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TITLE

Tax Evasion as a Criminal Offence in the Republic of Armenia (RA) Whether article 205 under the RA Criminal Code shall be amended or decriminalized

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Abstract

The Organisation for Economic Cooperation and Development recommends that jurisdictions have a specific legal framework, which will criminalize and view tax evasion as a criminal offence. This, as noted by the organization, will ensure effective control and sanctions as a major operating deterrent. Currently, the Armenian Criminal Code contains a provision, namely article 205, which specifically regulates and provides criminal penalties for tax evasion. However, the recent changes and amendments to the provision have become a target of debates and contradicting opinions. This comes to prove that the initiation of those amendments still needs some clarifications and thorough study as to the shortcomings and application of the provision in practice. Hence, the present research paper advances to analyze the major drawbacks of the article through comparison with international practice and case law, as well as to make relevant recommendations in accordance with the results gained through the comparative survey.

Keywords: tax evasion, tax crime, criminal offence, mental state in crime/mens rea, principle of proportionality, subjectivity in crime, criminal penalty/punishment, penal/criminal code, perpetrator, financial year, tax obligations, regulation, article, provision.

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LIST OF ABBREVIATIONS

AMD	Armenian dram
BEPS	base erosion and profit shifting
EU	European Union
OECD	Organisation for Economic Cooperation and Development
RA	Republic of Armenia
UK	United Kingdom
US	United States
U.S.C.	United States Code
VAT	value-added tax

INTRODUCTION

While some taxpayers choose to fulfill their tax obligations properly, others are determined not to. Tax evasion, in this sense, can amount to billions per year and become a substantial issue for a state. However, it is not only against the law and a significant damage to state revenue, but it also puts compliant taxpayers in an unequal and inappropriate condition.

Over the past few decades the Armenian economy has undergone a rapid transformation, and in line with establishment of new private institutions, the country has started facing major challenges of weak tax administration, which actually hinder its economic development.[1] Thus, weak tax administration brings forth challenges to the effective control and regulation of tax evasion in the country. In this view, the RA Government approved the initiation of article 205 within the Criminal Code specifying tax evasion as a criminal offence. More specifically, it criminalized *malicious* tax evasion and established liability either in form of fines or imprisonment. It was further emphasized by the Armenian government that the adoption of the provision would result in a positive change within the state budget revenues, and it was noted that the decriminalization of the article would bring forward disruption of tax discipline and increase of tax crimes, which, in their turn, would have a negative impact on state revenues.[2]

The above-mentioned provision, however, became subject to certain changes and amendments, which eliminated maliciousness as the mental state of the person committing the crime, and raised the threshold exceeding of which would result in criminal liability. This was a positive change as it eliminated difficulties as to proving the maliciousness of the perpetrator in tax evasion and raised the threshold from 2 million AMD to 4 million AMD, which is not a small amount of money and may in a way have a positive influence on small and medium-sized entities or businesses, which have smaller revenues than that specified within the provision. However, even after these amendments, the article itself raised other issues that still seem to be significant challenges. Firstly, it poses the question of whether the absence of the mental state of the perpetrator is in accordance with international standards

[1] Hamid R. Davoodi & David A. Grigorian, *Tax Potential vs. Tax Effort: A Cross-Country Analysis of Armenia's Stubbornly Low Tax Collection,* International Monetary Fund, WP/07/106. at 3 (2007). *available at:* https://www.imf.org/external/pubs/ft/wp/2007/wp07106.pdf

[2] Draft Laws "On Making Amendments to the RA Criminal Code" and "On Making Amendments to the RA Code on Administrative Offences" (Պ-647-22.10.2014-ՊԻ-010/0 and Պ-6471-22.10.2014-ՊԻ-010/0), Conclusion of the RA Government. 12, a*vailable at:* http://www.gov.am/files/docs/1465.pdf

and practice, or whether the elimination of the criminal subjectivity factor will result in a fairer and non-arbitrary sanction for the criminal. Secondly, the article also casts doubts as to the proportionality of the punishment envisaged by the provision. Last but not least, it is not clear, invasion of which types of taxes and for what period of time can amount to a criminal offence. Thus, these non-exhaustive problems bring forth the necessity of decriminalizing or amending the article- major reason, which has served as an essential ground for our decision to research the issues that the provision raises.

In order to answer the above-mentioned questions, the international practice concerning tax evasion regulations and sanctions has been studied. Making comparative legal analysis between the different legislations and the Armenian law has been chosen as a method of studying the aforementioned legal regulations.

As the research questions are mainly concentrated on local laws and regulations, there has been a certain limitation and relative lack of literature regarding the topic. However, the relevant laws and regulations of jurisdictions, other than Armenia, as well as works of international experts and scholars have helped us to thoroughly analyze the major shortcomings of article 205 of the RA Criminal Code.

Thus, the literature, which was used in the present paper mostly consists of legal acts and laws of countries such as Germany, Italy, the UK, the US, Denmark, Sweden, Ukraine, Russia, etc. More specifically, the relevant tax evasion provisions of the criminal/penal codes or fiscal codes of these countries have been initiated to analyze their approach to tax crimes or fraud. In addition, all the provisions concerning the regulation of tax evasion, including the Armenian practice, have been analyzed in line with the ten global principles of the OECD, which are a comprehensive guide for governments as to cultivating administrative, legal and strategic tools to fight against tax crimes. Furthermore, certain scholarly journals and articles have been considered to reveal expert opinion on tax evasion in general and its regulation as a criminal offence in individual states, as well as the principle of proportionality in tax crimes and the theory of subjectivity in crime (e.g. Verena Zoppei-"Tax Evasion as a Predicate Offence for Money Laundering" (2012), Mark C. Winings- "Ignorance is Bliss, Especially for the Tax Evader" (1993), Juan Canciardo- "The Principle of Proportionality: the Challenge of Human Rights" (2010), Youngjae Lee- "Why proportionality Matters" (2012), Francis Bowes sayre- "Mens Rea" (1932), etc.).

In order to comprehensively and completely answer the main research questions, the present research paper has been divided into three chapters.

Chapter 1 presents an analysis of tax evasion as a criminal offence based on the international practice. In this view, the relevant provisions of separate countries' criminal or fiscal codes have been analyzed to show the general tendency in regard to the theory of subjectivity in tax crimes, principle of proportionality in criminal penalties for tax evasion, as well as other question that will help to reveal the main drawbacks of article 205 of the Armenian Criminal Code.

Chapter 2 introduces the practice and application of the theory of subjectivity in crime based on laws and regulations of certain countries, which have deeply incorporated this principle, as well as several cases to illustrate the practical implementation of the subjectivity theory both on international and local level.

Chapter 3 elaborates on the establishment of the principle of proportionality within the laws and legal acts of different jurisdictions, as well as the application of the principle in line with the OECD ten global principles for fighting against tax crimes. It also analyzes arguments for and against the importance of considering the proportionality principle in assessing the gravity and severity of criminal penalties.

Chapter 4 examines the major shortcomings of article 205 of the Armenian Criminal Code on the basis of the international practice, including the OECD principles, as well as various opinions of experts in the field, illustrated through Chapters 1, 2 and 3.

In **Conclusion** we have included the results gained in the course of our survey, as well as recommendations as to the amendment of article 205 of the Armenian Criminal Code.

The **Bibliography** contains the materials we have made use of in doing our research.

CHAPTER 1

Criminal Offence for Tax Evasion: International Practice

In all states, citizens are required to pay taxes. This is natural, since taxes form the bulk of the state budget. In many countries, direct taxes paid by individuals and legal entities, comprise more than half of government revenues. It is also natural that citizens are reluctant to pay taxes, considering that the state does not always operate effectively. However, it is a fact that each state at least tries to utilize the received financial means for the implementation of its socio-economic programs.

