

# *Ultima ratio* Principle in the Criminalization of Tax Evasion

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This article evaluates the significance of the principle of *ultima ratio* for the national process of criminalization. It also assesses the criminalization of tax evasion in the Criminal Code of the Republic of Lithuania using the criminalization criteria established in both national and international legal regulation, case law and criminal law doctrine.

**Keywords:** tax evasion, tax avoidance, criminal law, criminalization.

## Mokesčių slėpimo kriminalizavimas *ultima ratio* principo kontekste

Šiame straipsnyje yra įvertinama baudžiamosios atsakomybės, kaip griežčiausios priemonės (lot. *ultima ratio*), principo reikšmė kriminalizuojant naujas nusikalstamas veikas. Taip pat pasitelkiant nacionalinio ir tarptautinio teisinio reglamentavimo, teismų praktikos ir baudžiamosios teisės doktrinos įtvirtintus kriminalizavimo kriterijus vertinamas mokesčių slėpimo kriminalizavimas Lietuvos Respublikos baudžiamajame kodekse.

**Pagrindiniai žodžiai:** mokesčių slėpimas, mokesčių vengimas, baudžiamoji teisė, kriminalizavimas.

## Introduction

The principle of *ultima ratio* (Latin for *last resort*, *final argument*), while not exclusive to criminal law<sup>1</sup>, should be regarded as one of the most influential principle of criminal law both by the legislator, which addresses the procedure of both criminalization and decriminalization, and by the judiciary, which qualify criminal offenses and impose punitive sanctions on individuals. Understanding the complexity of said principle with all the different aspects of its definition requires far greater research than an article could provide. For this reason, the purpose of this article is not to thoroughly analyze

<sup>1</sup> DAMBRAUSKIENĖ, A. *Ultima ratio principo įgyvendinimas kriminalizuojant veikas Lietuvos Respublikos baudžiamajame kodekse*: daktaro disertacija. Socialiniai mokslai, teisė (01S). Vilnius: Vilniaus Universitetas, 2017, p. 72.

the principle and its definition in detail but to evaluate whether current legislation in Criminal Code of the Republic of Lithuania (further – Criminal Code)<sup>2</sup>, regarding tax evasion offenses, adheres to current to the prevailing recognition of *ultima ratio* principle, as described by criminal law scholars in criminal law doctrine.

The principle of *ultima ratio* is a well-known principle of criminal law and has been researched by both national and international scholars. In the Republic of Lithuania, the subject of *ultima ratio* principle in criminal law was analyzed by Lithuanian criminal law scholars G. Švedas, O. Fedosiukas, V. Justickis, V. Pavilonis<sup>3</sup>. The most recent and very extensive analysis was written by A. Dambrauskienė in her PhD thesis<sup>4</sup>, which encompasses both theoretical and practical aspects of the *ultima ratio* principle. Furthermore, many international criminal law scholars also analyzed the significands of the *ultima ratio* principle regarding the process of criminalization, most notably: P. Minkkinen, N. Peršak, N. Jareborg, J. Schonsheek<sup>5</sup>. As stated beforehand, the subject of *ultima ratio* is not a novel concept but this article will distinguish itself because the core concept of *ultima ratio* principle will be used to evaluate whether criminalization of criminal offences, regarding tax evasion in the Republic of Lithuania does not infringe the said principle. In addition, this article will assess whether national criminalization of tax evasion is in line with European Union law. For the purpose of this article, the criminal offence of tax evasion is to be understood as defined in the Articles 220 and 221 of The Criminal Code of the Republic of Lithuania.

The research object of this article is the interaction of *ultima ratio* principle and national criminal legislature. Concerning the stated purpose, this article sets out to evaluate the importance of the principle of *ultima ratio* in the process of criminalization, furthermore it will analyze whether the current criminalization of tax evasion is compatible with the principle of *ultima ratio*. Lastly, this article will assess whether criminalization trends in the Republic of Lithuania, as far as they are related to tax evasion, are consistent with European Union law.

In order to achieve the purpose of this article, the logical analysis method was the main method applied to associate criminal legislation of tax evasion with *ultima ratio* principle (both its concept and definition). The linguistic method was used to establish definitions and their use in general language. The comparative method was also widely applied in this article while collating national criminal law and European Union provisions regarding criminalization of tax related offenses. Descriptive method was used to provide particular statements and court jurisprudence (Constitutional Court of the Republic of Lithuania (further – Constitutional Court) and Supreme Court of the Republic of Lithuania (further – Supreme Court).

<sup>2</sup> Lietuvos Respublikos baudžiamasis kodeksas. *Valstybės žinios*, 2000-10-25, nr. 89-2741.

