduled inspections, the trend is significantly different: if in 2017, over half of unscheduled audits ended with drawing up a compliance statement, then since 2018 the proportion began to change towards a gradual increase in non-compliance reports, reaching a maximum figure of **75% in 2023**.

It seems that tax audits should indeed be risk-oriented, which is confirmed by detection of violations and non-interference in the activities of honest taxpayers. But are violations found always justified?

The Council decided to look for the answer to this question in its own database. For this purpose, the Council analyzed the situation with administrative and judicial appeals of tax audits findings based on related complaints handled.

Thus, during 2017-2023, the Council received 1,430 complaints about tax audits findings. Out of them 1152 complaints (80.6%) were reviewed, within which the Council expressed

its legal position to STS in the administrative appeal procedure in favour of business.

During these seven years, in a total of 408 cases (35.4%), the Council managed to convince STS of the need to cancel additional reassessments out of court. The rest of the cases were closed as a result of the administrative appeal process failure.

From the Unified State Register of Court Judgements, it was established that the **Council's complainants went to court in 644 cases, i.e. ~87% of cases were closed without success**.

If we look only at the decisions in which the court settled the case on the merits, at the same time weeding out the cases where there are currently only procedural decisions, then the courts at each of the stages of the court appeal support the position of business in ~82% of cases.

This trend is also observed if we analyze only those decisions that have entered into legal force: here **the percentage of cases where the result is entirely or largely in favor of business is ~85%**.

1430

complaints received about inspections findings only

1152

80.6%

complaints reviewed

744

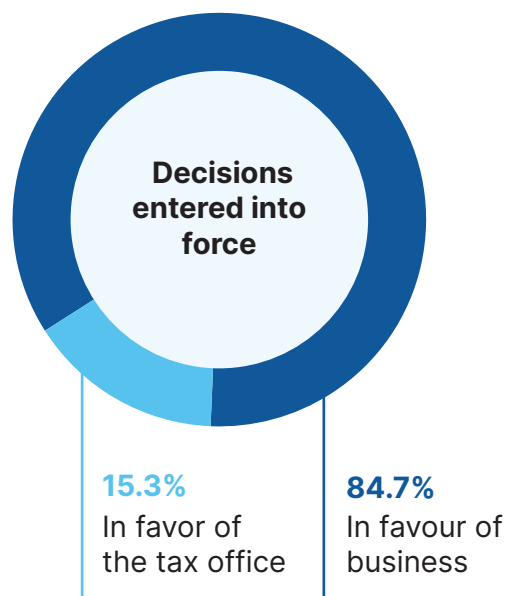
64.6%

complaints in which no success was achieved in the administrative appeal

644

86.6%

challenged in court after an administrative appeal



Thus, from the Council's cases statistics, it can be seen that **the level of confirmation by the court of the outcomes of the administrative appeal procedure based on decisions that have entered into force is only 15%.**

As part of the study, the Council also found out in 2017, the target value of the share of confirmation by courts of decisions made by the STS Head Office based on the administrative appeal procedure outcomes was set at 50%, while the strategic value – at 85%. The Council was unable to find any public communication from STS regarding progress in achieving these performance indicators. Meanwhile, according to the STS data, **during 2021-2023 the courts ruled in favor of STS**

bodies from 30% to 35% of decisions in cases that previously underwent the administrative appeal procedure²².

Meanwhile, in budgetary program passports²³ the Ministry of Finance annually sets key quantitative and value performance indicators (**KPI**) of STS in legal disputes. In recent years, the quantitative indicator was set at the level of ~44%²⁴, and the value indicator – ~55%²⁵. Although, as can be seen from the STS publications, tax authorities usually fulfill these KPIs, especially as regards value terms²⁶, they show the court is an important participant in tax matters, and as a whole the state sees losing at least half of court cases as sustainably acceptable.



²² 2021 – 34%; 2022 – 30%; 2023 – 35%.

²³ According to Budget Expenditure Classification Code 3507010 “Leadership and Management in Tax Policy”.

²⁴ of 2017 – 40%; 2018 – 30% (or 55.2%, as shown on the STS website); 2019 – 56.2%; 2020 is 43%; 2021 – 44%; 2022 – 44%; 2023 – 44.5%.

²⁵ 2017 – 50%, 2018 – 40% (or 41.4% as shown on the STS website); 2019 – 46%, 2020 – 54.5%, 2021 – 55.5%, 2022 – 55.5%, 2023 – 56%.

²⁶ According to the STS data, the fulfillment of the mentioned indicators was as follows: in 2021, quantitative – 64.3%, value – 73.7%; in 2022, quantitative – 49.9%, value – 56.3%; in 2023, quantitative – 45.1% and value – 58.8%.

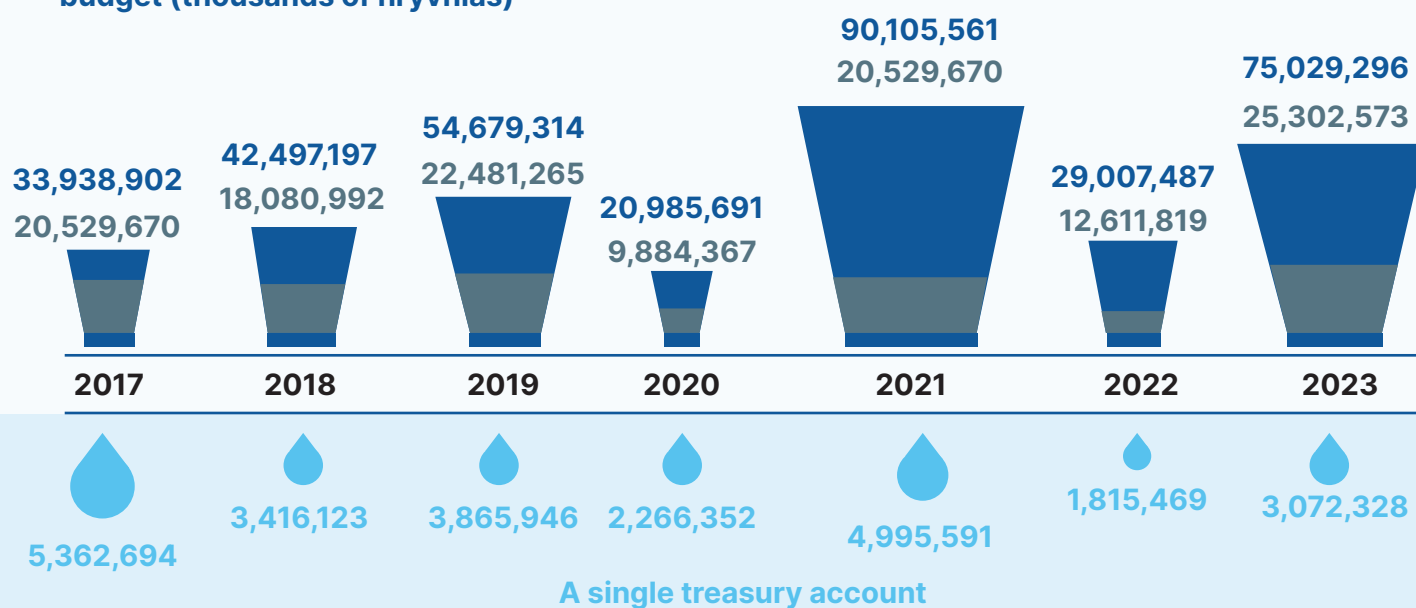
Problem #3

many surcharges – few agreements

Speaking about the additional reassessments²⁷, it should be emphasized that they do not automatically entail revenues to the budget: they must first undergo the coordination stage, which can take years in present-day realities

The general picture of surcharges is given in the graph below formed based on information from STS²⁸:

The ratio of monetary obligations additionally charged, agreed and actually received in the budget (thousands of hryvnias)



■ Surcharged
in total

■ Received
in the budget

■ Agreed
in total

²⁷ Without taking into account reduction of the budget VAT refund.