There are other reasons why citizens do not like to pay taxes, but they do so, realizing and accepting their need for the normal functioning of the state and the life of civil society. The state, in turn, understands that it is impossible to achieve payment of taxes only by strong and well-established enforcement mechanisms, therefore, it establishes various penalties for non-fulfillment or violations in the performance of a tax duty. In this view, there are two main types of liabilities for tax offenses implemented by different countries: administrative and criminal. However, in each state, the solution of the issue of responsibility has its own peculiarities, determined by legislation and doctrine of that specific state.

In 2015, the Organization for Economic Co-operation and Development (OECD) presented during one of its strategic summits a ready-made draft of international rules against tax evasion developed within the framework of the "base erosion and profit shifting" plan (BEPS)[3], where it noted that "tax policy is at the core of countries' sovereignty, and each country has the right to design its tax system in the way it considers most appropriate."[4] Although countries are endowed with this independence, international cooperation has resulted in establishment of common standards and principles, which have to be complied with. The same refers to the principles of liability mechanisms enshrined in different countries' legislations.

In this view, the ten global principles for fighting tax crimes set by the OECD, give specific recommendations on how to build more effective mechanisms for eliminating tax

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[3] OECD and G20, *G20 finance ministers endorse reforms to the international tax system for curbing avoidance by multinational enterprises, available at:*

https://www.oecd.org/g20/topics/taxation/g20-finance-ministers-endorse-reforms-to-the-international-tax-system-for-curbing-avoidance-by-multinational-enterprises.htm (Last visited May 10, 2018)

[4] OECD, *Action Plan on Base Erosion and Profit Shifting,* OECD Publishing (2013). 15, *available at:* https://www.oecd.org/ctp/BEPSActionPlan.pdf (Last visited May 10, 2018)

evasion and setting a more beneficial and effective liability system. Thus, in accordance with the OECD recommendations, one of the main principles refers to the criminalization of some of the tax offences. More specifically, the organization stresses the fact, that whatever approach the state has chosen for within the framework of its legislation, it would be most effective if some forms of tax offences were criminalized. However, there are also several limitations that shall be followed. For example, "the legal provisions should state the elements that constitute the crime. This includes articulating the specific conduct or activity that constitutes the criminal act, as well as the required mental state of the person in committing the activity (such as intention, recklessness or gross negligence)."[5]

In view of the above-mentioned OECD principles, the present chapter is intended to show the mechanisms for fight against tax evasion based on regulations and best practices being actively pursued by governments, such as Germany, Italy, the UK, Denmark, Sweden and the US- OECD countries, which have been enlisted among 2015 International Tax Competitiveness Index rankings[6], as well as Ukraine, which has intensified its cooperation with OECD[7] and the Russian Federation, the accession of which as a full member of OECD was approved by the OECD Council in 2007.[8]

Thus, coming to the analysis of the above-listed states individually, **Germany**, for example, has set criminal liability for tax evasion, which is provided for in section 370 of the Tax Regulations (Abgabenordnung). More specifically, in accordance with the clauses 1 and 3 of the above-mentioned section, *(1) A penalty of up to five years' imprisonment or a monetary fine shall be imposed on any person who 1. furnishes the revenue authorities or other authorities with incorrect or incomplete particulars concerning matters of substantial significance for taxation, 2. fails to inform the revenue authorities of facts of substantial significance for taxation when obliged to do so, or 3. fails to use revenue stamps or revenue stamping machines when obliged to do so and as a result understates taxes or derives unwarranted tax advantages for himself or for another person.*

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[5] OECD, *Fighting Tax Crime: The Ten Global Principles*, OECD Publishing, Paris (2017). 16, *available at:* http://www.oecd.org/tax/crime/fighting-tax-crime-the-ten-global-principles.pdf (Last visited May 10, 2018)
[6] Mateo Jarrin, *The Best Tax System (and the Worst) Among OECD Countries*, (2015), *available at:* https://taxlinked.net/blog/october-2015/best-tax-system-among-oecd-countries (Last visited May 10, 2018)

[7] OECD, *Ukraine and the OECD, available at:* http://www.oecd.org/countries/ukraine/ukraine-and-the-oecd.htm (Last visited May 10, 2018)
"The OECD has worked with Ukraine for a quarter-century, supporting the country's efforts to transform its economy and integrate more deeply into international markets and institutions. The OECD's co-operation with Ukraine has been greatly intensified since 2014, under a Memorandum of Understanding between the OECD and the Government of Ukraine signed in the wake of the "Euromaidan Revolution".
[8] OECD, *The Russian Federation and the OECD, available at:* http://www.oecd.org/russia/therussianfederationandtheoecd.htm (Last visited May 10, 2018)

(3) In particularly serious cases, a penalty of between six months and ten years' imprisonment shall be imposed. A case shall generally be deemed to be particularly serious where the perpetrator 1. deliberately understates taxes on a large scale or derives unwarranted tax advantages, 4. repeatedly understates taxes or derives unwarranted tax advantages by using falsified or forged documents, or 5. as a member of a group formed for the purpose of repeatedly committing acts pursuant to subsection (1) above, understates value-added taxes or excise duties or derives unwarranted VAT or excise duty advantages[9].

Moreover, *"(1) whoever as a taxpayer or a person looking after the affairs of a taxpayer recklessly commits one of the acts described in section 370(1) shall be deemed to have committed an administrative offence. (2) The administrative offence may be punished with a monetary fine of up to 50,000 euros."*[10]

Thus, pursuant to the German Fiscal Code, criminal liability is applicable if a person communicates to the tax authorities or any other state authorities incorrect data that are of important significance for taxation, more specifically, if the taxpayer, in violation of the obligations provided by law, does not provide information in a timely manner, as a result of which an individual or another person illegally enjoys tax benefits. For these actions (inaction) there is a liability in the form of imprisonment up to five years or a fine.

In addition, Part 3 of paragraph 370 of the German Fiscal Code provides for liability for more serious acts. It is noteworthy here that the clause applies the terms "deliberately" and "repeatedly", which comprise the main elements of more serious tax crimes, the former term to be used for mentioning the mental state of the person, as set by the OECD principles. Furthermore, the fifth part of the paragraph sets forth the specific types of taxes (such as VAT, excise tax, etc.), the understatement of which may result in a criminal offence. As to the mental state of the person committing the crime, part one of the section 378 clearly states that the reckless action of tax evasion in any form mentioned in the first part of section 370 constitutes an administrative offence with a certain monetary fine, as opposed to article 205

[9] The Fiscal Code of Germany (2002, amend. 3 December 2015), §370, *available at:* https://www.gesetze-im-internet.de/englisch_ao/englisch_ao.html#p2196
[10] Ibid. §378

of the Criminal Code of the Republic of Armenia[11], which does not contain any specification as to the mental state of the person or types of the taxes.

With a similar approach, the **Italian Penal Code** envisages a criminal offence for tax evasion or money laundering within the frames of article 648bis, which reads as follows: *"outside the cases of competition in the crime, anyone who substitutes or transfers money, goods or other benefits deriving from non-negligent crime, or performs in relation to them other operations, in order to hinder the identification of their criminal origin, is punished with imprisonment from four to twelve years and with a fine from € 5,000 to € 25,000. The penalty is increased when the act is committed in the exercise of a professional activity.*
The penalty is diminished if the money, goods or other benefits come from a crime for which the penalty of imprisonment is lower than a maximum of five years."[12] Hence, as set by the above-mentioned article, the Italian legislation has envisaged an imprisonment for a certain period of time and a fine, which seems to be more stringent, as compared to the regulation of tax evasion established by the RA Criminal Code. However, the Italian Penal Code, within the frames of article 648bis, has outlined *non-negligence*, as a key feature of a criminal offence in money laundering[13] cases. More specifically, it refers to the notion of *mens rea***,** i.e. the criminal intent or evil mind[14], which practically covers "knowledge of unlawfulness which, in this case, means knowledge of the criminal origin of the assets, as well as the willful impeding of the identification of the criminal provenance of the assets."[15]