<sup>3</sup> FEDOSIUK, O. Baudžiamoji atsakomybė kaip kraštutinė priemonė (*ultima ratio*): teorija ir realybė. *Jurisprudencija*, 2012, t. 19 (2); JUSTICKIS, V. *Kriminologija. I dalis: vadovėlis*. Vilnius, 2001; PAVILONIS, V. Baudžiamosios politikos pagrindai. *Justitia*, 1996, nr. 3; ŠVEDAS, G. Baudžiamosios politikos pagrindai ir tendencijos Lietuvos Respublikoje. Vilnius: *Teisinės informacijos centras*, 2006; ŠVEDAS, G. Veikos kriminalizavimo kriterijai: teorija ir praktika. *Teisė*, 2012, nr. 82.

<sup>4</sup> DAMBRAUSKIENĖ, A. *Ultima ratio principo įgyvendinimas <...>*, 2017.

<sup>5</sup> MINKKINEN, P. „If Taken in Earnest“: Criminal Law Doctrine and the Last Resort. *The Howard Journal*. 2006, 45(5); PERŠAK N. EU Criminal Law and It's Legitimation: In search for a Substantive Principle of Criminalisation. *European journal of criminal law and criminal justice*, 2018, vol. 26; JAREBORG, N. Criminalization as Last Resort (*Ultima Ratio*). *Ohio state journal of criminal law*, 2004, vol. 2; SCHONSHEK J. On Criminalization: An Essay in the Philosophy of Criminal Law. Springer Netherlands, 1994.

## 1. The significance of the *ultima ratio* principle

The *ultima ratio* principle in criminal law theory is inseparable from both the application of criminal liability and criminalization of criminal offenses. It is widely agreed that criminal liability, being the most restricting measure in terms of rights and freedoms of individuals, must be applied in exceptional cases only, when other legal or non-legal means are not sufficient in order to stop criminality.<sup>6</sup> Naturally, this fundamental principle of criminal law should also apply to the criminalization process, since criminalization of acts, which by their nature do not reach the degree of danger acceptable to criminal law, could not be justified and considered legitimate. The *ultima ratio* principle traditionally is perceived as the limits (constraints) on the State<sup>7</sup>.

One could argue that said principle is especially relevant in criminal law because of the defining aspect that separates criminal law from the others – the punitive nature of its sanctions. Only criminal law “threatens” an individual with a punitive sanction that is both legislated and administered by the State, and as such, it also represents the most austere manner in which a State exercises its legal powers over its citizens.<sup>8</sup> Currently in the Republic of Lithuania, imprisonment is the harshest punitive sanction that can be applied to an individual who has committed a criminal offence. P. Minkkinen also stated that central idea of penological theories is that a punishment imposed by the State – and in this case more specifically the punishment of imprisonment – is an ‘evil’ or an ‘infliction of pain’, and as such, it requires a justification.<sup>9</sup> Furthermore, he argued that the infliction of pain on another human being is wrong regardless of whether it is executed through democratically agreed upon institutions. Because imprisonment, especially in its polymorphous quality, constitutes an infliction of pain, as the punitive sanction of criminal law it can only be justified as a last resort, as the *ultima ratio*<sup>10</sup>.

N. Jareborg also extensively examined the penological theory under discussion. He stated that we are not any longer allowed to use criminal punishment just because we want it, or because a god is said to want it, or because we have always done it, or because it seems to be a natural or an effective means to some end. The basic reason for this is that punishment involves hard treatment, inflicting harm that is often serious. Given that a state organization is justified, only if it is largely to the advantage of the citizens, a punishment system and its design and contents must be justified by reference to convincing, rational (moral) reasons, including reasons that refer to some notion of the common good<sup>11</sup>.

Although some would argue that the principle of *ultima ratio* is a theoretical principle, which does bind neither legislator, nor judiciaries<sup>12</sup>, evaluation of Constitutional and Supreme Court decrees, legal research made into this subject by aforementioned scholars, would suggest that the principle of *ultima ratio* has a solid legal ground and it has a visible impact on both the legislator and practical implementation in the Republic of Lithuania.

While the principle of *ultima ratio* is not directly implemented in the Criminal Code of the Republic of Lithuania or any other legal act, it is possible to derive said principle from the definition of a crim-

<sup>6</sup> FEDOSIUK, O. Baudžiamoji atsakomybė kaip kraštutinė priemonė (ultima ratio): teorija ir realybė. *Jurisprudencija*, 2012, t. 19 (2), p. 715–738.

<sup>7</sup> PAVILONIS, V. Baudžiamosios politikos pagrindai. *Justitia*, 1996, nr. 3, p. 22

<sup>8</sup> MINKKINEN, P. „If Taken in Earnest“: Criminal Law Doctrine and the Last Resort. *The Howard Journal*. 2006, 45(5), p. 521–536.