²⁸ In response to a request on economic entities, the STS provided the following monetary indicators obligations:

- 1) the amount of additionally accrued monetary liabilities by STS bodies
- 2) the amount of agreed monetary obligations added by STS bodies
- 3) the amount of monetary liabilities that actually received by the budget from economic entities based on additional monetary liabilities calculated by the STS bodies

The graph shows **formation of “gaps” between three categories of monetary obligations: “surcharged-agreed”, “surcharged-paid” and “agreed-paid”**:

- According to the National Strategy, improving the effectiveness of mechanisms for working with the gap in terms of the “agreed-paid” indicator, i.e. with the tax debt, is one of the state’s tax policy mid-term priorities. This category of surcharges is not the subject of this study, as it refers to the confirmed results of tax audits, i.e. there is no dispute about their validity.
- There is “surcharged-paid” indicator that can show overall financial effect for the budget of the entire set of audit measures: pre-inspection work, actual audit, consideration of objections and complaints, court appeal. In 2017, the Ministry of Finance set for the first and only time as a KPI that the share of paid monetary obligations, determined by tax and customs audit findings, should be at least 30%²⁹. The Council is unable to assess how ambitious this 30% indicator was at that time, however, according to the Council’s calculations³⁰, over the past seven years, the maximum peak for this indicator reached 15.8%, and it happened in 2017³¹. Unfortunately, the Council does not have high-quality access to the necessary information (in particular, salaries of the involved employees of STS bodies, court costs, etc.) to calculate how much it “costs” the state to conduct tax audits for those revenues to the budget that can be subsequently obtained. Meanwhile, the Council hopes that the Accounting Chamber will be able to provide an assessment of the effectiveness of budget expenses³² to support the entire range of audit work, including defending further tax audits findings in courts.
- There is a significant gap between the “surcharged-agreed” indicators, i.e. monetary liabilities, additional accruals of which were not recognized as legitimate by business entities³³, which **was not taken into account in the road map of tax reforms in the National Strategy**. It also ceased to be defined as one of the KPIs after 2020, although before that it was set at the level of 30-35%³⁴, the strategic target was set at the level of 75%. At the same time, this indicator concerns business the most, as **it essentially shows the number of justified surcharges**, i.e. those later confirmed by appeals outcomes.

That is why the Council decided to analyze this “gap” in more detail.

First of all, it should be taken into account that additional reassessments are not the only type of financial consequences that can be applied to economic entities after drawing up an inspection report. For example, another type of consequences can be a refusal to refund

²⁹ According to the STS data, in 2017, the percentage of income from accrued monetary liabilities was 19% with KPI being 30%. In subsequent years, this indicator was not determined as a KPI and, as reported by the STS, actually reached the following figures: 2018 – 22.2%; 2019 – 19.9%; 2020 – 27.2%; 2021 – 41.8%; 2022 – 12.2%; 2023 – 18.7%.

³⁰ The Council independently calculated the percentage of recei from accrued monetary liabilities according to the formula: (“Amount of monetary liabilities that actually entered into the budget from business entities against additionally accrued monetary liabilities for the reporting year by the Security Service” / “Amount of accrued monetary liabilities” by STS bodies for the respective reporting year”) * 100%.

³¹ The formula applied by the Council made it possible to obtain the following figures: 2017 – 15.8%; 2018 – 8%; 2019 – 7.1%; 2020 – 10.8%; 2021 – 5.5%; 2022 – 6.3%; 2023 – 4.1%.

³² Within performance audit on the topic: «Results of Aministrative and Judicial Appeal of Decisions Made by Controlling Bodies.»

³³ Additionally charged monetary liabilities still contested by business and those that have already been canceled.

³⁴ 2017 – 35%; 2018 – 30%; 2019 – 33%; 2020 – 33%.

VAT from the budget both with³⁵ and without³⁶ charging additional monetary liabilities.

Delaying the moment of agreeing on additional charges means that when the state claims to receive the respective amounts to the budget upon completion of court procedures, these funds will lose their value over time. It's the same case with budget refund amounts, which can "hang" in the budget for years. However, while the state will be able to compensate itself

for the change in the value of money over time with a penalty³⁷, **the mirror norm for payers regarding withholding budget refund amounts is suspended for the period of force majeure circumstances**³⁸, and there is no option to compensate for the loss unreasonably reduced negative VAT amounts at all. Besides, it shows a significant imbalance of forces, which also does not contribute to building trusting relations.

Considering the fact that VAT is the largest revenue item for the state budget, tax officials always pay quite close attention to it.

As you know, the year 2022 became a crisis for business not only because of hardships caused by the war, but also due to dramatic changes in approaches to VAT administration due to SMKOR and delays in VAT refunds, the right to which has been confirmed by a supervisory authority or a court.

According to the STS statistics research done within the scope of this investigation, the Council found out that in 2022, entrepreneurs additionally faced an increase in budget refunds refusals, i.e, when the right to a refund was not recognized by tax authorities based on tax audits findings. Despite the fact that, in monetary terms, the VAT amount, a refund of which was refused⁴⁰ in 2022-2023, does not seem significant as compared to the refunded amount, the percentage ratio shows **an increase in the share of refusals by over 2 times compared to 2020-2021**.

³⁵ According to tax notifications-decisions in "B1" form (**TND B1 form**).

³⁶ According to tax notifications-decisions in "B3" form (**TND B3 form**).

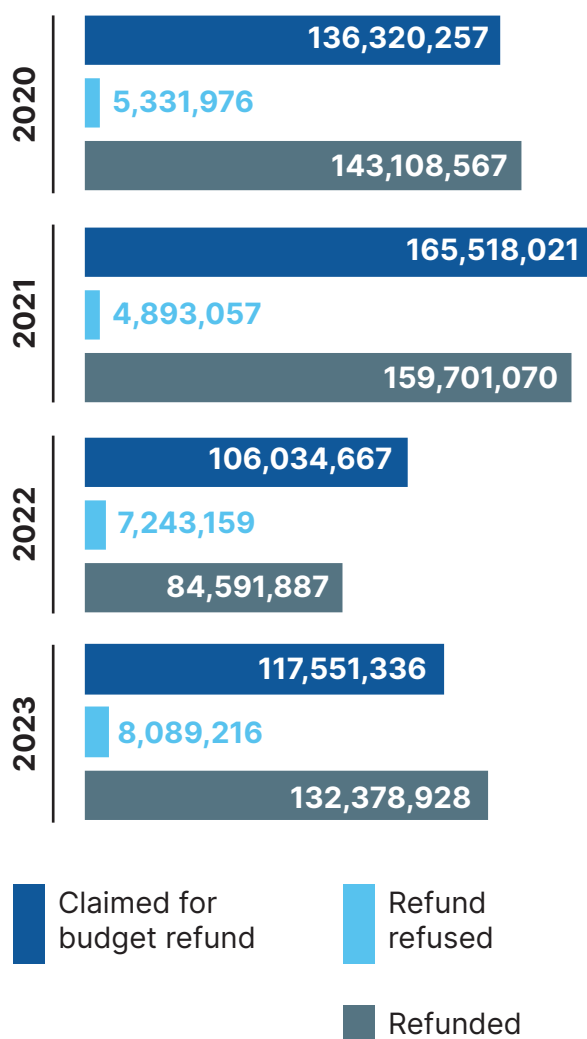
³⁷ Article 129 of the Criminal Code.

