

# Tax inspections

Rebuilding tax trust by dropping  
the presumption of bad faith



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# 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 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 bad faith** where every taxpayer is treated as a potential, indeed probable, violator. Our common goal should be **transition to a presumption of "good faith"** – 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.*



# Look at the essence



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