<sup>9</sup> MINKKINEN, P. „If Taken in Earnest“<...>, p. 521–536

<sup>10</sup> *Ibid.*

<sup>11</sup> JAREBORG, N. Criminalization as Last Resort (Ultima Ratio). *Ohio state journal of criminal law*, 2004, vol. 2, p. 521–524, 530–534.

<sup>12</sup> JUSTICKIS, V. *Kriminologija. I dalis: vadovėlis*. Vilnius, 2001, p. 122.

inal offence, which is implemented in the Criminal Code. Part 1 of the Article 11 of Criminal Code describes what constitutes a crime in the national criminal law. The definition states that a crime is a dangerous act (act or omission) prohibited by the Code that is punishable by a term of imprisonment. The principle of *ultima ratio* is referenced in the stated definition lies in the word “dangerous”, which means that for an illicit action to be considered a crime, the act itself has to be considered dangerous.

In legal literature, the principle of *ultima ratio* is usually understood in two ways: the principle of *ultima ratio* in “creation” of criminal offences and the principle of *ultima ratio* in the application of said offences. A legislator can use the principle *ultima ratio* to justify the criminalization or decriminalization of certain offences, also to establish the limits of criminal liability. This means that the legislator must verify if specific socially harmful behavior is harmful enough to impose criminal liability for such behavior. Concerning the practical application of said principle, criminal liability should be applied only in certain special cases, after carefully analyzing the offense committed, assessing all relevant facts of the case. Criminal liability in a democratic society must be perceived as a last resort (*ultima ratio*) used to protect the legal good, values in cases where lenient measure are not enough<sup>13</sup>.

This theoretical content of the definition of *ultima ratio* was entrenched in the practice of both The Constitutional Court and The Supreme Court. The Constitutional Court in its decrees derived the principle of *ultima ratio* mainly from the principle of proportionality, providing legally binding “rules” for the legislator, which are derived from the Constitution itself. The quotation marks are used because The Constitutional Court does not formally set any rules, but only checks whether a legal act is in line the Constitution and legal principles. Furthermore, The Constitutional Court does not evaluate the constitutionality of the act *ad hoc*, but if the legislator ignores the main principles set out in The Constitutional Court practice, the law in question could be declared unconstitutional, since the unconstitutionality of the action was established in the past.

On the topic of the principle of proportionality and the rule of law, The Constitutional Court stated that the legislator could criminalize only those acts which are genuinely dangerous and which actually cause, or threaten to cause, serious harm to the interests of the individual, the public and the State<sup>14</sup>. This interpretation of The Constitutional principles was further expanded upon, with The Constitutional Court stating that when imposing legal restrictions and liability for violations of law, the requirement of reasonableness, as well as the principle of proportionality, according to which legal measures established must be necessary in a democratic society and there must be a balance between goals and means, they must not restrict individual rights more, to the extent necessary to attain these objective<sup>15</sup>. While The Constitutional Court does not clearly use the concept of *ultima ratio*, the core principle of rules set out for the national legislator are in line with the definition of the aforementioned principle, established in legal literature. Furthermore, The Constitutional Court not only established rules for the legislator, but it also interpreted the content of the *ultima ratio* principle having in mind its practical application in criminal proceedings by stating that in order to prevent unlawful acts, it is not always appropriate to make such an act a criminal offense and to apply the most severe measure – a criminal penalty. Therefore, each time it is necessary to deal with a criminal offense or other

<sup>13</sup> PRANKA, D. Lietuvos Respublikos baudžiamojo kodekso 179 straipsnyje numatyta nusikalstamą veiką ir civilinę teisės pažeidimą skirianti riba. *Socialinių mokslų studijos*, 2011, t. 3(2), p. 651.

<sup>14</sup> Lietuvos Respublikos Konstitucinio Teismo 2003 m. birželio 10 d. nutarimas Nr. 13/02-22/02, 2004 m. gruodžio 29 d. nutarimas Nr. 8/02-16/02-25/02-9/03-10/03-11/03-36/03-37/03-06/04-09/04-20/04-26/04-30/04-31/04-32/04-34/04-41/04.

<sup>15</sup> Lietuvos Respublikos Konstitucinio Teismo 2006 m. sausio 16 d. nutarimas Nr. 7/03-41/03-40/04-46/04-5/05-7/05-17/05.

offense, it is essential to assess the results that can be achieved by other non-criminal measures<sup>16</sup>. The impact it had on the practical implementation of criminal offence is clearly seen when analyzing the decrees of criminal cases of The Supreme Court. It expanded upon the definition established by The Constitutional Court by stating that criminal liability in a democratic society must be perceived as a last resort (*ultima ratio*) used to protect the legal good, values in cases where measures that are more lenient cannot achieve the same objectives<sup>17</sup>.