³⁸ The third paragraph of clause 200.23 of Article 200 of the TCU.

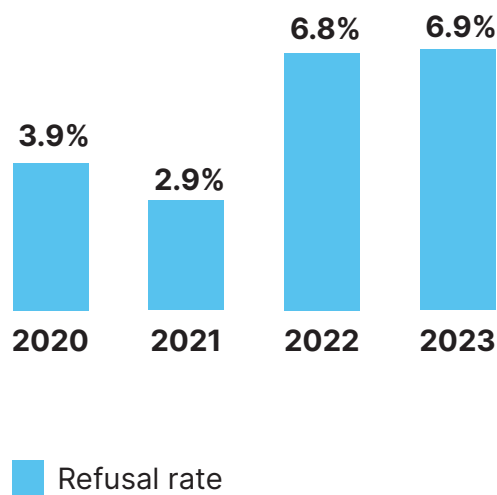
These are changes to the first criterion of the riskiness of transactions. For more details, see the report "[SMKOR as a VAT Administration Tool](#)".

⁴⁰ It is the aggregate indicator of the VAT amount, the refund of which was refused based on tax inspections findings on the TND B1 and B3 form.

VAT amounts claimed for refund, refunded and refused on TNDs B1 and B3 forms (thousand UAH)

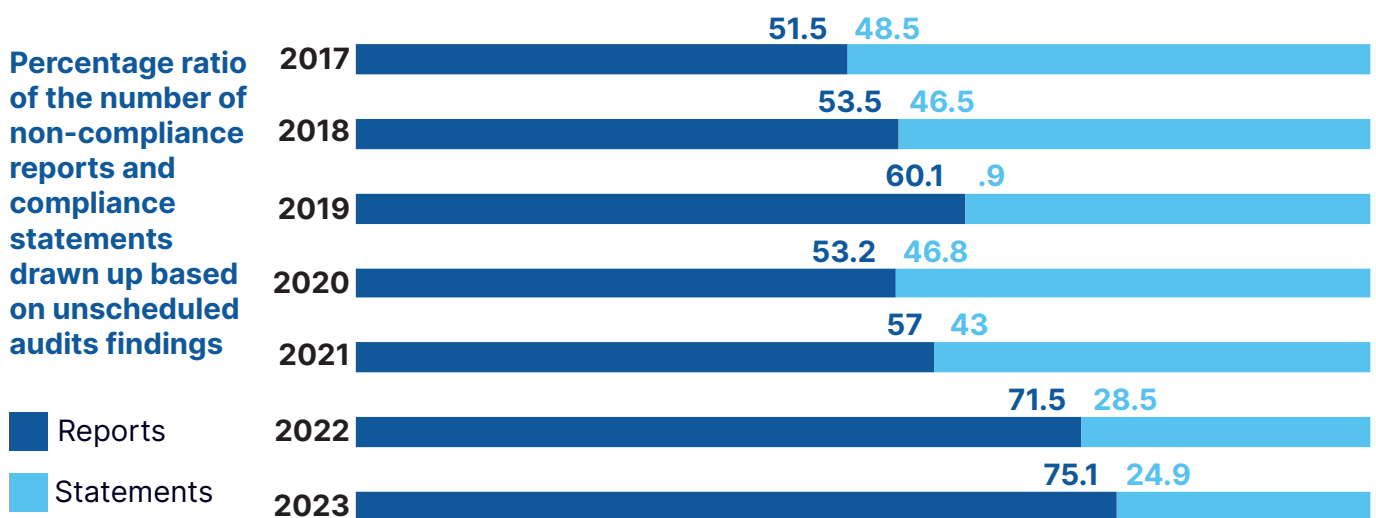
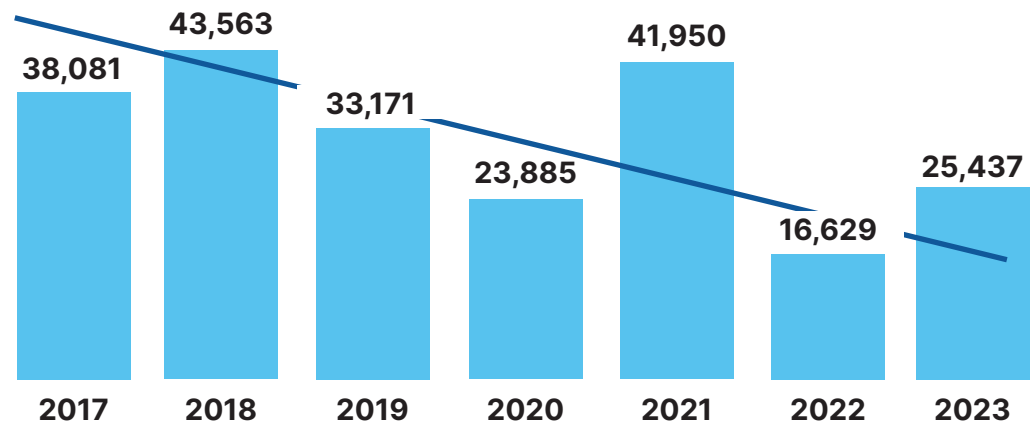


The ratio of VAT amounts refused to be refunded on TNDs B1 and B3 forms, to those claimed for refund



Despite the fact that, for objective reasons, the year 2022 cannot be considered comparable to the years 2021 and 2023, the Council drew attention to the fact that **the share of inspections that ended in drawing up a non-compliance report during this period grew to 71.5%, which is almost a quarter more than in 2021 (the indicator was 57% then)**. The fact of a decrease in the number of these inspections in 2022 is primarily related to peculiarities of legislation during the martial law period (suspension of budgetary refund during March-May, shifting deadlines for conducting desk audits for February-July reporting periods, increasing the legally set deadlines for conducting documentary inspections to 60 days, etc.). However, it can also show a drop in the economic activity of business and a general decrease in its profitability (because this is an indirect indicator of a decrease in the number of cases of declaration/application for budgetary VAT amounts refund exceeding UAH 100,000). Accordingly, the economically active part of business could feel more careful attention of tax authorities compared to previous years.

Number documentary unscheduled audits conducted



In contrast to inspections, which end with charging monetary liabilities the effect of which can only be tangible for the budget if they are agreed, denial of budgetary refund has an **“instant”** effect. Therefore, in this context, business assumptions about the reasons for “imposition” of violations can have logical grounds.