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[11] The RA Criminal Code (2003), art.205, *available at:* arlis.am
Article 205 of the Code specifies that: "In regard to avoiding paying taxes, duties or other mandatory obligations in large amounts,
1) imposing an obviously false statement in the statutory report, computation, declaration or other mandatory taxation document, which is the basis for taxation, duty, compulsory payment or other obligation;

2) non-submission of a mandatory other document, which is an obligation to calculate or pay tax, duty, other mandatory payment, as prescribed by law, for calculation, declaration or taxation, is punished with a fine in the amount of up to 200 thousand times the minimum salary or with imprisonment for the term of 2 to 5 years.
2. The same act committed in a particularly large amount, is punished with imprisonment for the term of 5 to 10 years with confiscation of property.
3. In the meaning of this Article a large amount is considered to be an amount not exceeding 15,000 times the minimum salary at the time of the offense, and the particularly large amount- exceeding 15,000 times the minimum monthly salary.
[12] Penal Code of Italy, Book II, Title XIII, "Of Crimes against Property", art. 648-bis, *available at:* http://www.altalex.com/documents/news/2014/10/22/dei-delitti-contro-il-patrimonio
[13] In this case, particularly in the Italian legislation, "money laundering" and "tax evasion" are used interchangeably, as the consequence of both types of conduct are the deterioration of economic base of the state and distortion of allocation of resources.
[14] Editors of Encyclopedia Britannica, *Mens Rea,* (2018), *available at:* https://www.britannica.com/topic/mens-rea (Last visited May 10, 2018)
[15]Verena Zoppei, *Tax evasion as a predicate offence for money laundering*, (University of the Western Cape, Faculty of Law, Research paper, 2012). 50, *available at:* https://etd.uwc.ac.za/bitstream/handle/11394/4448/Zoppei_LLM_2012.pdf?sequence=1&isAllowed=y

The UK, on the other hand, takes a less stringent approach in establishing a criminal offence for corporations in case of tax evasion. Firstly, as opposed to the Italian legislation, the UK Criminal Finances Act (2017) clearly defines "tax evasion" and "tax evasion facilitation" offences. Specifically, article 45 (4, 5) of the UK Criminal Finances Act defines:
(4) "UK tax evasion offence" means— (a) an offence of cheating the public revenue, or (b) an offence under the law of any part of the United Kingdom consisting of being knowingly concerned in, or in taking steps with a view to, the fraudulent evasion of a tax.
(5) "UK tax evasion facilitation offence" means an offence under the law of any part of the United Kingdom consisting of— (a) being knowingly concerned in, or in taking steps with a view to, the fraudulent evasion of a tax by another person, (b) aiding, abetting, counselling or procuring the commission of a UK tax evasion offence, or (c) being involved art and part in the commission of an offence consisting of being knowingly concerned in, or in taking steps with a view to, the fraudulent evasion of a tax[16].

Given the above-mentioned relevant definitions, the criminal offence in the UK for tax evasion also underlines the importance of establishing the mental state of the perpetrator "knowingly concerned in the fraudulent evasion of a tax". However, this provision does not extend to imprisonment of the person responsible for tax evasion, as it is envisaged by the German Fiscal Code, Italian, and Armenian Criminal Codes. Rather, point 8 of article 45 of the UK Criminal Finances Act[17] establishes a fine as a liability in both tax evasion and tax evasion facilitation cases.

In **Denmark**, as well, non-compliance with taxation requirements raises either administrative or criminal liability. Thus, in accordance with chapter 28 of the Danish Criminal Code, a criminal penalty supposes either imprisonment or a fine. In regards to tax evasion in form of providing false and misleading information, § 296 of the Criminal Code sets the following regulation: *"(1) Any person who 2) gives false or misleading information concerning legal persons' state of affairs a) in public announcements concerning financial conditions, b) in accounts required by law, c) in reports, accounts or declarations to a general meeting or similar group or the legal person's management, d) in notifications to a registration authority, or e) in offers concerning the legal person's foundation or capital increase as well as concerning sale of shares or issuance or sale of convertibles bonds; shall*

[16] UK Criminal Finances Act (2017), article 45 (4,5), *available at:* http://www.legislation.gov.uk/ukpga/2017/22/pdfs/ukpga_20170022_en.pdf
[17] Ibid. article 45 (8), (8) A relevant body guilty of an offence under this section is liable— (a) on conviction on indictment, to a fine; (b) on summary conviction in England and Wales, to a fine; (c) on summary conviction in Scotland or Northern Ireland, to a fine not exceeding the statutory maximum.

be liable to a fine or to imprisonment for any term not exceeding one year and six months. Furthermore, *(2) If any of the acts or omissions referred to in Subsection (1) above has been committed through gross negligence, the punishment shall be a fine or, in aggravating circumstances, imprisonment for any term not exceeding four months."*[18]

Hence, taking into account the above-mentioned regulation provided for in the Danish Criminal Code, tax evasion or provision of false and misleading information on the legal person's financial condition and accounts is itself a criminal offence in Denmark. However, it is noteworthy that the criminal offence in case of tax evasion is either a fine or imprisonment for the term not exceeding one year and six months, which is not as severe and tough as the punishment provided by article 205 of the Armenian Criminal Code (i.e. large amount- a fine in the amount of up to 200 thousand times the minimum salary or with imprisonment for the term of 2 to 5 years, particularly large amount- imprisonment for the term of 5 to 10 years with confiscation of property).

Furthermore, the major prerequisites of criminal offence for tax evasion under the Danish Criminal Code are *intention* and *gross negligence*, which constitute a crime respectively (e.g. gross negligence in case of tax evasion- imprisonment for the term not exceeding four months). Thus, the Danish legislation also takes into account the mental state of the person committing the crime with a view that "a breach of an obligation is intentional when a taxpayer is aware that their acts contravene a concrete provision; it is their intention to contravene the provision. There is negligence when a taxpayer fails to have sufficient regard for what is required in the circumstances."[19]

The Swedish Penal Code also stresses *intention* and *careless neglect* of the obligation to properly carry out and disclose necessary accounting and bookkeeping information. More specifically, section 5 of Chapter 11 of the Swedish Penal Code clearly states that, *"a person who intentionally or through carelessness neglects the obligation to maintain accounts in accordance with the Bookkeeping Act (1976:125), The Act on Foundations (Law 1994:1220) or the Pension Obligations Protection Act (1967:531) by failing to enter business transactions into the accounts or to preserve accounting material, or by entering false information into the accounts or in some other way, shall, if in consequence the course of the business or its financial results or status cannot in the main be assessed from the accounts, be sentenced for bookkeeping crime to imprisonment for at most two*

[18] Criminal Code of Denmark (Sep. 27, 2005, amend. Dec. 21, 2005), § 296, *available at:* http://www.legislationline.org/documents/section/criminal-codes

[19] Professor Jane Bolander & Professor wsr Inge Langhave Jeppesen, *Surcharges and Penalties in Tax Law*. 6, *available at:* http://www.eatlp.org/uploads/public/2015/National%20report%20Denmark.pdf

years, or, if the crime is petty, to a fine. If the crime is gross imprisonment for not less than six months and not more than four years shall be imposed."[20]

In the **United States of America** as well "criminal penalties encourage proper reporting, but go further by punishing through fines and incarceration. As with the charge of any crime in the United States, the element of *mens rea (i.e., intent)* must be established by the government beyond a reasonable doubt to impose a criminal tax penalty."[21] In this view, §7201 (Attempt to evade or defeat tax) of Chapter 75 of the U.S. Code sets the following rule: *"any person who willfully attempts in any manner to evade or defeat any tax imposed by this title or the payment thereof shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be fined not more than $100,000 ($500,000 in the case of a corporation), or imprisoned not more than 5 years, or both, together with the costs of prosecution."*[22] Later, sections 7203, 7206 and 7207 of Chapter 75 of the U.S. Code specify respectively *"not more than $25,000 ($100,000 in the case of a corporation) fine, or imprisonment for not more than 1 year for willfully failing to pay such estimated tax or tax, make such return, keep such records, or supply such information, at the time or times required by law or regulations"*[23], *"not more than $100,000 ($500,000 in the case of a corporation) fine, or imprisonment for not more than 3 years for concealment, provision of false and misleading statements"*[24], *" not more than $10,000 ($50,000 in the case of a corporation) fine, or imprisonment for not more than 1 year for willfully delivering or disclosing to the Secretary any list, return, account, statement, or other document, known by him (the taxpayer) to be fraudulent or to be false as to any material matter".*[25]