This analysis confirms a conclusion made by A. Dambrauskienė, which outlines the positive aspects of the *ultima ratio* principle and shows the significance it has to both the adopted legislation and practical implementation of criminal liability. A. Dambrauskienė argues that The Constitution and its requirements bind not only the executive or judicial power of the state, but also the legislative power, therefore the decision of the legislator in criminalizing the relevant acts depends on balancing between the protective function of the State and *ultima ratio* ideas<sup>18</sup>. The conclusion made highlights the current understanding of the principle of *ultima ratio* in national criminal law both by the judiciary and criminal law scholars. Furthermore, regarding the significands of said principle, O. Fedosiukas argued that the *ultima ratio* is not merely a wish of the legislature. This idea, like other principles of criminal law, can be regarded as the elaboration of constitutional principles in criminal law. A criminal law, which clearly fails to comply with these provisions, may be challenged as being in conflict with The Constitution<sup>19</sup>.

In the light of the above, it would be difficult to question the significance of the *ultima ratio* principle both for legislative purposes and for the practical qualification of criminal offenses. It is therefore presumed that it should be possible to assess each provision of criminal law in the context of the principle in discussion, with the possibility of providing comprehensive legal assessment, whether an offence described in the criminal law is still dangerous enough to merit the harshest response from the State.

## 2. Criminalization of tax evasion

Determining whether a certain criminal offence is worthy of criminalization or decriminalization, it firstly requires establishing of criteria on which the criminal offence in question should be evaluated. Jeremy Bentham devised one of the first used principles of criminalization. He stated that punishment ought not to be inflicted where it is groundless, i.e. where there is no mischief for it to prevent because the act was not overall harmful; where it must be ineffective, i.e. where it cannot act so as to prevent the mischief; where it is unprofitable, or too expensive, i.e. where the mischief it would produce would be greater than what it prevented; and where it is needless, i.e. where the mischief may be prevented or cease of itself without it, i.e. at a cheaper rate<sup>20</sup>. On the national level, Professor G. Švedas identified the national criminalization criteria which Lithuanian criminal law scholars have almost unanimously recognized. He concluded that there are four dominant our criteria for criminalization: (1) the majority's belief that criminal law protects those social values that are vital to the desired order in society;

<sup>16</sup> Lietuvos Respublikos Konstitucinio Teismo 2005 m. lapkričio 10 d. nutarimas Nr. 01/04

<sup>17</sup> Lietuvos Aukščiausiojo Teismo Baudžiamųjų bylų skyrius. 2009 m. spalio 6 d. Nutartis baudžiamojoje byloje Nr. 2K-369/2009; Lietuvos Aukščiausiojo Teismo Baudžiamųjų bylų skyrius. 2011 m. gegužės 24 d. nutartis baudžiamojoje byloje Nr. 2K-262/2011, Lietuvos Aukščiausiojo Teismo Baudžiamųjų bylų skyrius. 2012 m. balandžio 3 d. nutartis baudžiamojoje byloje Nr. 2K-161/2012, Lietuvos Aukščiausiojo Teismo Baudžiamųjų bylų skyrius. 2013 m. kovo 19 d. nutartis baudžiamojoje byloje Nr. 2K-160/2013, Lietuvos Aukščiausiojo Teismo Baudžiamųjų bylų skyrius. 2014 m. birželio 3 d. nutartis baudžiamojoje byloje Nr. 2K-257/2014.

<sup>18</sup> DAMBRAUSKIENĖ, A. *Ultima ratio* principo įgyvendinimas <...>, p. 88.

<sup>19</sup> FEDOSIUK, O. Baudžiamoji atsakomybė kaip kraštutinė priemonė <...>, p. 715–738.

<sup>20</sup> BENTHAM, J. An Introduction to the Principles of Morals and Legislation. *UCL Bentham Project*, 2017, p. 92–95.

2) a particular social value cannot be defended without the use of strict criminal law measures; (3) the prevalence of the offense; and (4) the possibility of criminal offenses being established<sup>21</sup>. Furthermore, he emphasizes that the subject, which initiates the procedure of criminalization or decriminalization, must provide information on all the criteria for criminalization, e. g. information on the severity of the proposed offense (social problem), the prevalence (potential) of the offense, possible solutions to the social problem, potential direct and secondary outcomes of the criminalization, financial and other necessary costs of criminalization<sup>22</sup>. This illustrates that criminal law theory has clearly identified core aspects of criminalization of certain behavior and provides logical steps and guidelines for the legislator to act upon when presented with such a task. In regards to said theories and principles of criminalization, J. Schonscheck developed what one could call a hypothetical filter, which consist of three layers, 1<sup>st</sup> layer – the main substantive criminalization principle, on the 2<sup>nd</sup> layer – normative limiting factors and lastly – pragmatic limiting factors<sup>23</sup>.