Meanwhile, it should be borne in mind currently business transactions are first checked through the SMKOR (introduction of which was designed to replace inspections on non-merchantability of transactions and to provide business with guarantees on undisputedness of the tax credit⁴¹), where every interaction with the tax office is like TIs/ACs registration suspension, submission of a data table or riskiness, requires passing a quasi-tax audit, during which commissions check everything – from economic transactions performed to the tax burden, fixed assets and the level of salaries. Furthermore, when declaring/applying for a VAT refund of over UAH 100,000, a tax payer undergoes a full desk and, where appropriate, documentary unscheduled audit, during which the reality of these transactions is re-checked. Notwithstanding that fact, a successful registration of TIs/ACs by the regional or central level commissions at the previous stage does not guarantee that the same transactions will not be questioned during an unscheduled audit. Failure to guarantee a tax credit for transactions earlier “verified” through the SMKOR undermines not only business confidence in control and inspection measures (as it contradicts TCU regulations), but also **poses questions about trust within the tax department – between the audit and risk management departments.**

⁴¹ It is about para. 3 cl. 201.10 of Art. 201 of the TCU, according to which TIs/ACs, drawn up and registered after July 1, 2017 in the Tax Register by a taxpayer performing transactions for the supply of goods/services, is for the buyer of such goods/services is a sufficient ground for charging tax amounts related to the tax credit, and does not require any other additional confirmation.



Of course, not all non-agreed monetary obligations can be considered unreasonably overcharged, since the final decision based on the results of the appeal can be made both in favor of the payer and in favor of the tax office. The arbitrator in this process is STS at the administrative appeal stage, while the court – during the judicial appeal.

However, business is often skeptical of the administrative appeal procedure at STS, believing that it lacks impartiality. Such skepticism also has a certain objective ground in the form of a KPI, which can be perceived as **the upper limit of complaints satisfaction according to the value criterion**⁴². The KPI in its current version can serve as a negative incentive for STS, because a natural urge not to exceed the KPI may be stronger than the desire for an objective assessment of the circumstances of an administrative complaint. As a result, this may cause generating refusals to satisfy substantiated administrative complaints to comply with the “target” set

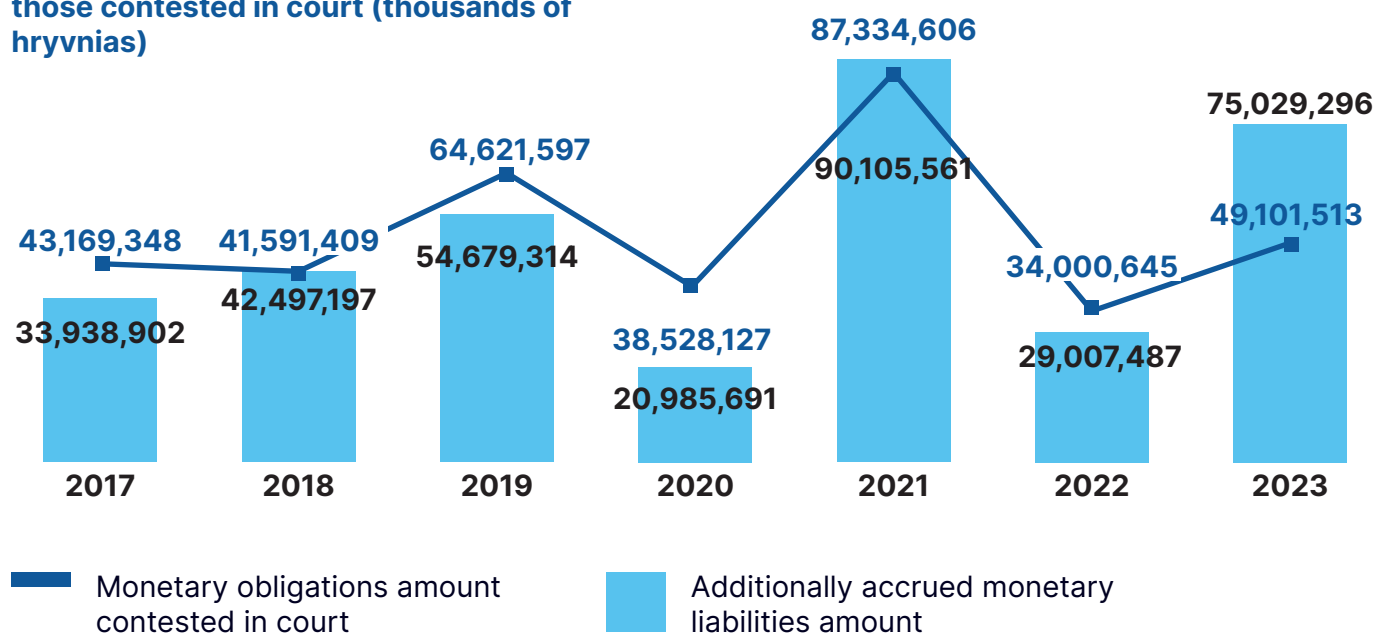
and the possibility of assigning responsibility for making a final decision to the court. Accordingly, in order for this KPI to serve as an objective indicator of the quality of tax audits conclusions, it should be set **not for STS, but for regional tax** authorities conducting audits directly and forming opinions in reports. **STS, however, should not be limited by either the quantitative or the value indicator of administrative complaints satisfaction rate.**

As for the courts, according to the statistics provided by STS during 2017, in 2023, UAH 346.2 bn of monetary liabilities were charged with business. At that time, UAH 358.3 bn of surcharges were contested in court. Such high indicators are an obvious manifestation of **mass non-recognition of tax audits outcomes by business entities.**

As can be seen from the graph below, an increase in court appeals corresponds to an overall increase in surcharges in the respective periods.

⁴² A KPI entitled “The share of canceled monetary obligations additionally accrued by audit departments based on the administrative appeal outcomes, in the total amount of contested tax notifications-decisions, in respect of which a decision was made (cancellation level in the administrative procedure)”, which during 2018-2023 made up from 20% to 16%.

The ratio of accrued monetary liabilities and those contested in court (thousands of hryvnias)



Such a high tax audits contesting rate may be connected not only with disagreement with additional reassessments, but also with distrust of the administrative appeal procedure in STS and good judicial prospects

for payers. This leads to **the judicial system overload, responding with extremely lengthy consideration of cases**⁴³, in turn, negatively affecting all participants in legal relations.

51.85% of complaints on tax audits findings received from businesses by the Council during 2023, in a geographical section, concern and Kyiv Oblast. Until December 2022, the judicial appeal of the results of such inspections was reviewed by two separate courts of first instance – the Kyiv City Administrative District Court (KCAC) and the Kyiv Oblast District Administrative Court (KOAC).

In December 2022, the KCAC which considered disputes involving city taxpayers, was dissolved⁴⁴. Instead, Kyiv City District Administrative Court was supposed to be created, and during the “transitional” period, cases will be transferred to and considered by the KOAC (which earlier reviewed Kyiv Oblast cases only). For over a year, this court, where only 30 judges currently work (at the same time, three of them temporarily do not perform their duties), has been trying to cope with its own “regional” caseload, as well as the “capital” one, which was previously distributed among 49 judges of the liquidated KCAC. For the year 2023, the percentage of consideration of cases by the KOAC was 43%, which indicates a rather significant backlog of pending cases⁴⁵.

