

IN THE NAME OF THE RUSSIAN FEDERATION

CONSTITUTIONAL COURT
OF THE RUSSIAN FEDERATION

Judgment
of 17 March 2009 No. 5-II

in the case concerning the review of the constitutionality of the provisions of Paragraphs 4 and 5, Section 10, Article 89, of the Tax Code of the Russian Federation, in connection with a complaint of Varm LLC.

Saint Petersburg, 17 March 2009

The Constitutional Court of the Russian Federation composed of Presiding Judge L. M. Zharkova and Judges Yu. M. Danilov, V. D. Zorkin, S. M. Kazantsev, M. I. Kleandrov, N. V. Melnikov, N. V. Seleznev, V. G. Strekozov,

in the attendance of A. A. Motos, President of Varm LLC; Permanent Representative of the State Duma to the Constitutional Court of the Russian Federation A. N. Kharitonov; Representative of the Council of the Federation Ye. V. Vinogradova, PhD in Law; Plenipotentiary Representative of the President of the Russian Federation to the Constitutional Court of the Russian Federation M. V. Krotov,

pursuant to Section 4, Article 125 of the Constitution of the Russian Federation, Subsection 3, Section 1, Sections 3 and 4 of Article 3, Subsection 3, Section 2 of Article 22, Articles 36, 74, 86, 96, 97 and 99 of the Federal Constitutional Law “On the Constitutional Court of the Russian Federation”,

in an open hearing, examined the constitutionality of the provisions of Paragraphs 4 and 5, Section 10, Article 89, of the Tax Code of the Russian Federation.

The reason for the consideration of the case is a complaint of Varm LLC. The ground for the consideration of the case is the discovered uncertainty of whether the provision challenged by the applicant is in conformity with the Constitution of the Russian Federation.

Having heard the report of Judge-Rapporteur M. I. Kleandrov, interventions by O. A. Naumov, Judge of the Supreme Arbitration Court of the Russian Federation, for the Supreme Arbitration Court of the Russian Federation, T. A. Vasilyeva for the Office of the Prosecutor General of the Russian Federation, D. V. Kostennikov for the Ministry of Justice of the Russian Federation, N. V. Yelina for the Federal Tax Service; and having considered written submissions and other materials, the Constitutional Court of the Russian Federation,

e s t a b l i s h e d :

1. Article 89 of the Tax Code of the Russian Federation, entitled “Field Tax Audit”, providing, in Section 10, for legal regulation of a repeated field tax audit of the taxpayer, states that it may be exercised by a superior tax authority as a means of supervision over a tax authority that conducted the initial tax audit (Paragraphs 4 and 5).

Relying on the abovementioned legal provision, on 25 June 2007 the Omsk Regional Department of the Federal Tax Service initiated a field tax audit of Varm LLC as a means of supervision over Interdistrict Inspectorate No. 2 of the Federal Tax Service in the Omsk Region, which conducted the initial field tax audit in respect of the fiscal period from 1 January 2004 till 31 December 2005, and, as a result, held the taxpayer liable for the failure to pay certain taxes in full.

The decision of the tax authority to hold Varm LLC liable was partially overruled by the Arbitration Court of the Omsk Region on 23 November 2006, and this decision was upheld on appeal and cassation. This is why the applicant, who believed that the repeated field tax audit would actually result in reconsideration of a judicial act, brought another action to the Arbitration Court of the Omsk Region aimed at invalidating the decision on the repeated field tax audit.

On 26 September 2007, the Arbitration Court of the Omsk Region rejected the action of Varm LLC on the ground that the judicial act in force issued in relation to the results of the initial field tax audit cannot preclude a repeated tax audit from initiation. This decision was upheld by the arbitration courts on appeal and cassation. In its Decision of 18 June 2008, the Supreme Arbitration Court of the Russian Federation refused to grant certiorari to Varm LLC for the review of the case by the Presidium of the Supreme Arbitration Court of the Russian Federation on supervision.

The Omsk Regional Department of the Federal Tax Service, as a result of the repeated tax audit, decided to hold Varm LLC liable for the failure to pay the corporate tax and value added tax in full and imposed a penalty and interest. The Arbitration Court of the Omsk Region ruled in favor of the claim by Varm LLC to invalidate this decision (and this judgment was upheld on appeal and cassation). However the court did not consider the issue of whether the repeated field tax audit was lawful.