There is no doubt that tax evasion, as a specific offence, “goes through” the first filter because it is wrongful and harmful conduct. Harmfulness of tax evasion was known from the States started collecting it to invest for the greater good. While at first taxation was a way for individuals in power and dominance (kings, regional leaders, land owners and etc.) to accumulate wealth, it slowly became an investment into society (greater good). J. Bentham identified and classified tax evasion as fourth class act and said such acts ought to be made offences because of the distant mischief they threaten to bring on an unidentifiable indefinite multitude within the community, with no particular individual appearing more likely than any other to be a victim<sup>24</sup>. Furthermore, Z. M. and J. Prebble developed an interesting hypothesis regarding tax avoidance. While there is a significant difference between tax avoidance and tax evasion, when evaluating the impact of both offences, the hypothesis in discussion can be applied to strengthen the argument, that tax evasion is a harmful conduct, which must be criminalized. Z. M. and J. Prebble argued that tax avoidance is a deadweight loss to the economy, as the taxpayer in achieving the tax benefit undertakes no actually beneficial activity. To illustrate said hypothesis they offer a thought experiment: “imagine that everyone, rather than just a subset of taxpayers, actively and aggressively pursued tax avoidance schemes wherever there was an opportunity to do so and there was little chance of being found out. The effect would be that tax rates would have to be raised and no one would achieve any gain. In fact, everyone would be worse off because tax avoidance is itself a deadweight cost<sup>25</sup>.”

In the light of the above, one could presume that offences related to taxation should be considered as public offences or offences against the State that can reach the degree of danger inherent in the regulation of criminal law.

## 2.1 Tax evasion as a criminal offence

To properly assess whether tax evasion should be considered as a criminal offence, firstly it should be distinguished from similar legal relations, mainly from tax avoidance and tax optimization.

<sup>21</sup> ŠVEDAS, G. Veikos kriminalizavimo kriterijai: teorija ir praktika. *Teisė*, 2012, nr. 82, p. 12–25; PAVILONIS, V. Baudžiamosios politikos pagrindai. *Justitia*, 1996, nr. 3 ir 4, p. 22.

<sup>22</sup> ŠVEDAS, G. Veikos kriminalizavimo kriterijai <...>, p. 12–25.

<sup>23</sup> PERŠAK, N. EU Criminal Law and It's Legitimation: In search for a Substantive Principle of Criminalisation. *European journal of criminal law and criminal justice*, 2018, vol. 26, p. 20–39.

<sup>24</sup> BENTHAM, J. An Introduction to the Principles of Morals <...>, p. 92–95.

<sup>25</sup> PREBBLE, Z. M.; PREBBLE J. The morality of tax avoidance. *Victoria University of Wellington Legal Research Papers* No 9/2012, 2012, p. 726.

Tax optimization (tax mitigation, tax planning) is considered to be the legitimate behavior of the taxpayer. It is recognized that every taxpayer has the right to choose the operating model that ensures (maximizing) profits at the lowest tax expense<sup>26</sup>. An indicator of the legitimacy of tax planning (optimization) is that the underlying purpose of transactions and transactions is the need for business or other the fulfillment of legitimate objectives and the tax benefits arise as an additional result of such activities<sup>27</sup>. An example of tax optimization is the legitimate business planning of a company to obtain the maximum possible tax benefit. In most cases, tax optimization involves transactions with foreign companies and the transfer of one's income and capital, international tax treatment, transfer to a lower-tax country, tax incentives or different tax treatment for the taxpayer. This can easily be achieved with the globalization of world markets. Each state has its own set of taxation rules, e. g. different rates for the same types of income, the subject of the tax, entities, types of non-taxable income, expenses that can be used to reduce taxable profits, different tax benefits<sup>28</sup>. Given that entities seeking to optimize tax payments do not engage in any activity contrary to the applicable law, nor do they pursue an unlawful purpose, there is no reason to treat the activity in question as criminal in nature.