⁴³ During the analysis of the judicial process of cases closed by the Council without success, it was established that some cases had been at proceedings launching stage since 2018-2019 without a decision having been made even at the level of the court of first instance.

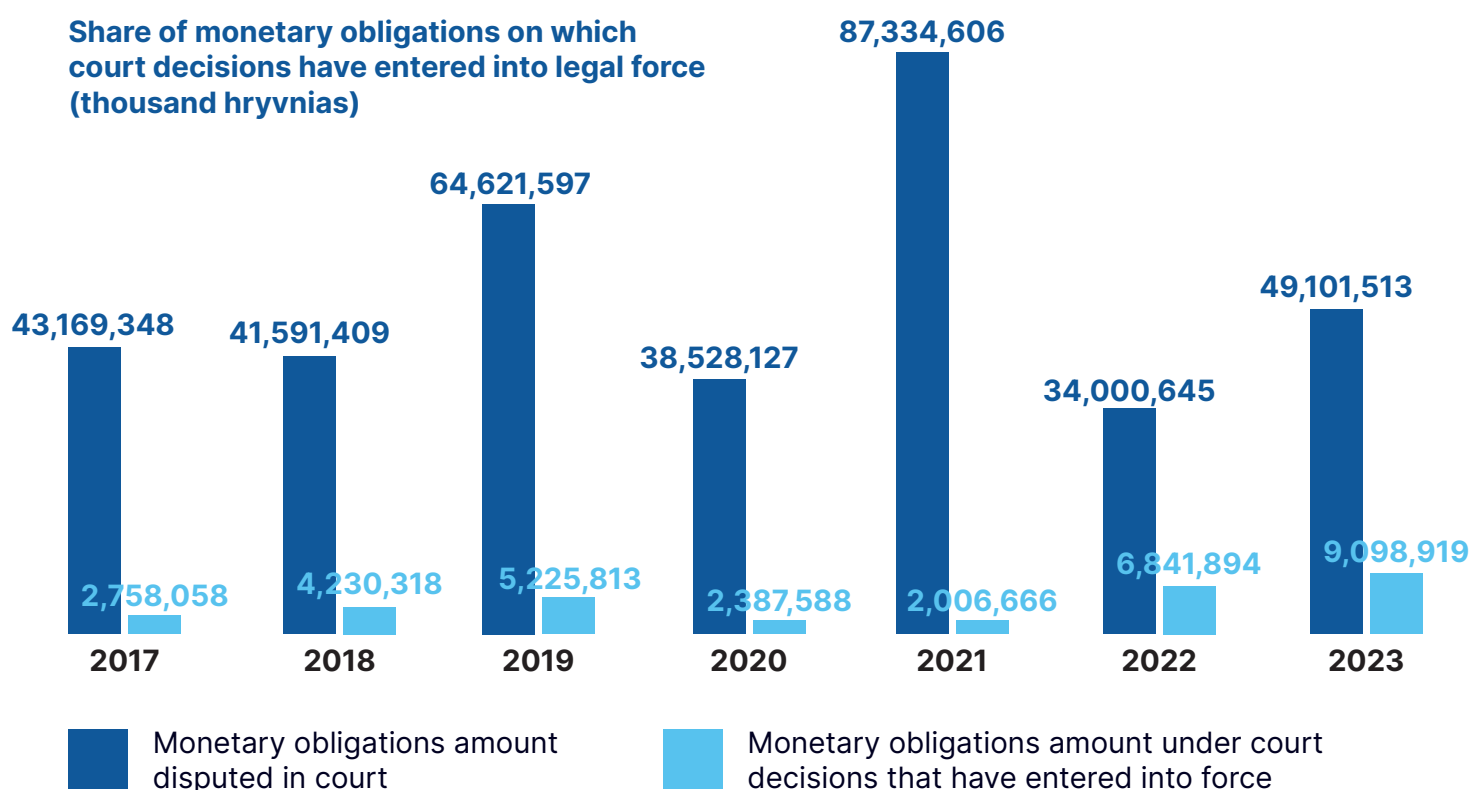
⁴⁴ Based on the Law of Ukraine “On Liquidation of the Kyiv City District Administrative Court and Establishing the Kyiv Oblast District Administrative Court” dated December 13, 2022 No. 2825-IX.

⁴⁵ For more detail, read the [Analysis of Justice Administration by Administrative Courts in 2023](#).

From the Council's experience, KCAC overload in some places causes not only a procedure for monetary obligations agreement, but also has the opposite effect – premature “technical” agreement. That is, in situations where the business filed a claim for declaring tax notifications-decisions illegal and their cancellation, the case was registered and assigned a number, but the court did not timely consider the issue of launching proceedings, the tax office can consider the monetary obligations as agreed and demand “debts” repayment further generating complaints from payers.

The judicial review effectiveness overall level can be estimated from the graph below, from which it can be seen that the share of monetary obligations on which court decisions become legally binding, is quite insignificant compared to the total amount of surcharges under appeal.

Share of monetary obligations on which court decisions have entered into legal force (thousand hryvnias)

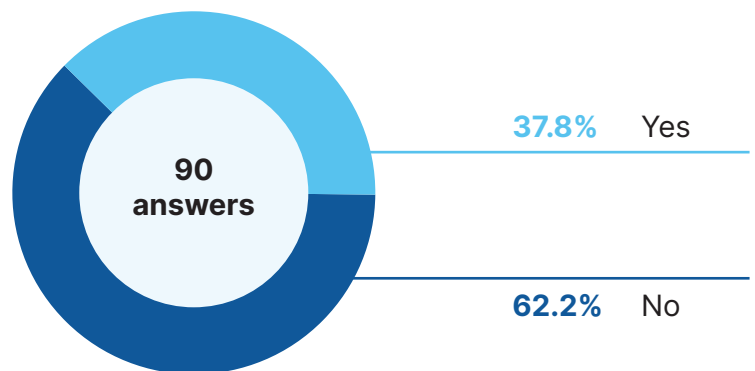


When providing the Council with judicial statistics, the Administrative Court of Cassation as part of the Supreme Court commented on the situation with a considerable burden on tax disputes as follows: “Analysis of case-law shows tax authorities consider it necessary to bring all cases to the Supreme Court, while having their own procedure for reviewing their decisions at the same time – administrative appeal. The number of refusals to launch cassation proceedings is a sign of waste of money and time by tax authorities, courts, and judges. The indicator of cassation appeals return shows their poor preparation, despite clear requirements set by the procedural law for their form, and extensive court practice on these issues. **Based on court decisions analysis results, it can be concluded that tax authorities exercise their powers not as a service provider for taxpayers, but as a body performing control and fiscal functions.** In addition, the variability of tax legislation, unfortunately, does not contribute to tax discipline.”

