



Taxpayers' right to correct mistakes in the tax period of their detection



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On July 28, 2021, the Federal Tax Service of the Russian Federation (FTS) published letter No. BV-4-7/10638 with a Review of the Legal Positions reflected in the Judicial acts of the Constitutional Court and the Supreme Court adopted in the second quarter of 2021 in respect of tax issues.

Paragraph 10 of the letter analyzes an important court decision (Supreme Court ruling of No. 306-ES20-20307 of 12.04.2021), which clarifies the legal position of the Supreme Court on the conditions for correction of mistake committed by a taxpayer in the previous tax period (period of an error) in the following tax period, when mistake is detected (period of detection).

The dispute between the taxpayer and the tax authority was as follows.

In 2018, the taxpayer deducted a non-operating expense consisting of namely, the write off of the amount of a bad (uncollectable) debt. Since according to

the data of the Unified State Register of Legal Entities (USRLE) the debtor was liquidated in 2016, the debt became uncollectible in 2016, and it would have been deductible in 2016.

However, the taxpayer corrected the error (i.e. deducted the expense) in the period of detection of this error, i.e. in the tax period 2018.

The Russian Tax Code provides for the following rules of correction of errors: (1) if an error is detected in the calculation of the tax base of the past tax (reporting) periods, the tax base and the tax amount are recalculated for the period in which the error was committed; (2) if it is impossible to determine the period of committing the error, the tax base and the amount of tax are recalculated for the tax (reporting) period in which error is detected.

Starting from 01.01.2009, the legislator introduced a third rule: (3) taxpayers are entitled to recalculate the tax base and the amount of tax for the tax (reporting) period in which the error is detected,



provided that “the errors made led to overpayment of tax”.

The third rule was ordinarily interpreted in the sense that mistakes favorable or neutral for the budget (treasury) can be corrected in the period of their detection (instead of adjusting the tax base of the past period, when it was committed).

However, in the case at stake the tax authority applied a very literal approach, noting that in 2016 the taxpayer declared a loss and paid no tax, therefore, the committed mistake did not lead to ‘overpayment of tax’. Since the period of the mistake was also known (2016), the authority claimed that the taxpayer was not entitled to correct the mistake, i.e. to deduct the bad debt, in 2018, but had to submit adjusted tax declaration for 2016 with the amount of that expense.

The taxpayer argued against this approach. He claimed that the updating the declaration for 2016 would lead to an increase of the loss for 2016. Since Russian tax legislation allows taxpayers to carry loss forward (with certain restrictions and limitations), the taxpayer would be entitled to use the loss of year 2016 to reduce the taxable profit for 2017 and 2018 and would be able to reduce taxable profits for 2017 and 2018. Therefore, the late declaration of the bad debt in period of detection did not lead to any unfavorable consequences for the treasury.

The court of first instance ruled in favor of the taxpayer, but the court of appeal and the court of cassation embraced the position of the tax authority.

The Supreme Court of the Russian Federation did not agree with the conclusions of the appeal and cassation instances and upheld the decision of the court of first instance.

The Supreme Court considered that taxpayers’ right to correct a mistake in period of its detection is not limited only to cases when a taxpayer receives a positive financial result (profit) in the period of committing of an error . According to the Supreme Court, “regardless of the financial result of the

taxpayer's activity (profit or loss) received during the period of the error, what is important is the impact of the error on the treasury in this and (or) subsequent periods - until the period in which the taxpayer declared the recalculation”.

The Court noted that the taxpayer in his particular situation had demonstrated based on figures that an increase on the loss for 2016 by the amount of detected expense does not lead to non-payment of tax for 2016, and taking into account the taxpayer’s right to carry forward the loss, this entailed an excessive payment of corporate profits tax in 2017. The tax authority did not refute this statement of the taxpayer and did not prove negative consequences for the treasury.

Therefore, the Supreme Court found in favor of the taxpayer.

Even though the case was lost by authorities, the Federal Tax Service managed to derive a rule from the Supreme Court’s ruling, i.e. the need to analyze and take into account the impact of an error not only during the period of making the error, but also in subsequent periods, until the period of its correct on.

It should be noted that according to the Russian Tax Code the corporate profits tax base for the period from 01.01.2017 until 31.12.2021 can be reduced by no more than 50% for losses of previous years. It is not difficult to construct situations where correcting an error in the period of its detection (instead of making corrections to the declaration in the period of making the error) can lead to an underestimation of taxable profit and non-payment of the tax.

For example: in 2016, the taxpayer realized a loss (100 mio rub). By mistake he does not deduct some expense (800 mio rub). In year 2017, the taxpayer makes a profit of 1,000 mio rub and detects the error committed in 2016. In such a situation, the correction of the error in the period of detection (2017), results in a decrease of the taxable profit of 2017 to 200 mio rub (1,000-800). Whereas the correction of the error in the period when it is committed (2016), means an increase in the loss for 2016 to

900 mio rub (100+800). Then the corporate taxable profits of 2017 can be reduced by the losses carried forward by no more than 50%. Therefore, the taxable profits for 2017 (1,000 mio rub) is allowed to be reduced to 500 mio rub by part of loss of 2016 (500 mio rub). The unused part of the loss of 2016 (400 mio rub) can be used in the following years. As a result, the corporate tax base for 2017 is understated by 300 mio rub (500-200).

It appears that in such situations, the tax authorities should be able to prove that

the correction of the error in the period of detection results in an underestimation of the taxable profit and underpayment of the tax (in comparison with the amounts of tax that would have been paid, if the error was corrected in the period when it is committed). Therefore, the outcome of a court dispute in such a situation would not as favorable to taxpayers as in the Ruling of the Supreme Court.

Taxpayers should exercise caution and take into account the legal position of the Supreme Court when correcting errors made in the period of their detection.



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