While it is relatively easy to distinguish tax evasion and tax optimization, the differentiating line between tax avoidance and tax evasion is much thinner. Although the OECD provides a glossary of tax terms in English, there is a discrepancy of separate definitions of tax evasion and tax avoidance. Tax evasion (tax avoidance) is defined as a legal action by a taxpayer, if it is based on its own taxes, but is likely to be fair, contrary to the purpose of the tax claim. Tax evasion is justified as unlawful activity which results in the taxpayer reducing his tax burden by concealing or ignoring his tax liability<sup>29</sup>. It is noteworthy that such a discrepancy exists in the vast majority of English-language legal terms. The main criterion for delimiting these concepts in the glossary of legal terms is a mixture of tax evasion, fraud and fraud aimed at avoiding payment of compulsory taxes to the state budget<sup>30</sup>. While the legal definitions of aforementioned legal relations are vague, legal scholars have identified most noteworthy differences. A. Jain stated that tax avoidance implies a situation in which the taxpayer reduces his tax liability by taking advantage of the loop-holes and ambiguities in the legal provisions, in the case of tax evasion, facts are deliberately misinterpreted and the tax liability is understated. Thus, while tax avoidance is perfectly legal and is, at times, referred to as 'tax planning', tax evasion is illegal and, therefore, carries with it the risk of penalties and prosecutions under the tax laws. As such, the black economy comprises the sum total of all the various methods of tax *evasion* but does not include *tax avoidance*. Accordingly, whereas the consequences of the two phenomena are different for the taxpayers, both reduce the revenue of the Exchequer and consequently need to be checked to the greatest extent possible<sup>31</sup>. A. Paulauskas expands on this concept while evaluating national legislation. He identified that tax avoidance differs from tax evasion in that the taxpayer reduces the tax base by performing actions that formally comply with the requirements of the law, thus creating an artificial situation for

<sup>26</sup> VASILIAUSKAS, V. Mokesčių planavimą nuo mokesčių vengimo skirianti riba. Optimizuoti ar vengti? *Apskai-tos ir mokesčių apžvalga*, 2005, nr. 5, p. 28–29.

<sup>27</sup> PAULAIUSKAS, A. Mokesčių vengimo sąvoka, požymiai bei santykis su mokesčių slėpimu. *Viešojo politika ir administravimas*, 2006, p. 29.

<sup>28</sup> PAULAIUSKAS, A. Mokesčių vengimo sąvoka <...>, p. 32.

<sup>29</sup> EBPO mokesčių terminų žodynas [interaktyvus. Žiūrėta 2020-01-17]. Prieiga per internetą: <<http://www.oecd.org/ctp/glossaryoftaxterms.htm>>.

<sup>30</sup> The Law Dictionary. Featuring Black's Law Dictionary, Free Online Legal Dictionary, 2nd Ed. [interaktyvus. Žiūrėta 2020-01-17]. Prieiga per internetą: <<http://legal-dictionary.thefreedictionary.com/tax+evasion>>.

<sup>31</sup> JAIN, A. Tax Avoidance and Tax Evasion: The Indian Case. *Modern Asian Studies*, 1987, 21(2), p. 233–255.

him to receive a tax benefit. These actions are recorded in the accounts without distorting their content. By hiding taxes, the tax base is reduced by concealing or distorting the reality<sup>32</sup>.

Aforementioned criteria of tax evasion are also identified in relevant case law of Tax Dispute Commission of The Republic of Lithuania and Supreme Administrative Court of Lithuania. The Tax Disputes Commission states in its rulings that tax avoidance and tax evasion are different in ways and means. The taxpayer, through tax evasion, reduces the tax base by taking actions that formally comply with the requirements of the law, which artificially creates a tax advantage. These actions, without distorting their content, are recorded in the accounts. In the case of tax evasion, the tax base is reduced by concealing or distorting the facts, conducting unlawful acts, not recording the actual transactions that have taken place in the accounts<sup>33</sup>. The Supreme Administrative Court of Lithuania also analyzed this relation and stated that tax evasion is different from tax avoidance in that the tax avoidance actually involves economic transactions which, without distorting their content, are recorded in the accounts. However, the principal purpose of these transactions is not to carry out a genuine economic activity but to obtain a tax advantage through the abuse of tax law<sup>34</sup>. The comparative analysis above leads to the reasonable conclusion that both tax evasion and tax avoidance are offenses and both are committed with the intent to obtain tax advantage, but the fundamental difference is the manner in which the offense is committed. One could argue that the rationale of criminalizing tax evasion lies in both the result (the amount of tax evaded) and the manner that the offence is committed. The use of fraudulent conduct, which may in fact mislead the tax authorities, should be the basis for criminalizing tax evasion. Expanding on this position, when a tax authority loses a real opportunity to find out the will of individuals, and such determination is only possible through the use of highly restrictive means of criminal proceedings, one could state that a criminal offense was committed.

Identification of tax evasion as a criminal offence requires further evaluation by using the aforementioned J. Schonscheck's filter, to determine whether it passes the second layer, much thinner one. For a harmful conduct to pass the second layer of said filter the legislator should inspect whether other possible means, less coercive and intrusive than the criminal statute could do the task satisfactorily enough, this layer also encompasses normative limiting factors, such as rule of law requirements, principles of *ultima ratio* and legality, constitutional constraints<sup>35</sup>. As stated beforehand, the principle of *ultima ratio* should be considered the most significant in relation to other normative limiting factors, since it is derived from The Constitution, mainly from the principle or rule of law and proportionality. To properly measure whether the criminalization of tax evasion in national criminal law, one must identify specific provision of the Criminal Code.