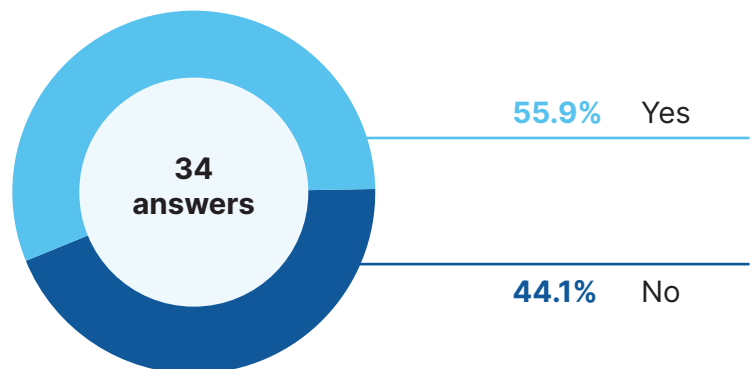
The active use of court procedures to agree on tax audits findings may testify to the transfer of legal responsibility of tax authorities behaviour from STS to courts. Under these conditions, **the “tax authority-payer” bilateral relationship essentially becomes tripartite**, since the court is their highly likely (if not mandatory) participant along the way to finalizing each individual tax audit findings.

As a result, business perceives tax audits as an additional administrative and financial burden to support their conduct and subsequent appeal. Answering the Council’s questionnaire, **over a third of respondents** reported that the inspections support costs are included in the structure of planned costs. Of them, more than half reported that they include planned costs indicators for administering inspections in the price of delivered products, which accordingly **affects the end customer**.

When carrying out business planning, do you include tax audits administration and their consequences in the costs structure?



Do you include planned expenses indicators for administering tax audits in the price of product you supply?



On the other hand, now all this induces state to think about other options, such as tax mediation, and incentives for taxpayers. Thus, with the resumption of tax audits, a rule appeared⁴⁶, according to which, during the martial law period, the state of emergency, the payer is exempted from fines and penalties, if he or she independently paid accrued liabilities within a month and did not appeal them.

⁴⁶ Sub-clause 69.37 of clause 69 of subsection 10 of Chapter XX “Transitional Provisions” of the TCU.

Conclusions

Mutual trust between business and the state represented by tax authorities and vice versa is a long-term process of recognition and acceptance of each other's interests and needs. A period of crisis is a time for decisive actions, on which the strengthening or weakening of trust will depend strategically.

Although the National Strategy states corruption as the main obstacle to trust, the Council believes that this study can cast doubt on this statement. After all, the prerequisite for corruption itself and, accordingly, an even more important obstacle to building trust, are established **formalistic approaches of state bodies, particularly in the context of inspections**. After all, providing only less than 1% of budget revenues as a result of tax audits is carried out under the terms of the rules of the game, fairness of which is not recognized. Meanwhile, with a probability of 85%, tax officials will find violations, and if the Business Ombudsman Council does not help to cancel them administratively, then the chance of success in court will reach the same 85%. However, on this thorny path, everyone will be overloaded: entrepreneurs, tax officials, courts, and even the Council's experts, time, money and faith in a bright future will be wasted. This state of affairs has already led to the fact that the level of trust in regional tax authorities in the context of audits is 13%, and 19% as regards the State Tax Service (STS) Head Office.

The conducted research gives the Council grounds to assert that over the past seven years, the configuration of key issues surrounding tax audits has generally not changed, and the Council's previous recommendations in this area remain largely relevant. On the other hand, it shows that old problems are not being solved and are even

deepening (for example, for the taxpayers of the city of Kyiv due to ignoring the problem of blocking access to the court after the dissolution of KCAC).

The strategic goals of activity, defined at the most diverse levels, in different years and for different periods of time, are set in the activity plans of the STS, the Ministry of Finance, the CMU, etc., unfortunately, they often remain strategic, without being put into practice.

As a result, today the very purpose of conducting tax audits must be reviewed at the state level. An approach in which tax audits will not have the purpose of making additional reassessments, but will serve as an authoritative compliance check for payers with a focus on providing professional recommendations to managers, accountants and lawyers, is considered appropriate. Such a goal could be attained based on the level of voluntary compliance with tax audits findings, which, as far as the Council understands, is currently not measured in any way.

From the Council's viewpoint, the following approaches can positively influence tax audits effectiveness, and thus contribute to building trust between business and the state. The key to this is setting a strategic indicator of the level of agreement of accrued monetary obligations thanks to a set of measures taken by the state.



Idea #1

Consult First

The Council is convinced that a lion's share of tax audits adverse financial consequences could be avoided if the tax authority informed the taxpayer in advance about the need to adjust activities or eliminate inaccuracies in documents. Such unfortunate situations can be avoided by implementing the "Consult First" principle, the concept of which was developed in Latvia in 2017⁴⁷.

This principle implies that authorities should allow those they inspect to make the necessary adjustments themselves, as any administrative proceeding is a complex process involving high costs for both the authority and business. Therefore, the application of a warning is the mechanism that can save financial and administrative resources of both parties.

According to this principle, creating conditions for business compliance should be the state's policy foundation. This includes the following:

- the main purpose of inspections is to ensure compliance, not to impose a fine
- fines must be proportionate to the violations committed
- authorities should promote and support the business in striving to independently adjust its activities to fulfill its obligations; if an entrepreneur does not cooperate to eliminate the violation, fines increase
- there should be a clear, transparent and comprehensible penalty policy for society
- within the scope of powers, uniform criteria for applying fines are determined, which provide for the possibility of not punishing and solving corruption risks

Currently, in Ukraine, the "Consult First" principle in the tax field is limited to only a small part of it – information through [the STS official website](#), individual and general tax consultations, "hot" lines. However, such measures are not enough to increase trust, since the information materials do not cover the entire range of possible business problems, nor do they relate to the problems of each specific entrepreneur, and the practicality of their enforcement by taxpayers raises additional questions.

Therefore, in the current conditions, the Council believes that the most effective way to increase business compliance, as well as trust in tax authorities, is to report signs of a violation before imposing a fine with the opportunity to independently eliminate it. At the same time, the business must have equal access to such information, without giving any preference. Such functionality can be implemented in the secured part of the taxpayer's e-office by highlighting all existing tax risks there.

A tax audit should be scheduled if business does not take actions to correct detected discrepancies within a certain period of time.

On the whole, this approach is consistent with the idea of the development of tax legislation compliance risk management system, the range of response measures of which will vary from promoting voluntary compliance with legislation requirements by taxpayers (by warning them of the tax risk and the possibility of its independent elimination) to requirements enforcement (by focusing tax control on the activities of taxpayers who regularly grossly violate the law).

⁴⁷ For more details, see the document: [Guidelines for the Application of the Principle "Consult First" in the Work of State Authorities.](#)

Idea #2

Mandatory legal assessment of conclusions

Back in 2020, in its systemic report on tax issues, the Council emphasized the importance of taking into account case-law and court appeal prospects when forming tax audits opinion. After the said report was published, STS implemented Methodological Recommendations, which introduced the procedure for the employee conducting the audit to apply to the legal support department to obtain a conclusion on completeness of the evidence base on violations detected during the tax audit, as well as, in certain cases, on the legality of application of the rule of law⁴⁸. When providing such conclusions, the legal support department must, among other things, take into account the judicial perspective. Despite this, cases when results of inspections could be taken into account based on future legal prospects are rare. After all, since the legal support department conclusions are not attached either to audit reports or to tax notifications-decisions, it is impossible to practically establish whether the analysis of judicial prospects of violations discovered by auditors really took place. The fact that an employee of the specified department signs only one copy of the inspection report, kept in the tax authority, also does not make it possible to verify whether the legal support department approved the respective report.