In the opinion of Varm LLC, the provision of Section 10, Article 89 of the Tax Code of the Russian Federation, as applied in its case and as interpreted in the law-enforcement practice, permits tax authorities to initiate a repeated field tax audit in presence of a judicial act reviewing the results of the initial tax audit, violates the right of property, guaranteed by the Constitution of the Russian Federation, its Articles 8 and 35.

Thus, pursuant to Articles 74, 96 and 97 of the Federal Constitutional Law “On the Constitutional Court of the Russian Federation”, the subject-matter for the Constitutional Court of the Russian Federation to be considered in the present case is the provision contained in Paragraphs 4 and 5, Section 10, Article 89 of the Tax Code of the Russian Federation, that provides for legal regulation of the right of a superior tax authority to initiate a repeated field tax audit as a means of supervision over the subordinate tax authority which conducted the initial audit of the taxpayer, specifically, with regard to cases when a judicial act reviewing the initial field tax audit results is present and has not been overruled as prescribed by procedural law.

2. According to Article 57 of the Constitution of the Russian Federation, everyone shall pay taxes and duties established by law. Pursuant to this constitutional prescription, the tax regulation scheme introduced by the lawmaker shall ensure that taxes are paid fully and in due time, and at the same time that the activity of the authorities and the officials engaged in their collection is lawful.

A system of tax control measures is an element of the legal mechanism that guarantees due performance of the constitutional duty to pay taxes; according to the Tax Code of the Russian Federation, tax control is defined as activities of authorized bodies carried out in order to control that the taxpayers, withholding agents and payers of duties comply with the legislation on taxes and duties as prescribed by the Code (Section 1, Article 82). Tax authorities, in their turn, form a single centralized supervisory system aimed at control of compliance with the legislation on taxes and duties, ensuring that they are calculated correctly and paid (transferred) to the budgetary system of the Russian Federation fully and in due time (Section 1, Article 30 of the Tax Code of the Russian Federation, Articles 1 and 2 of Law of the Russian Federation No. 943-I of 21 March 1991, “On the Tax Authorities of the Russian Federation”).

The centralized nature of the tax authorities system predetermines the supervisory powers of a superior tax authority over the subordinate tax authorities, which are aimed at ensuring compliance with the legislation on taxes and duties as prescribed by the constitutional principle of legality (Article 15 of the Constitution of the Russian Federation). One of the forms of such supervision is a field tax audit provided for by Paragraphs 4 and 5, Section 10, Article 89 of the Tax Code of the Russian Federation.

Taking into consideration the very nature of actions of tax authorities, which are directly related to tax control over taxpayers, the appraisal of a subordinate tax authority, which allows to determine whether decisions of the subordinate authority are efficient, lawful, and valid, to eliminate the defects in its work and to improve the mechanism of tax collection so the public function of taxation is fully performed, is basically impossible without a review of previous tax control activities taken in respect of a particular taxpayer, *inter alia* analysis of his tax and

accounting records and factual circumstances of his entrepreneurial and other economic activities. Accordingly, both the process of supervision over a tax authority within the scope of a repeated field tax audit (as the scope of possible activities, means, methods and procedures are the same as within a regular field tax audit), its results, and consequences inevitably influences a taxpayer affecting his rights and lawful interests.

Consequently, a repeated field tax audit exercised by a superior tax authority, Omsk Regional Department of the Federal Tax Service, as a supervisory measure over the tax authority that conducted the initial field tax audit, shall meet the criteria of necessity, reasonableness and legality so that it does not become an unlawful burden on the taxpayer. The Constitutional Court of the Russian Federation pointed out in its Judgment of 16 July 2004, No. 14-II, that the Tax Code of the Russian Federation is based on the presumption that no unlawful damage shall be caused by tax control measures (Articles 35 and 103). Tax control turns from a necessary instrument of tax policy into an instrument of suppression of economic autonomy and initiative, excessive restriction of the freedom of entrepreneurial activity and right of property if tax authorities, in contradiction to Articles 34 (section 1), 35 (sections 1–3) and 55 (section 3) of the Constitution of the Russian Federation, carry it out pursuing aims and motives which contradict the existing legal order. The abuse of power by the tax authorities and their officials or the use of these powers in contravention to the lawful purposes and legally protected rights and freedoms of individuals, organizations, the State and the society, is incompatible with the principle of a rule of law state where the exercise of the rights and freedoms of man and citizen shall not violate the rights and freedoms of others (Articles 1 (Section 1), 17 (Section 3) of the Constitution of the Russian Federation).