Without going into further discussion regarding the practical implementation of criminal offences of tax evasion, the national legislator envisioned the place of tax evasion offence, with regards to the whole Criminal Code system, in Chapter XXXII of Criminal Code<sup>36</sup>. The Articles 220 and 221<sup>37</sup> could

<sup>32</sup> PAULAUSKAS, A. Mokesčių vengimo sąvoka, <...>, p. 33.

<sup>33</sup> Mokestinių ginčų komisijos 2005 m. balandžio 21 d. sprendimas Nr.: S-202-(7-143-2005).

<sup>34</sup> Lietuvos vyriausiojo administracinio teismo 2005 m. liepos 7 d. nutartis administracinėje byloje A-1-495-05 „Boslita“ ir Ko v Valstybinė mokesčių inspekcija.

<sup>35</sup> PERŠAK, N. EU Criminal Law and It's Legitimation <...>, p. 20–39.

<sup>36</sup> Chapter XXXII „Crimes and misdemeanors against the financial system“.

<sup>37</sup> Criminal Code of the Republic of Lithuania

**Article 220. Provision of Inaccurate Data on Income, Profit or Assets**

1. A person who, seeking to evade the payment of taxes the amount whereof exceeds 100 MSLs, provides data on the person's income, profit, assets or the use thereof that are known to be inaccurate in a tax return or in a report approved in accordance with the specified procedure or in another document and submits such data to an institution authorised by the State shall be punished by a fine or by a custodial sentence for a term of up to four years.



be considered the main criminal offences, regarding tax evasion in national criminal law. Although criminal law is not the only school of law that governs identical legal relations; administrative and financial law also regulate offences related to the same object. O. Fedosiukas expresses a critical view by stating that the lack of proper criminalization in the field of tax evasion has created a situation where as many as three different branches of law (tax - financial, administrative misconduct, criminal law) are used to regulate this phenomenon<sup>38</sup>. One could agree with the stated reasoning because if we establish that tax evasion is a harmful enough conduct to merit criminalization, we should not have less intrusive branches of law competing with criminal law. However, the analysis of current criminalization of tax evasion in the Criminal code clearly shows that the legislator, while identifying the harmfulness of tax evasion, had not criminalized tax evasion in full. Without an in depth analysis of all the constituent elements of criminal offences in Articles 220 and 221 of Criminal Code, one could see that tax evasion in national law gives rise to criminal liability only if the amount of evaded tax reaches at least 100 MSLs<sup>39</sup>, which means that 5000 Eur of evaded tax could merit criminal liability. As mentioned beforehand, the harmfulness of tax evasion lies in both the manners it is done in and actual monetary harm it causes to the State. So the amount of harm caused (evaded tax) sets the scope of criminal liability and for this reason and it could be considered as one of the criteria when assessing whenever criminalization is just, the scope of the criminalization should be evaluated in the light of the principle of *ultima ratio*.

For instance, a proper way to assess whether certain amount of evaded tax is harmful enough to be considered a criminal offence, there should be a clear analysis whether different branches of law could resolve the conflict both cheaper and faster, while also attaining the same result. For e. g. in the Republic of Lithuania, most of the legal regulation, regarding taxation, is established in special laws (Tax administration act, VAT administration act and etc.)<sup>40</sup>, many legal scholars in the field of tax law, separate the administrative control means, supplied to tax administrator by Tax administration act and control means of criminal law, stating that the main type of legal responsibility should arise from tax law and criminal law should only be complementary, last resort, if administrative means, supplied by Tax administration act, are not enough, to resolve problems arising from taxation between State and its citizen<sup>41</sup>. Furthermore, if we agree that national tax administrator has the necessary legal tools to properly evaluate whether a small amount of tax was evaded (less than 5000 Eur) and quickly apply proportional administrative sanctions which remove the negative effects of the offense committed, than

2. A person who commits the act indicated in paragraph 1 of this Article, where the tax amount exceeds 750 MSLs or by participating in an organised group, shall be punished by a custodial sentence for a term of up to eight years.

3. A legal entity shall also be held liable for the acts provided for in this Article.

**Article 221. Failure to File a Tax Return or to Submit a Report or Another Document**

1. A person who fails, in accordance with the procedure laid down by legal acts and seeking to evade the payment of taxes or other fees the amount whereof exceeds 100 MSLs, to timely file with an institution authorised by the State a tax return or to submit thereto a report approved in accordance with the specified procedure or another document concerning a person's income, profit or assets after this state institution reminds him in writing of the duty to submit them shall be punished by a fine or by a custodial sentence for a term of up to four years.

2. A person who commits the act indicated in paragraph 1 of this Article, where the amount of taxes or other fees exceeds 500 MSLs, shall be punished by a custodial sentence for a term of two up to six years.