Thus, as provided by the above-mentioned provision, the American law clearly emphasizes the will and intent of the person committing a tax crime or fraud, and imposes a

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[20] The Penal Code of Sweden (1962, amend. 1999), section 5, *available at:* http://www.legislationline.org/documents/section/criminal-codes

[21] Simon Whitehead, *The Tax Disputes and Litigation Review* n.405 (3d. ed. 2015), *available at:* https://media2.mofo.com/documents/1502taxdisputeslitigationreview.pdf

[22] 26 U.S. Code, § 7201 - Attempt to evade or defeat tax, *available at:* https://www.law.cornell.edu/uscode/text/26/7201

[23] 26 U.S. Code § 7203 - Willful failure to file return, supply information, or pay tax, *available at:* https://www.law.cornell.edu/uscode/text/26/7203

[24] 26 U.S. Code § 7206 - Fraud and false statements, *available at:* https://www.law.cornell.edu/uscode/text/26/7206

[25] 26 U.S. Code § 7207 - Fraudulent returns, statements, or other documents, *available at:* https://www.law.cornell.edu/uscode/text/26/7207

less period of time for imprisonment for tax evasion cases as compared to the term provided by article 205 of the Armenian Criminal Code.

Almost similar terms are provided by the **Ukrainian Criminal Code**, article 222 (financial fraud), which specifies that, *"1. filing knowingly false information by a private entrepreneur or a founder, owner or official of a business entity to government agencies, authorities of the Autonomous Republic of Crimea or local government authorities, banks or other creditors in order to obtain subsidies, subventions, grants, loans or tax credits, where no elements of criminal offense against property are involved, shall be punishable by a fine of 500 to 1000 tax-free minimum incomes, or restraint of liberty for a term up to three years, with the deprivation of the right to occupy certain positions or engage in certain activities for a term up to three years. 2. The same actions, if repeated, or where they caused significant pecuniary damage, shall be punishable by imprisonment for a term of two to five years with the deprivation of the right to occupy certain positions or engage in certain activities for a term up to three years."*[26]

Based on the above-mentioned provision, the Ukrainian Criminal Code likewise establishes less period of time in regard to imprisonment for tax evasion and emphasizes the consciousness and awareness of the tax evader. Moreover, the provision also specifies the persons who can be held liable for financial fraud, e.g. the founder or owner of the legal entity. It is an essential regulation from the perspective of legal certainty and the OECD ten global principles, which states that: "the law may hold the legal person or arrangement criminally liable for the crime, and also impose punishment on key actors such as directors, officers, agents or key employees of the legal person / arrangement criminally liable."[27]

The regulation of tax evasion in **the Russian Federation** is similar to that of the Republic of Armenia. More specifically, article 198 of the Criminal Code of Russia reads as follows: *"1. The evasion by a natural person of paying taxes and (or) fees by way of his failure to submit a tax declaration or other documents whose submission is obligatory under the laws of the Russian Federation on taxes and fees or by showing in the tax declaration or such documents data known to be false made on a large scale, shall be punishable with a fine in an amount of from 100 thousand to 300 thousand rubles or in the amount of the wage or salary, or other income of the convicted person for a period from one to two years, or with compulsory labour for a term of up to one year, or by arrest for a period of up to six months,*

[26] The Criminal Code of Ukraine (2001, last amend. 2010), article 222, *available at:* http://www.legislationline.org/documents/action/popup/id/16257/preview
[27] See footnote 5

or by deprivation of liberty for a term of up to one year. 2. The same deed committed on an especially large scale, shall be punishable with a fine in the amount of 200 thousand to 500 thousand rubles or in the amount of a wage/salary or other income of the convicted person for a period of eighteen months to three years, or with compulsory labour for a term of up to three years, or with deprivation of liberty for the same term.

Notes. 1. A large amount in this Article means an amount of taxes and (or) fees totalling within the period of three consecutive financial years over 600,000 rubles, provided that the share of unpaid taxes and (or) fees exceeds 10 per cent of the payable amount of taxes and (or) fees, or exceeding one million eight hundred thousand rubles, while an especially large amount means an amount totaling, within a period of three consecutive financial years, over three million rubles, provided that the share of unpaid taxes and (or) fees exceeds 20 per cent of the payable amount of taxes and (or) fees, or exceeding nine million rubles.

2. The person who has committed for the first time the crime provided for by this Article shall be discharged from criminal liability if he/she has paid in full the amount of arrears and appropriate penalties, as well as the sum of the fine at the rate fixed in compliance with the Tax Code of the Russian Federation".[28]

Hence, it is obvious from the above-mentioned provision that, in consonance with the regulation of the same offence in the Armenian law, tax evasion as a criminal offence in Russia, as prescribed by the latter's Criminal Code, does not hold any specification on the mental state of the tax criminal. However, it shall be noted that article 110 of the Tax Code of the Russian Federation[29] clearly states the forms of guilt in the event of commission of a tax offense, such as negligence or intention, which are respectively defined within the provision[30]. Furthermore, article 205 of the RA Criminal Code does not indicate whether the threshold for the amounts generated as a result of tax evasion or fraud should be extended over several reporting periods, while article 198 of the Russian Criminal Code expressly

[28] The Criminal Code of the Russian Federation (1996, last amend. 2012), art.198
available at: http://www.wipo.int/edocs/lexdocs/laws/en/ru/ru080en.pdf

[29] The Tax Code of the Russian Federation (1998, amend. 2018), art.110,
*Available at:*http://www.consultant.ru/document/cons_doc_LAW_19671/383b0373584c7d8ed335ddb4af0bf0b517069f9c/

[30] 1. A person who committed a wrongful act intentionally or through negligence is deemed guilty of committing a tax offense.
2. A tax offense shall be recognized as committed intentionally if the person who committed it was aware of the unlawful nature of its actions (inaction), wished for or knowingly allowed the onset of harmful consequences of such actions (inaction).
3. A tax offense is recognized as committed by negligence, if the person who committed it did not realize the unlawful nature of its actions (inaction) or the harmful nature of the consequences arising from these actions (inaction), although it should and could be aware of it.
4. The fault of the organization in the commission of a tax offense is determined depending on the fault of its officials or its representatives, actions (inaction) which led to the commission of this tax offense.

states that, "a large amount means an amount of taxes totaling over 600,000 rubles…*within the period of three consecutive financial years*…".

Thus, based on the analysis of the approach adopted by Germany, Italy, the UK, Denmark, Sweden, the US, Ukraine and Russia, it may be clearly stressed that all of them, except for the UK, apply criminal offence for tax evasion, which supposes application of more severe means of state control. However, it is also noteworthy that based on these countries' practice and experience, several common grounds may be revealed. Particularly, Germany, Italy, the UK, Denmark, the US, Sweden and Ukraine apply the doctrine of *mens rea* as a key element of a tax crime. The relevant laws and regulations of these countries specify the mental state of the perpetrator. More specifically, they clearly establish that intention, negligence, gross negligence, recklessness, deliberateness, etc. form part of the criminal offence.

Moreover, as opposed to the Armenian Criminal Code, which establishes criminal sanctions for tax evasion in form of fines or imprisonment (2-5 years or 5-10 years for more serious crimes), most of the above-mentioned states apply less stringent means of punishment (e.g. Germany establishes a monetary fine or imprisonment of up to 5 years for more serious crimes, the UK- only fines as a liability, Denmark- a fine, or in aggravating circumstances, imprisonment for a term not exceeding 1 year and 6 months, Sweden- imprisonment for at most 20 years, etc.).