3. Within the meaning of Article 57 of the Constitution of the Russian Federation, the obligation to pay taxes and duties established by law is correlated with everyone's right not to be compelled to pay taxes and duties which do not meet the abovementioned criterion. These rights, as follows from the Article, together with Article 18 of the Constitution of the Russian Federation determines the essence, the content and the application of the tax legislation, the respective activities of the legislature and the executive, local self-government, and is ensured by administration of justice.

The Constitution of the Russian Federation guarantees judicial protection of everyone's rights and freedoms (Section 1, Article 46). The right to judicial protection is among the fundamental rights and freedoms of the individual, it is recognized and guaranteed in the Russian Federation according to the generally recognized principles and norms of international law and the Constitution of the Russian Federation, and shall not be restricted (Sections 1 and 2, Article 17, and Section 3, Article 56 of the Constitution of the Russian Federation). As the

Constitutional Court of the Russian Federation repeatedly stated, this right presumes the existence of specific legal guarantees which permit to fully exercise it and to ensure effective restoration of the rights through administration of justice, which meets the general legal requirements of fairness and equality (Judgments No. 9-II of 14 July 2005, No. 14-II of 26 December 2005, and No. 6-II of 25 March 2008).

The value of the right to judicial protection as the most important constitutional guarantee of all the other rights and freedoms, is predetermined by a special role of the judicial branch and its prerogative to administer justice, *inter alia* by seeing that the supremacy and direct effect of the Constitution of the Russian Federation are ensured (Articles 18, 118 (Section 2), 120 (Section 1), 125, 126, 127 and 128 (Section 3) of the Constitution of the Russian Federation). These prerogatives, set out in the Constitution of the Russian Federation, stemming from the principle of separation of powers into legislative, executive and judicial (Articles 10 and 11 (Section 1) of the Constitution of the Russian Federation) are coherent with the essence of judicial power, which is independent and impartial by nature. They also predetermine the significance of judicial decisions, which are delivered in the name of the Russian Federation and are binding, particularly in respect of reviewing legality of the tax authorities' acts, and actions or omissions of their officials (Judgment of the Constitutional Court of the Russian Federation No. 8-II of 4 April 2002).

4. According to Article 118 (Sections 1 and 2) of the Constitution of the Russian Federation, justice in the Russian Federation shall be administered only by courts by means of constitutional, civil, administrative and criminal proceedings. Within the meaning of this Article, together with Article 10 of the Constitution of the Russian Federation, a court has exclusive power to render a final decision in a dispute on points of law, including cases arising from tax relations. This, in its turn, means that it is impermissible to override a judicial decision by a jurisdictional act of an administrative authority.

Overriding of a judicial decision by a jurisdictional act of an administrative authority, which causes the parties to the dispute to experience consequences other than those determined by the judicial decision, results in violation of judicial guarantees of the rights and freedoms set out in the Constitution of the Russian Federation. Such procedure does not conform to the very nature of justice administered only by courts and is incompatible with the constitutional principles of autonomy of the judiciary and independence of courts, which are subordinated to the Constitution of the Russian Federation and the federal laws alone.

According to the legal opinion of the Constitutional Court of the Russian Federation, set forth in its Judgments No. 5-II of 11 May 2005 and No. 2-II of 5 February 2007, an exceptional, in its nature, possibility to override final judicial acts in force presupposes certain special

procedural conditions of reconsideration. These conditions shall, above all, meet the requirement of legal certainty ensured by recognition of court judgments' legal force and irrefutability. Even within court proceedings these presumptions can be put in question only if a judicial error, which cannot be remedied other than by a competent court, is proven beyond dispute by a new or newly discovered circumstance or a grave violation of law. All the more it is impermissible to renounce a court judgment through any non-judicial proceedings.