Considering that it is employees of the legal support department who defend inspections findings in courts, the competence of such employees should be broader, while the procedural status should be higher. Therefore, the Council proposes to improve the current procedure for interaction of tax audit and legal enforcement departments, so that it works in such a way that already at the STS territorial body level, prior to issuing tax notifications-decisions, a comprehensive conclusions quality analysis preliminary made by auditors based on the inspection outcomes. In particular, the employee of the legal support department should have the right to empower the auditor to take actions during audits that, in his opinion, are appropriate to confirm or refute previous conclusions or assumptions. The Council is aware that it may take more time, and it is better to pay attention to the high-quality formalization of inspections findings than to go to court for years.

Therefore, the Council finds it expedient to increase the competence and procedural status of the legal support department to actively participate in the inspection process and be better prepared for apparent legal defense of the auditors' opinion.

⁴⁸ Clauses 2.2.5 and 2.2.7 of Section II of Methodological Recommendations regarding the procedure for interaction between the divisions of the State Tax Service in organizing, conducting and implementing taxpayer's audit materials, approved by the STS order dated September 4, 2020 No. 470.

In other words, according to the general rule, a lawyer who at one time signed a tax audit report should go to court. In addition, the possibility of engaging external legal experts for particularly important cases should be considered.

According to the Council, legislative regulation of the legal status of the legal support department conclusions will also help to ensure that they are taken into account by both STS bodies and courts. Conclusions should be available to taxpayers to ensure transparency and the ability to assess the tax authority's legal position.

It is expected that expanding the legal support department competence while strengthening its procedural status will improve the quality of decisions made by regional tax authorities, provided that such a department is given enough time to make a proper legal assessment. Since such a legal assessment will be carried out before the tax notifications-decisions adoption stage, the regional tax authority will already have a ready legal position in the event of a dispute in court, and therefore preparation for presenting inspections findings and their defense will take less time. In turn, better quality of decisions made based on the results of inspections will increase the effectiveness of tax authorities during court appeals.

Idea #3

Transparency and openness of data through effective KPIs

In 2016, KPIs for STS⁴⁹ were set for the first time, but then STS did not report on their fulfillment to the Ministry of Finance. In 2017-2018, the Ministry of Finance did not bring the KPI to the STS attention, and during 2019-2020, STS, with the approval of the Ministry of Finance, approved the KPI and their calculation methodologies, regarding which it periodically

published information on its websites. Today, the question of defining KPIs lies in the law-making process⁵⁰.

This state of affairs resulted in the fact that there was no unified KPI system for STS, various indicators of tax authorities performance are set in a number of program

⁴⁹ More information on [KPI for the State Fiscal Service](#).

⁵⁰ In order to legislatively settle the issue of introducing tax authorities performance assessment, the Ministry of Finance has developed amendments to the TCU, according to which the Ministry of Finance is given the right to approve the KPIs list for STS as well as the methodology for their calculation, and the STS functions are supplemented by the norm on implementing KPIs target values for the relevant year and submitting a report on their fulfillment.

Presently, the draft Law of Ukraine "On Amendments to the Tax Code of Ukraine on Assessing the Performance of Tax Authorities" has been registered in the Verkhovna Rada of Ukraine (Register No. 9471 dated July 10, 2023). According to the Verkhovna Rada of Ukraine Legislative Work Plan for 2024, approved by the Resolution of the Verkhovna Rada of Ukraine dated February 6, 2024 No. 3561-IX, the deadline for considering the draft law is set for the II quarter of 2024.

documents (e.g., in internal orders, budgetary program passports, etc.). The Council also has to note that the way which statistical information is presented on the STS website is extremely hard to understand; it is quite difficult to track strengths and weaknesses of the existing control mechanism from it, the information may vary in different sections of the site, and the chronological dynamics can be traced only if you separately “dig” into archive materials. Moreover, the figures the Council independently calculated based on publicly available information as part of this investigation are often hard to compare with the final figures that the Council received from STS in response to its inquiries.

In the Council’s opinion, control measures should be covered by clear KPIs for taxpayers, the number of which should not be excessive, but fulfillment of which will be qualitatively correlated with increasing trust in tax authorities.

KPIs are also inextricably linked with the availability of information about tax authorities activity to society. The openness of data on inspections, actual results and their confirmation degree in courts will provide an opportunity to understand to what extent the state’s spending of resources to support a specific type of inspection on a specific issue is comparable to the economic results in the form of real receipts of funds to the budget. This will make it possible to respond to and leave only effective control and inspection measures and abandon ineffective audits.

At the same time, despite the fact that in 2023 STS should have published a report on tax disputes consideration results in administrative and judicial procedures with an overview of the most common disputed issues and a proper way to resolve them (taking into account the Supreme Court conclusions) for the previous year, in early 2024, STS announced that such a report would be released only after martial law had been suspended or lifted. The connection between publication of such a report and martial law conditions remains unclear for the Council.

Ultimately, the Council is convinced that building confidence between the taxpayer and tax authorities in this area should be driven by transparency and, most importantly, by availability of information about real consequences of tax audits and measures constantly taken by supervisory authorities to correct obvious downsides of the existing system.

For example, an important indicator, in the Council’s view, is tax audits findings strategic coordination level both as a result of voluntary payment (a priority) and administrative and judicial appeals. Accordingly, implementing the “Consult First” principle also requires setting clear KPIs, which will make it possible to assess the effectiveness of measures taken. Such indicators should be aimed at tracking trends of achieving a certain level of business compliance (for example, the number of warnings about recording a violation in the STS information bases and the number of eliminated violations).

Idea #4

Fair and reasonable administration

Fair and reasonable administration principles are an integral guarantee of proper securing the rule of law as a fundamental constitutional principle, as well as an important criterion of the negotiating framework for Ukraine in the course of its integration process into the European Union. That is why, in December 2023, the Council turned to state bodies, including the Ministry of Finance, with the development of the Declaration of Fair and Reasonable Administration (Declaration).

The mentioned principles are extremely relevant for the work of tax authorities within the scope of tax audits. In particular, from the Council's experience, the driving force of tax officials to make additional reassessments is often the fear of making a decision in favor of business, as there is an opinion that a favorable decision for business may be considered as a loss for the state or contain a corruption component.

The Council is convinced that the Declaration developed by it can serve as a road map for a tax officer when making a decision affecting interests of business and the state. In particular, following the Declaration will allow to substantiate, if necessary, that, when making the relevant decision, he or she was reasonable, because he or she was guided by fundamental principles and adhered to the

principle of the rule of law. Therefore, in the opinion of the Council, applying the Declaration will help reduce a taxpayer's fear of being in the spotlight of law enforcement bodies in case of making a well-considered decision in favor of business.

Implementing proportionality and reasonableness principles will help to find a balance between the interests of the state and business, reduce cases of ungrounded fines for minor violations that do not affect budget revenues, and reduce the risk of imposing unfair sanctions without taking into account the fault of the payer.