In addition, some of these states' legislations even specify the list of persons who may be held liable in tax evasion cases (Ukraine) and stress the exact types of taxes (Russia, Germany), the false statement or concealment of which constitute a criminal offence.

CHAPTER 2

Theory of Subjectivity in Crime

As can be seen from the analysis of the relevant provisions and regulations of the English, Italian, American, Danish, Swedish and Ukrainian law, these countries are inclined to emphasizing and establishing *mens rea* or the subjective side of the crime as a key element of criminal offences for tax evasion.

In general terms, the subjective side of the crime is perceived by experts of criminal law as the mental state of the person when committing a crime. It forms the psychological part of the crime, and in contrast to the objective side, subjectivity in crime characterizes the processes or conduct that results from the mental state of the perpetrator.[31] Moreover, guilt has been defined by many scholars as "the mental attitude of the perpetrator towards the socially dangerous act and its consequences provided for by the criminal law."[32] This means that the person will be held liable only in case he/she has committed the crime intentionally, willfully or knowingly, i.e. conscious and aware of the nature and significance of the dangerous effects of the actions. Thus, consciousness and will of the person form part of the guilt.

In this view, under the **Armenian law**, article 28 of the Criminal Code specifies negligence and intention as forms of guilt.[33] More specifically, article 29 of the RA Criminal Code defines direct and indirect intention, which reads as follows: *"the offence shall be deemed to have been committed with direct intention, if the person was conscious of the danger of his / her actions (inaction) and its dangerous consequences for the public", and "the offence shall be deemed to have been committed with indirect intention, if the person is aware of the nature of his / her actions (inaction), the nature of the danger to the public, envisaged the possibility of its dangerous consequences but did not want them to happen".*[34]

Further, article 30 of the RA Criminal Code defines negligence in crime specifying that: *"1. Crime committed through negligence can be manifested by self-confidence or negligence. 2. The offence shall be deemed self-reliant, if the person had presumed the dangerous effect of his / her action (inaction), but without sufficient grounds, had hoped that it would be prevented. 3. The offence shall be deemed to be negligent if the person does not*

[31] С.С. Аветисян, А.И. Чучаев, *Уголовное право Армении и России. Общая и Особенная части*, Москва (2014), n.106, *available at:* https://www.hse.ru/pubs/share/direct/content_document/126899673
[32] Ibid. n.108
[33] See footnote 11. art. 28
[34] Ibid. art. 29 (2, 3)

envisage the possibility of a dangerous effect of his / her action (inaction), although he / she was obliged and could envisage them."[35]

A similar legislative approach has been adopted by the **United States of America**, the Model Penal Code of which specifically defines ignorance or mistake in criminal law. In this view, section 2.04 (1) of the U.S. Mode Penal Code states that: *"ignorance or mistake as to a matter of fact or law is a defense if: (a) the ignorance or mistake negatives the purpose, knowledge, belief, recklessness or negligence required to establish a material element of the offense; or (b) the law provides that the state of mind established by such ignorance or mistake constitutes a defense"*[36].

Accordingly, in practice the theory of ignorance, negligence, willfulness and intent has constituted an extensive case-law in the U.S. More specifically, it has been established and interpreted by the Tenth Circuit Court in *United States v. Richard R. Phillips* case, where the "Defendant was convicted of *willfully and knowingly* failing to file income tax returns for three years. In his defense, he argued that he had not filed because he had sincerely and honestly believed that wages were not income." Hereby, the Court came to the conclusion that: "A mistake of law must be objectively reasonable to be a defense. If you find that the defendant did not have a reasonable ground for his belief, then regardless of the defendant's sincerity of belief, you may find that he did not have a good faith misunderstanding of the requirements of the law."[37]

The Fifth and Tenth Circuits also referred to the theory of subjectivity in trying to assure whether the tax crime defendant in the *U.S. vs. Phillips* truly believed his actions complied with the law. The trial court convicted the defendant irrespective of his good or bad faith in committing the tax crime, but the Tenth Circuit reversed and remanded for a new trial, and here the court reasoned that by requiring a "willful" violation, "Congress did not intend to impose criminal liability on those who rely on their good faith belief that they need not file a tax return. For this reason, the Tenth Circuit stated, *courts should use a subjective standard when evaluating a defendant's claim that he did not know he was breaking the law*."[38]

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[35] Ibid. art. 30

[36] U.S. Model Penal Code § 2.04(l) (1985), *available at:* http://www.icla.up.ac.za/images/un/use-of-force/western-europe others/UnitedStatesofAmerica/Model%20Penal%20Code%20United%20States%20of%20America%201962.pdf

[37] *United States v. Richard R. Phillips*, 775 F.2d 262 (10th Cir. 1985), *available at:* https://www.courtlistener.com/opinion/459931/united-states-v-richard-r-phillips/

[38] Mark C. Winings, *Ignorance is Bliss, Especially for the Tax Evader*, 84 Journal of Criminal Law and Criminology. 579 (1993)

The Seventh Circuit Court in *United States v. David N. Moore* case also applied the "willfulness and good faith" test in order to understand the grounds of the defendant's conviction, who "was charged with failing to file income tax returns for the years 1972, 1973, and 1974, in violation of 26 U.S.C. § 7203." The district court held that the government must prove that the defendant "willfully, purposely as distinguished from inadvertently, negligently or mistakenly failed to file such a return." The court went on to instruct that:

"The term willful for purposes of these instructions means voluntary, deliberately and intentionally, as distinguished from accidentally, inadvertently or negligently. Willfulness in the context of a failure to file a proper tax return simply means a voluntary, intentional violation of a known legal obligation to file such a return."[39]

In comparison with the U.S. legislative practice, the Armenian Criminal Code, article 205, before it was amended in 2017, stressed the *malicious intent* of the taxpayer in committing a tax crime or fraud, which stated that: *"1. Malicious evasion from taxes, duties or other mandatory payments by means of not presenting the reports, calculations or other mandatory documents which are the basis of taxation provided by the legislation or entering obviously false data into the mentioned documents, in large measures, is punished with a fine for the amount of 2000 to 3000 times the minimum wage or with imprisonment for the term of 2 to 5 years. 2. The same act committed in particularly large measures is punished with imprisonment for the term of 5 to 10 years with property confiscation. 3 In this article large measure means the amount of 2000 to 15000 times the minimum wage in time of crime, and the particularly large amount means the amount exceeding 15000 times the minimum wage in time of crime".*[40]

This regulation was practically seen in a lot of cases and court decisions in Armenia. Particularly, in case #ԵԿԴ/0121/01/16, Ruzanna Abrahamyan was convicted for *intending to engage* in profit-oriented business activities and avoid the fulfillment of her tax obligations. Being the only founder and director responsible for conducting accounting, as well as for accurately reflecting the company's performance through the reports, for delivering them to the territorial tax inspectorate in a clearly distorted way and income tax calculations, as provided for by the legislation and subject to taxation; resulting in a reduction in the amount of VAT and profit tax payable to the state budget, and through this *maliciously* avoided

[39] *United States v. David N. Moore*, 627 F.2d 830 (7th Cir. 1980), *available at:* https://www.courtlistener.com/opinion/380990/united-states-v-david-n-moore/

[40] Tax Service of the Republic of Armenia, *Violations and liabilities-Criminal Responsibility*, article 205, *available at:* http://taxservice.am/Content.aspx?itn=LBRCriminalResponsibility (Last visited May 11, 2018)

paying taxes to the state budget.[41]Further, under the same regulation, Martun Ohanjanyan was accused of creating predetermined insolvency characteristics in his company, not executing tax liabilities against the state budget, and *maliciously* avoiding to pay taxes as prescribed by law.[42]

Thus, the former regulation of tax evasion was then more compliant with international standards and practice of emphasizing the mental state of the perpetrator.