While providing for more detailed regulation of the provision concerning the legal force of the acts of judiciary, stemming from Articles 10 and 118 of the Constitution of the Russian Federation, the Arbitration Procedure Code of the Russian Federation establishes that judicial acts of arbitration courts, which came into force, shall be binding for the State and local self-government authorities, other authorities, organizations, officials and individuals and shall be executed within the whole territory of the Russian Federation (Section 1, Article 16). That is to mean that a judicial act rendered in a dispute between the tax authority acting on behalf of the State and a taxpayer shall not be neglected by any other tax authority, including the superior one, until it is overruled within court proceedings.

The legality and validity of judicial acts is reviewed solely under specially established procedures, i.e. through considering the case by courts of appellate, cassation, and supervisory instances. Any other non-judicial procedure of reconsideration of judicial acts is fundamentally impermissible as it would allow substituting a judicial act with an administrative act, in spite of reconsideration of judicial decisions and review of their lawfulness by a superior judicial authority only, which is immanent to the nature of justice and established by procedural law mechanisms. This is a clear deviation from the crucial guarantees of autonomy, completeness, and exclusiveness of the judicial power.

The abovementioned legal opinion, which follows from Judgment of the Constitutional Court of the Russian Federation No. 1-II of 25 January 2001, corresponds to the international standards in the field of administration of justice, which preclude reconsideration of judicial acts in non-judicial proceedings (Article 4 of the Basic Principles of the Independence of the Judiciary, adopted by the Seventh United Nations Congress on the Prevention of Crime and the Treatment of Offenders and endorsed by General Assembly Resolution of 13 December 1985); and is coherent with the opinion of the European Court of Human Rights, according to which the right to a fair trial (Article 6 of the Convention for the Protection of Human Rights and Fundamental Freedoms) presumes that the power to give a binding decision which may not be altered by a non-judicial authority is inherent in the very notion of a "tribunal" (Judgment of 19 April 1994 *Van de Hurk v. the Netherlands*).

5. As follows from the provisions of Paragraphs 4 and 5, Section 10, Article 89, a repeated field tax audit is conducted by a superior tax authority as a means of supervision over the tax authority that conducted the initial tax audit and, accordingly, pursues an aim to ensure the legality and validity of the decisions taken by it. However, both within the literal meaning of the abovementioned provision and if taken together with other provisions of the same Article and Section 2, Article 87 of the Tax Code of the Russian Federation, such audit is, too, a repeated field tax audit of the taxpayer's activities and compliance with legislation on taxes and duties:

- generally, a field tax audit is conducted at the taxpayer's location (on his premises); the subject-matter of the audit is the examination of whether the taxes are paid fully and in due time; the taxpayer may be requested to produce documentation necessary for the audit and expert examinations may be conducted (Sections 1, 4, 9 and 12 of Article 89);

- if a fact of a tax offence committed by a taxpayer but not discovered during the initial field tax audit is discovered as a result of a repeated field tax audit, the taxpayer shall not be subject to tax sanctions, except if the tax offence was not discovered during the initial field tax audit due to collusion between the taxpayer and an official of the tax authority (this provision, as set out in Paragraph 7, Section 10, Article 89, pursuant to Article 7 of Federal Law No. 137-Φ3 of 27 July 2006, shall be applicable to the legal relations arising from the repeated field tax audit if the decision to conduct the initial field tax audit was taken after 1 January 2007);

- if necessary and as prescribed by Article 92 of this Code, authorized officials of tax authorities, who conduct a field tax audit, may take inventory of the taxpayer's property, inspect production, storage, sale and other premises and locations used by the taxpayer to gain profit or related to the maintenance of taxable assets (Section 13, Article 89);

- if officials who conduct the field tax audit have reasonable grounds to believe that the documents revealing a committed offence can be destroyed, concealed, altered, or replaced, these documents shall be seized as prescribed by Article 94 of this Code (Section 13, Article 89).