The principle of timeliness in control and inspection activities is important to prevent undue increase of fines due to delays in conducting inspections. It is also important to observe the principle of legitimate expectations of taxpayers, who have the right to count on reasonable and predictable actions of tax authorities.

Implementing these principles will ensure not only the effectiveness, but also fairness of tax audits, increasing trust in the tax system and contributing to creating a stable and predictable business environment in Ukraine.

Idea #5

Considering judicial system realities

KOAC currently reviewing cases of payers of Kyiv Oblast and cases of the liquidated KCAC, had the lowest case review rate among all administrative courts in 2023⁵¹. As a result, even the European Commission, analyzing Ukraine's fulfillment of the requirements to start negotiations on joining the EU, noted that "citizens' access to justice in disputes involving central authorities after the liquidation of the KCAC is undermined, since a new court has not been created, and the temporary court is overloaded."⁵²

This situation affects all disputes considered by the KOAC in general, i.e, including disputes involving tax authorities of the city of Kyiv and Kyiv Oblast regarding additional tax charges based on tax audits findings.

A low rate of cases considered by the KOAC affects both the indicators of agreement and payment of monetary obligations based on inspections results, as well as indicators of confirmation and receipt by businesses of VAT budget refund amounts.

Although in 2023 KOAC was created to replace KCAC and registered as a legal entity as well as its temporary structure and staff were agreed⁵³, based on public information, as of March 2024, the selection of judges for it was not carried out⁵⁴.

From the Council's standpoint, definition of competence, selection of judges and launching Kyiv City District Administrative Court should be performed as soon as possible in view of the need to ensure real access to justice for businesses in the city of Kyiv and Kyiv Oblast and the prospects of completing court appeal procedures regarding tax audits. In addition, it is worth bearing in mind that every month of delay in launching a new court continues accumulating an already considerable backlog of pending court cases.

Meanwhile, for the "transitional" period, while the KOAC considers cases of city taxpayers, it would be advisable to increase the number of judges in it (e.g. to send additional judges there) or to distribute its caseload among other courts, at least in the part of the KCAC cases that have not yet been distributed for consideration by the KOAC.

⁵¹ Read more in [the Analysis of the state of administration of justice by administrative courts in 2023](#).

⁵² See more details in [the Report of the European Commission on Ukraine for 2023](#).

⁵³ See more details on [Ukraine Judiciary Portal](#).

⁵⁴ As the Council understands, it is related to the need to take into account the IMF's requirements for creating a new administrative court to consider cases against NABU, NAZK, and the National Bank and, accordingly, the need to separate competences of such a court from the planned competence of the Kyiv City District Administrative Court. Read more in the publication: ["IMF Creating a New Administrative Court to Hear Cases Against State Bodies Will Help Resolve Business Disputes"](#).

Until it is done, STS as the body whose cases make up the lion's share of disputes in the KOAC, it is expedient to take the lead in creating tools for alternative settlement of disputes with Kyiv city taxpayers.

In particular, it is advisable to start a discussion on the possibility to extrajudicially agree on tax audits findings for taxpayers of the city of Kyiv within the mediation procedure⁵⁵.

Idea #6

Individual proposals for improving tax audits approaches

The Council proposes to increase the amount of VAT declared before the budget refund and the VAT negative value, being the ground for appointing an unscheduled documentary inspection of a taxpayer⁵⁶. This indicator was set at UAH 100,000 at the time of adoption of the TCU in 2010 and was never revised, despite considerable inflationary and other macro-financial processes in the country. From the Council's viewpoint, it would be fair to establish the said indicator not in absolute, but in relative figures (e.g., as a ratio to a certain level of minimum wages). It will help reduce the number of low-risk tax audits and free up the tax office's resources to improve the quality of control and inspection activities results.

Also, with the aim of reducing the burden on the taxpayer, the Council proposes to legislate that in case of unblocking by regional or central level commissions of a separate TI/AC based on the VAT payer's explanations or complaints consideration results in the course of SMKOR operation, an economic transaction against this TI/AC cannot be questioned by the STS authorities. After all, "double" control by different STS units only multiplies work of all parties involved and undermines trust within the service.

For documentary unscheduled inspections, scheduled according to the procedure for control based on actions or inaction of officials of a lower-level control

⁵⁵ According to the first part of Article 3 of the Law of Ukraine "On Mediation" dated November 16, 2021 No. 1875-IX, the effect of this law extends, among other things, to social relations related to conducting mediation for the purpose of settling any conflicts (disputes) **including administrative ones**.

Q4 2023 was the deadline for the STS to develop a draft act on amendments to legislation on alternative (out-of-court) resolution of a tax dispute through mediation. In this regard, the STS commented that implementation of the tax mediation mechanism would cause an increase in the number of STS functions and its territorial bodies and, accordingly, in the STS employees, which, in turn, would affect the need to increase the number of employees of STS bodies as well as additional expenses from the budget, which is not expedient in the conditions of martial law. However, in the Council's view, introduction of this mechanism, on the contrary, would allow more efficient use of available resources.

⁵⁶ Sub-clause 78.1.8. of clause 78.1 of Article 78 of the TCU.

body⁵⁷, it is advisable to approve a separate form of the audit report, which would contain sections and information on the reasons for the appointment of such a tax audit and measures taken by a supervisory body to correct errors made during the preliminary audit.

It is also necessary to cease the practice when conducting an actual inspection, a tax

authority essentially conducts a documentary unscheduled inspection of the taxpayer. In its practice, the Council has frequently encountered situations when STS bodies during actual inspections recorded past periods violations that occurred long before the appointment and conduct of the actual inspection.

Idea #7

Assessing level of trust in STS bodies

In the opinion of the Council, the effective implementation of any mechanisms aimed at increasing business confidence in the STS bodies is possible only provided timely feedback is received. The Council notes that the need to conduct regular (at least once every two years) independent surveys of taxpayers, publicize their results and plans for response measures is reflected in the National Strategy.

However, from the Council's experience, it can be seen that often the same problems during inspections arise almost simultaneously among a significant number of payers and evoke many of the same types of complaints. As far as the Council understands, STS currently does not monitor such trends. Therefore, it is important that the state monitors them in a timely manner and responds promptly, since the cause of these problems often lies not on the side of business, but on the side of either deficiencies in regulatory framework or flaws in law enforcement. Prompt tracking is only possible if business is able to give feedback on the issues it is facing.

Therefore, from the Council's standpoint, it is advisable to introduce a permanent survey on the problems faced by business during inspections, and to define the procedure for processing the information obtained this way, as well as the way of providing feedback.

This survey should also be aimed at measuring business confidence in auditors, since this value is not constant and will be the first to respond to situations when "something goes wrong" and systemic intervention by a competent regulator is required.

Such a survey can be introduced as an additional functionality of the payer's e-office or through [the communication component of the "Made in Ukraine" platform](#).

At the same time, in longer periods – at least once a year – it is advisable to measure the level of taxpayers' trust in tax authorities with the help of authoritative international institutions. It will help to relatively objectively assess readiness of society for implementing tax reforms envisaged by the National Strategy.

⁵⁷ Subparagraph 78.1.12 of para 78.1 of Article 78 of the TCU.

Getting to the core of things



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