In this light, the **German Criminal Code** also establishes elements of subjective side of the crime, and accordingly, section 15 of its Criminal Code states that, *"...only intentional conduct shall attract criminal liability"*[43]. A similar approach is adopted by **Italy,** article 42 of the Penal Code of which clearly states that: *"no one can be punished for an action or omission foreseen by the law as a crime, if he has not committed it with conscience* and *will. No one can be punished for a fact foreseen by the law as a crime, if he has not committed it with intent, without prejudice to the cases of intentional or gross negligence expressly foreseen by law."*[44] In addition, the list of countries stressing the subjective side of the crime can be added through the **Swedish** legal practice, which establishes that: *"an act shall be regarded as a crime only if it is committed intentionally".*[45]

Chapter 5 of the **Russian Criminal Code** also specifies deliberateness, carelessness, intent, negligence and recklessness as forms of guilt[46].

Thus, all of the above-mentioned states establish and apply the theory of subjectivity in crime, which is aimed at understanding the motives and goals of the criminal's behavior, the psychology of the latter.

The term "subjective side", as seen from the practice of these countries, is not used in criminal law as such. However, the legislator discloses it by using such concepts as negligence, intention, carelessness, recklessness, deliberateness, etc. Each of these concepts characterizes the psychic nature of the crime from different sides. The fault reflects the psychic attitude of the guilty person to the socially dangerous act (action or inaction) and the socially dangerous consequences of the committed crime.

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[41] *RA State Revenue Committee vs. Rusanna Abrahamyan,* #ԵԿԴ/0121/01/16 (2016), *available at:* http://datalex.am/?app=AppCaseSearch&case_id=14355223812340392

[42] *RA State Revenue Committee vs. Martun Ohanjanyan,* #ՄԴ/0032/01/16 (2016), *available at:* http://datalex.am/?app=AppCaseSearch&case_id=35465847065563363

[43] German Criminal Code (1988, last amend. 2013), section 15, *available at:* https://www.gesetze-im-internet.de/englisch_stgb/englisch_stgb.html#p0122

[44] See footnote 12. art.42

[45] See footnote 20. section 2

[46] See footnote 28. chapter 5 (articles 24, 25, 26)

These characteristics constitute the subjective basis of criminal liability, which is as compulsory as the objective basis - action (inaction). Ignoring the signs of the subjective side can lead to an objective imputation, i.e. bringing to criminal liability for innocent harm. Hence, the analysis of the practice of Germany, Italy, Russia, Sweden and the USA, clearly illustrate that the principle of subjectivity forms one of the key elements of criminal offence, and it has been deeply rooted within the legislation of these states.

On the other hand, a layman might look at the crime as something "wrong" and "malicious", without giving attention to whether the crime was committed with intention, maliciousness, recklessness, negligence, etc. However, it would not be an exaggeration to state that establishment of the subjective side of the crime has become a practice among different jurisdictions, and it has become a general rule that "a crime requires, in addition to an act, a *mens rea*- a guilty mind with respect to the act."[47] For hundreds of years the books have repeated with unbroken cadence that *"A ctus non facit reum nisi mens sit rea."*[48]

[47] R.D.L., *Crimes: Negligence and Criminal Negligence*, 24 Michigan Law Review. 285 (1926)
[48] Francis Bowes Sayre, *No crime can be committed unless there is mens rea*, 45 Harvard Law Review. 974 Vol. (1932)

CHAPTER 3

Proportionality in Criminal Penalties

Sanctions are perhaps the most important tools for enhancing tax compliance, and they are generally applied for the purpose of deterring unwanted behavior. It is noteworthy, however, that sanctions should be fair, i.e. they should not be unduly tough or disproportional. From the perspective of tax crimes, the analysis of individual states in Chapter 1 of the present survey, reveal the fact that countries generally put fines and imprisonment for a certain period of time as major means of punishment for tax evasion. Thus, a question arises here: what role does the principle of proportionality have in criminal penalties?

"For the last twenty years, constitutional courts have applied the principle of proportionality as a procedure that aims to guarantee the full respect of human rights (or fundamental rights) by the state. This principle is applied in both civil law and common law systems, in countries such as the United States, Argentina, Germany, Great Britain, Spain, Italy, France, Belgium, Denmark, Ireland, Greece, Luxemburg, Holland, Portugal, and Switzerland, just to mention a few; and also by the European Court of Human Rights, the Inter-American Court of Human Rights and the European Court of Justice."[49]

After the 2015 amendment, the Constitution of the Republic of Armenia has also for the first time directly referred to the principle of proportionality relevant for the protection of fundamental rights. According to that principle, to achieve the aim set by the Constitution, only those means shall be applicable, which are *necessary* and *effective* to pursue that aim. Furthermore, the chosen means and the aim pursued shall be in a proportionate ratio. In this view, the chosen means is effective in case it at least contributes to the achievement of the aim. The means will be necessary if it supposes the least intervention of limiting the right in the subject matter. In addition, the chosen means shall be *proportionate* to justly assess the severity of the limitation of a specific right.[50]More specifically, "a restriction of a right is proportional *stricto sensu* if it is "pondered or balanced because more benefits or advantages for the general interest are derived from it than damages against other goods or values in conflict."[51]

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[49] Juan Cianciardo, *The Principle of Proportionality: the Challenge of Human Rights*, 3 Journal of Civil Law Studies.177 (2010)

[50] Վարդան Պողոսյան, Նորա Սարգսյան, ՀՀ *2015*թ. խմբագրությամբ Սահմանադրությունը: Համառոտ պարզաբանումներ, n.82, Երևան (2016)

[51] See footnote 49. 180-181

It is noteworthy that the principle of proportionality is also applicable in case of criminal offences. This has been established by legislations of different countries and the **EU Charter of Fundamental Rights**, article 49 of which specifically states that: "*1. No one shall be held guilty of any criminal offence on account of any act or omission which did not constitute a criminal offence under national law or international law at the time when it was committed. Nor shall heavier penalty be imposed than that which was applicable at the time the criminal offence was committed. If, subsequent to the commission of a criminal offence, the law provides for a lighter penalty, that shall be applicable, 3. The severity of penalties must not be disproportionate to the criminal offence."*[52]

The principle of proportionality is also enshrined in the **German Criminal Code**, section 62, which specifies that: *"A measure of rehabilitation and incapacitation must not be ordered if its use is disproportionate to the seriousness of the offence committed by or expected to be committed by the convicted person and to the degree of danger he poses to society."*[53]

The same regulation has become a fundamental principle under the **Russian Criminal Code**, article 38 of which states that: *"a clear disproportion between the measures required for the detention of a person who has committed a crime and the character and the degree of the social danger of the offence perpetrated by the detained person and the circumstances of the detention, when harm is caused to the infringer without valid reasons, shall be deemed to be an excess of necessary measures. Such excess shall involve criminal liability only in cases of intentional infliction of harm".*[54]

The principle of proportionality in criminal law, however, has become a target of debates, as some of the scholars held the view that more severe punishment mechanisms bring more effective preventive measures. That said, these scholars were inclined to the approach that, "where two offences come in competition, the punishment for the greater offence must be sufficient to induce a man to prefer the less."[55]In fact, the OECD, in its attempt to give general recommendations on the effective mechanisms to prevent tax evasion, has extensively emphasized the urgency and necessity for states to adopt criminal offences

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[52] EU Charter of Fundamental Rights, *Article 49 - Principles of legality and proportionality of criminal offences and penalties*, *available at:* http://fra.europa.eu/en/charterpedia/article/49-principles-legality-and-proportionality-criminal-offences-and-penalties

[53] See footnote 43. section 62,

[54] See footnote 28. art. 38

[55] Andrew von Hirsch, *Proportionality in the Philosophy of Punishment*, 16 The University of Chicago Press. 58 (1992)

and measures to combat tax evasion, as the imposition of criminal liabilities for tax fraud is proved to be an effective deterrent.[56]

Moreover, "Posner supplies his own vivid illustration. Because deterrent effects depend on the likelihood as well as severity of punishment, the same preventive effect can be achieved by punishing a few offenders very severely or more offenders less harshly. Given that choice, he argues, one should prefer the severe punishment of the few because it is more cost efficient."[57]

However, another wing of the arguments against heavier punishments implemented in case of criminal offences stressed the idea of fairness and morality. Particularly, they relied on the approach that, "the suggested basis of the principle of proportionality is that a censuring sanction must in fairness be allocated according to the blameworthiness of the conduct."[58]This approach implies that the gravity of punishments in different criminal offences shall vary in consonance with the severity and onerousness of the committed crime.