Thus, conducting a repeated field tax audit as a means of supervision over a subordinate tax authority, the superior tax authority actually audits, anew and in full, the taxpayer's activities in respect of the fiscal period which has been already a subject-matter of a field tax audit. As a result, on the basis of repeated examination of the same documents and assessment of the same facts nothing excludes a possibility to reconsider specific conclusions made during the initial field tax audit and, consequently to adopt a jurisdictional act which determines anew the taxpayer's rights and obligations in respect of the same fiscal period; *inter alia* the tax arrears may be discovered and respective interest may be calculated.

The provision of Paragraphs 4 and 5, Section 10, Article 89 of the Tax Code of the Russian Federation, due to its place within the system of tax regulation norms, allows the

superior tax authority to conduct a repeated field tax audit as a means of supervision over the tax authority that conducted the initial tax audit, even when the dispute between the taxpayer and the tax authority was resolved by a court. This provision together with other provisions of the same Article, as is demonstrated by the enforcement practice and the applicant's case, actually allows the superior tax authority to adopt a decision concerning the taxpayer's rights and obligations established by a neither reconsidered nor annulled judicial act which resolved the dispute between the same taxpayer and the subordinate tax authority, and contradicting the facts established by the court earlier and the evidence in the case-file confirmed by this judicial act.

Such regulation violates the right to judicial protection guaranteed by Article 46 (Section 1) of the Constitution of the Russian Federation and does not accord to the prescriptions of its Articles 10, 118 (Sections 1 and 2) and 120, establishing the autonomy and independence of the judiciary, its exclusive function to administer justice, which, in its nature and designation, ensures effective implementation of this right.

Within the meaning of Article 57 of the Constitution of the Russian Federation together with the abovementioned constitutional prescriptions, in resolving a dispute between a taxpayer and a tax authority, including disputes over payable tax amounts, the criterion of "a tax established by law" as applied in specific cases predetermines not only a decision being made in accordance with a law by which a tax is established, but also a lawful procedure of decision-making. If a taxpayer is compelled to make tax payments on the basis of an administrative decision taken in spite of a judicial act in force, these payments cannot be considered satisfying this criterion. The taking of property in the form of taxes or any other payments conducted through undue procedure, also violates judicial guarantees for protection of the right of property set out in Articles 8 and 35 of the Constitution of the Russian Federation. As a result, a restriction of the abovementioned rights, disproportionate to the constitutionally significant purposes set out in Article 55 (Section 3) of the Constitution of the Russian Federation, takes place.

Concluding from the above and by virtue of Sections 1 and 2, Article 71, Articles 72, 75, 79, 87 and 100 of the Federal Constitutional Law "On the Constitutional Court of the Russian Federation", the Constitutional Court of the Russian Federation

h e l d :

1. To recognize the provision of Paragraphs 4 and 5, Section 10, Article 89 of the Tax Code of the Russian Federation, according to which a repeated field tax audit of a taxpayer may be exercised by a superior tax authority as a means of supervision over the tax authority that conducted the initial tax audit, as non-conforming to the Constitution of the Russian Federation,

its Articles 46 (Section 1), 57 and 118 (Sections 1 and 2), to the extent that this provision within the meaning attributed by the enforcement practice does not exclude a possibility that the superior tax authority, during a repeated field tax audit, adopts a decision affecting the taxpayer's rights and obligations previously established by neither a reconsidered nor annulled judicial act which resolved the dispute between the same taxpayer and the subordinate tax authority, and thereby contradicting the facts established by the court earlier and the evidence in the case-file confirmed by this judicial act.

2. The law-enforcement decisions in the case of Varm LLC based on the provision of Paragraphs 4 and 5, Section 10, Article 89 of the Tax Code of the Russian Federation, in any event shall be reconsidered by competent authorities according to the established procedure.

3. This Judgment shall be final and shall not be subject to any appeal, it shall come into force immediately upon pronouncement, shall be directly applicable and shall not require confirmation by other authorities and state officials.

4. Pursuant to Article 78 of the Federal Constitutional Law "On the Constitutional Court of the Russian Federation", this Judgment shall be published immediately in *Rossiyskaya Gazeta* and the Collection of Laws of the Russian Federation. The Judgment shall also be published in the Bulletin of the Constitutional Court of the Russian Federation.

Constitutional Court
of the Russian Federation

No. 5-II