This consideration and the importance of the notion of proportionality have also been emphasized by the OECD ten global principles. Particularly, it stressed that, "each jurisdiction will have its own approach to categorising the types of offences and the seriousness of these. *Whatever the approach is, the seriousness of the offence should correspond to the seriousness of the consequences for the offender."*[59]

Thus, despite the differences of the above-mentioned approaches, the latter one has become a well-established principle and has already been incorporated into states' legislations. This may further be illustrated through the Criminal Code of the **Czech Republic**, section 38 of which expressly states that: *"(1) Criminal penalties shall be imposed with regard to the nature and gravity of the criminal offence committed and the personal situation of the offender. (2) In cases where the imposition of a less severe criminal penalty to the offender will suffice, a more severe penalty may not be imposed."*[60]

In this view, the **US Model Penal Code** also establishes *"the general purposes of the provisions governing the sentencing and treatment of offenders, again within the general framework of a preventive scheme. Subsidiary goals in this case are to promote the correction*

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[56]See footnote 5. 14
[57] See footnote 55. 63-64
[58] Ibid. 75
[59] Ibid. 17
[60] The Criminal Code of the Czech Republic, section 38 (2009, last amend. 2011), *available at:* http://www.legislationline.org/documents/section/criminal-codes

and rehabilitation of offenders, within a scheme that safeguards them against excessive, disproportionate or arbitrary punishment".[61]

The principle of proportionality set by the above-mentioned provision has also been extensively confirmed by the U.S. Supreme Court, which generally employs several tests so as to "justly" assess the proportionality of criminal penalties imposed on perpetrators in different cases. One of the prominent tests used by the Court is the "culpability test", which matches "the gravity of the offence and the severity of the sentence. It requires the court to take a particular crime and a particular punishment and set them against each other, without regard to how other crimes are punished."[62]

Another test, which by some scholars has been called a "pointless suffering" test, "asks whether the punishment advances one of the goals of punishment or whether it is "nothing more than the purposeless and needless imposition of pain and suffering."[63]

Hence, the non-exhaustive list of countries, which define, prescribe or employ the principle of proportionality in their criminal codes, constitutions or judicial decisions, clearly indicates that the principle itself has become a fundamental aspect of most of the modern systems. The mediating point between the two wings of approaches in regard to the principle of proportionality has been adopted by these moderns systems, and as H.L.A. Hart has noted, *"we can agree that the reason for having a penal system at all is the general betterment of society…we can at the same time maintain with consistency that punishment should only be handed out to those who deserve it, and only to the extent of their guilt."*[64]

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[61] *USA Model Penal Code, Official Drafts and Explanatory Note*, 3, *available at:* http://www.icla.up.ac.za/images/un/use-of-force/western-europe-others/UnitedStatesofAmerica/Model%20Penal%20Code%20United%20States%20of%20America%201962.pdf (Last visited May 11, 2018)

[62] Youngjae Lee, *Why Proportionality Matters,* 160 University of Pennsylvania Law Review. 1840 (2012), *available at:* http://scholarship.law.upenn.edu/cgi/viewcontent.cgi?article=1068&context=penn_law_review

[63] Ibid.

[64] Joel Goh, *Proportionality - An Unattainable Ideal in the Criminal Justice System*, 2 Manchester Student Law Review. 48-49 (2013)

CHAPTER 4

Regulation of Tax Evasion in Armenia: Major Shortcomings

The analysis of the legal practice of states, such as Germany, Italy, Denmark, the UK, the US, Sweden, Ukraine, Russia, etc. set forth in Chapters 1, 2 and 3, may serve as a fruitful ground for revealing the major shortcomings of the provision regulating tax evasion in Armenia.

Generally, "tax evasion is a universal phenomenon. It takes place in all societies, all social classes, all professions, all industries, and all economic systems. Two thousand five hundred years ago, Plato was writing about it, and the aging Ducal Palace of Venice has a stone with a hole in it, through which people once informed the republic about tax evaders"[65]. However, the surprising thing is that tax evasion, especially in regard to being a criminal offence, has received much attention only recently in the Republic of Armenia. In this view, tax evasion has obtained a specific definition through article 205 of the RA Criminal Code, unlike concepts of tax avoidance or tax fraud, which still do not have any accurate clarification within the Armenian law. More specifically, in accordance with article 205 of the RA Criminal Code (before the provision was amended in 2017), *"1. Malicious evasion from taxes, duties or other mandatory payments by means of not presenting the reports, calculations or other mandatory documents which are the basis of taxation provided by the legislation or entering obviously false data into the mentioned documents, in large measures, is punished with a fine for the amount of 2000 to 3000 times the minimum wage or with imprisonment for the term of 2 to 5 years. 2. The same act committed in particularly large measures is punished with imprisonment for the term of 5 to 10 years with property confiscation. 3. In this article large measure means the amount of 2000 to 15000 times the minimum wage in time of crime, and the particularly large amount means the amount exceeding 15000 times the minimum wage in time of crime".*[66]

Further, as of April 8, 2017 and after a lot of hot debates on the severity of the criminal offence specified by the above-mentioned provision, the new amendment of the latter entered into force, which expressly stated, *"for the purpose of avoiding to pay taxes, duties or other mandatory payments, 1) imposing an obviously false statement in the statutory report, computation, declaration or other mandatory taxation document, which is*

[65] Vito Tanzi and Parthasarathi Shome, *A Primer on Tax Evasion,*40 Staff Papers (International Monetary Fund). 807 (1993)
[66] See footnote 40

the basis for taxation, duty, compulsory payment or other obligation; 2) non-submission of a mandatory other document, which is a duty to calculate or pay tax, duty, compulsory payment, as prescribed by law, the calculation, declaration or tax basis, is punished with a fine in the amount 2000 to 3000 times the minimum salary or with imprisonment for the term of 2 to 5 years. 2. The same act committed in a particularly large amount, is punished with imprisonment for the term of 5 to 10 years with confiscation of property. 3. For the purposes of this Article a large amount is considered to be an amount not exceeding 4000 to 15,000 times the minimum wage at the time the offense was committed, and the particularly large amount- exceeding 15,000 times the minimum salary"[67].

Accordingly, if the objective aspect of the crime was previously the evident and malicious avoidance to pay taxes, duties, or to fulfill other mandatory payments, then with this new amendment, the disposition is expressed by simply not paying taxes, fees or other mandatory obligations. The above-mentioned amendment has also raised the threshold from 2 million to 4 million AMD, which means that avoiding to pay taxes, duties or other mandatory charges will result in criminal liability only if it exceeds 4 million AMD.

In developing countries, where the financial resources and the general revenue are particularly limited, a truly well-established and good operating tax evasion policy may be especially essential, as they raise a legitimate concern for these countries. However, it is also important to design and implement appropriate sanctions to build a fair and effective deterrence mechanism. In this view, some jurisdictions, including Armenia, punish tax evasion "through both the civil system (e.g. increased fines for fraud) and the criminal system (additional fines and even prison terms for fraud)."[68]Thus, from the perspective of criminal sanctions, certain elements are necessary so that an act or omission could amount to a criminal offence, and the subjective side of the crime is possibly the most essential one.

Mark C. Winings, in one of his scholarly articles, presents comedian Steve Martin's sarcastic joke on the importance of the definition and establishment of the mental state of the person committing a crime. Hence, in accordance with Mr. Martin's view, there is a very simple way to earn a million dollars and never pay taxes. "Step one, he advises, is to get a million dollars. Step two, naturally, is to not pay taxes. The beauty of the strategy, however, rests in step three. When the Internal Revenue Service agent comes to your door asking why you have not paid taxes, Martin says, simply smile and say, "I forgot."[69]Thus, it is obvious

[67] See footnote 11
[68] Victor Thuronyi, *Tax Law: Design and Drafting*, n.124 (1996)
[69]See footnote 38. 575

from Mr. Winings' article that he does not adhere to the theory of subjectivity in crime. Rather, he emphasizes the importance of the "objective reasonableness" and is clearly against the idea that ignorance, negligence, recklessness or willfulness shall matter for the just assessment of a particular criminal offence. He says, "those who earn income, must pay taxes. Ignorance should not be rewarded, it shall be punished."[70]

In general terms, motive and the aim/purpose of the committed crime form fundamental elements of each criminal offence. More particularly, the purpose of the crime is the idea of the desired result, which the perpetrator seeks to accomplish by committing a criminal offense, and the motive is the *conscious motivation* that guided the person through the commission of a crime. In other words, it is the source of action, its internal driving force. This is motivated by needs and interests, which contribute to the person's determination to commit a crime. The needs of a person should be considered as all that is necessary for his normal life, but what he does not possess at the given time.[71]

Thus, to understand the motivation of the perpetrator, it is essential to analyze his/her intent or, in general terms, the mental state, which stimulated his/her actions.

As illustrated in Chapter 1 and 2 of the present research, unlike the Armenian Criminal Code, many jurisdictions employ intention, negligence, recklessness, willfulness, etc. in their criminal codes, so as to define certain tax crimes and understand the gravity or severity of particular criminal sanctions to punish these crimes.

It is important to note, however, that irrespective of the above-mentioned dissenting opinions, the subjective side of the crime has a fundamental legal significance. Firstly, it allows us to delineate from each other the elements of a crime that are similar in objective features. Thus, malicious and negligent tax evasion cases bring the same result, i.e. they may both constitute a criminal offence. However, they obviously differ in the form of guilt, and how fair would it be to impose years of imprisonment in both cases without giving any consideration to the motives and mental or other circumstances that resulted in that specific crime? Thus, definitions or establishments of the importance of the mental state of perpetrators would be an important step to differentiate between different forms and elements of criminal offences and accordingly, punish those crimes by employing different stages of severity and gravity, which would also prevent any arbitrariness and give an opportunity to individualize those crimes.

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[70] Ibid. 602-603

[71] *Мотив и цель преступления. Их уголовно-правовое значение, available at:* https://studfiles.net/preview/5267721/page:38/ (Last visited May 11, 2018)

Hence, the subjective side of the crime is important to justify the purpose and application of a specific criminal punishment, and to justly, fairly and completely assess and qualify a particular crime. Moreover, concerning article 205 of the RA Criminal Code, the exclusion of the subjective side of the crime from the provision will most probably result in the article's further strengthening as a tax collection tool and will further deepen existing problems.

Another important shortcoming of article 205 of the RA Criminal Code, in our view, is the disproportionate penalty envisaged for tax evasion. From this perspective, some scholars are quite skeptical of the establishment of the principle of proportionality in criminal law, as they think that the acknowledgment of the principle "is really the reflection of ever-changing social sentiments and moral values rather than an objective conclusion to be derived from a comparison of crimes and punishments on their own, it is clear that proportionality can only ever be strived towards as an ideal, rather than attained completely."[72]Other scholars, as presented in Chapter 3 of the present research, consider that more severe punishments result in more compliance and more effective deterrent mechanisms.

However, severe sanctions, in their turn, may raise a lot of issues. Firstly, they may objectively be unfair, especially "if they reached only a small number of violators, since the violators who were caught would be much worse off than those who were not."[73]Secondly, they may become important tools for corrupt officials and contribute to the increase of corruption. Thirdly, in opposition to the view that severe sanctions are better deterrent mechanisms, such harsh penalties may not be frequently imposed. Thus, the conclusion here is that it is much better to combat non-compliance through moderate sanctions more frequently rather than by having "draconian" penalties that are rarely applied.[74]

Furthermore, the general practice of different countries and the principles of the OECD, presented through Chapter 1 of the present research, clearly illustrate the fact that most of these countries use more moderate periods of time for imprisonment, and higher thresholds to consider the gravity of the evaded tax and accordingly assess the severity of the punishment in each case.

Thus, the article raises a fundamental question whether non-submission of a financial report, calculation, declaration or any documents on tax obligations shall be considered to be

[72] See footnote 64. 65
[73] See footnote 68. 125
[74] Ibid.

a criminal offence or whether such an offence would be proportionate to the mentioned actions committed.

Further, article 205 does not specify the answer to the question whether the threshold should be applied to each type of tax or fee or their total cost, and another important disadvantage is that it does not indicate whether the threshold for the amounts generated as a result of tax evasion or fraud should be extended over several reporting periods. For example, article 199 (2) of the Criminal Code of the Russian Federation expressly states that, "the large amount is the amount of taxes, fees, insurance premiums that for a period of *three consecutive financial years* exceeds five million rubles".[75]

Hence, the above-mentioned shortcomings or omissions put forward the urgent necessity to decriminalize the article or contribute necessary changes to it. Otherwise, it may later on affect more people and businesses and become an irrecoverable and fatal damage to them.

[75] *Статья 199 УК РФ. Уклонение от уплаты налогов, сборов, подлежащих уплате организацией, и (или) страховых взносов, подлежащих уплате организацией - плательщиком страховых взносов, available at:* http://ppt.ru/kodeks.phtml?kodeks=20&paper=199 (Last visited May 11, 2018)

CONCLUSION

Given the analysis of the general practice of jurisdictions specified within the frames of the present research paper, it can be well illustrated that these states have adopted almost similar strategy in fighting tax evasion. Particularly, Germany, Italy, the UK, the US, Denmark, Sweden and Ukraine view the mental state of the perpetrator as a key element in tax evasion as a criminal offence. It becomes clear especially from the specific regulations of tax evasion within criminal or fiscal codes, which establish and define the mental state or the subjective side of the crime through recklessness, deliberateness, negligence, gross negligence, intention, etc. In this view, in the general part of the Criminal Code, the Armenian law also provides negligence, direct and indirect intention as the elements of criminal offence.

Moreover, many of the above-mentioned countries' criminal codes and constitutions, namely those of Germany, Denmark, the US, Armenia, as well as Russia and Czech Republic, enshrine the principle of proportionality to establish the fairness and just evaluation of criminal punishments. The establishment of this principle, as well as the subjective side of the crime have been also recommended by the OECD ten global principles with the purpose of effectively and justly fighting against tax crimes.

Tax evasion in form of false statements, reports and non-submission of mandatory tax documents is regulated in Armenia through article 205 of the RA Criminal Code, which as of April, 2017 has undergone changes and amendments. At first glance, these amendments make the impression that the state is taking an effort to soften the criminal punishment by raising the threshold, which means that evading from payment of taxes will result in a criminal offence, only if they exceed this amount specified by the provision. However, taking into account the legal practice of OECD countries, as well as the experience of other progressive and developing states, the provision still raises issues (namely, elimination of the mental state of the perpetrator, disproportionate sanctions of the provision, the absence of a specific period of time of tax evasion) that may later on become a substantial deterioration for the business environment in Armenia.

Thus taking into consideration the above-mentioned issues of the article, we recommend certain changes and amendments to the provision. Particularly, the article may, in our view, be edited in the following way:

"1. Deliberate evasion from taxes, duties or other mandatory payments by means of submitting deliberately and obviously distorted data or not presenting the reports,

calculations or other mandatory tax documents, as a result of which during one financial year large amount of tax liabilities have been concealed, is punished with a fine in the amount of the unpaid taxes, or with imprisonment for up to 1 year.

2. The same act committed in a particularly large amount, is punished with imprisonment for the term of 2 to 3 years.

3. For the purposes of the present article, a large amount is considered to be an amount not exceeding 100,000 times the minimum wage at the time the offence was committed, and the particularly large amount shall be the amount exceeding 100,000 times the minimum salary".

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