3. A legal entity shall also be held liable for the acts provided for in this Article.

<sup>38</sup> FEDOSIUKAS, O. Mokesčių slėpimas kaip nusikalstama veika: sisteminė normų analizė ir aktualūs taikymo klausimai. *Teisės apžvalga*, 2017, nr. 2 (16).

<sup>39</sup> Lietuvos Respublikos Vyriausybės 2008 m. spalio 14 d. nutarimas „Dėl bazinio baudmių ir nuobaudų dydžio patvirtinimo“, *Valstybės žinios*, 2008-10-21, nr. 121-4608.

<sup>40</sup> Lietuvos Respublikos mokesčių administravimo įstatymas, *Valstybės žinios*, 2004-04-28, nr. 63-2243.

<sup>41</sup> PAULAUŠKAS, A. Mokesčių vengimo sąvoka <...>, p. 31.

surely the basis for the emergence of criminal liability, needs proper evaluation. To add to what was stated, the current economic analysis of small sized business<sup>42</sup> indicates that a 5000 Eur threshold for criminal liability is such a small amount that it cannot be considered as a threshold that criminalizes only the most dangerous conducts of tax evasion. In the light of what was stated, the conclusion could be drawn that in the current national legislation, the threshold for criminal liability is so low that almost all acts in which a person, especially legal person, manages to evade tax, would result in criminal liability, while there are well established different branches of law that could reach the same effect, without the use of extremely restrictive measures of criminal proceedings. This could mean that core part of tax evasion criminal offence does not pass the 2<sup>nd</sup> layer of aforementioned filter, which could be an indication that the criminalization of tax evasion is not in line the principle of *ultima ratio* and needs to be reevaluated.

## 2.2 The criminalization of tax evasion in the European Union legislation

To assess what threshold of evaded tax could be considered as a criminal offence of tax evasion, one should go beyond the limits of national law and to evaluate supranational legislation, in this regard – the European Union legislation. Firstly, Paragraph 1 of the Article 83 of the Treaty on the Functioning of the European Union<sup>43</sup> states that The European Parliament and the Council may, by means of directives adopted in accordance with the ordinary legislative procedure, establish minimum rules concerning the definition of criminal offences and sanctions in the areas of particularly serious crime with a cross-border dimension resulting from the nature or impact of such offences or from a special need to combat them on a common basis. These areas of crime are the following: terrorism, trafficking in human beings and sexual exploitation of women and children, illicit drug trafficking, illicit arms trafficking, money laundering, corruption, counterfeiting of means of payment, computer crime and organized crime. While it does not directly mention tax evasion, but said Paragraph further states that on the basis of developments in crime, the Council may adopt a decision identifying other areas of crime that meet the criteria specified in this paragraph. With regards to this, Directive (EU) 2017/1371 of the European Parliament and of the Council of 5 July 2017 on the fight against fraud to the Union's financial interests by means of criminal law was adopted<sup>44</sup>. The objective of the Directive 2017/1371 is stated in the Paragraph 4 of the recital, which indicates that the protection of the Union's financial interests calls for a common definition of fraud falling within the scope of this Directive, which should cover fraudulent conduct with respect to revenues, expenditure and assets at the expense of the general budget of the European Union (the 'Union budget'), including financial operations such as borrowing and lending activities. The notion of serious offences against the common system of value added tax ('VAT') as established by Council Directive 2006/112/EC<sup>(8)</sup> (the 'common VAT system') refers to the most serious forms of VAT fraud, in particular carousel fraud, VAT fraud through missing traders, and VAT fraud committed within a criminal organization, which create serious threats to the common VAT system and thus to the Union budget. This objective is in line with the basis for criminalization on the EU level, set out in the Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions – Towards

<sup>42</sup> Official Government statistic [interaktyvus. Žiūrėta 2019-09-10]. Prieiga per internetą: <[https://osp.stat.gov.lt/statistiniu-rodikliu-analize?indicator=S8R722#/>](https://osp.stat.gov.lt/statistiniu-rodikliu-analize?indicator=S8R722#/).

<sup>43</sup> Treaty on the Functioning of the European Union of 26 October 2012. *Official Journal* C 326, 2012, P. 0001–0390.

<sup>44</sup> Directive (EU) 2017/1371 of the European Parliament and of the Council of 5 July 2017 on the fight against fraud to the Union's financial interests by means of criminal law, *Official Journal of the European Union* L 198/29.

an EU Criminal Policy: Ensuring the effective implementation of EU policies through criminal law<sup>45</sup>, which established one of the basis for criminalization – the principle of *ultima ratio*, by stating that for criminal law measures supporting the enforcement of EU policies, the Treaty on the Functioning of the European Union explicitly requires a test of whether criminal law measures are “essential” to achieve the goal of an effective policy implementation. Therefore, the legislator needs to analyze whether measures other than criminal law measures, e.g. sanction regimes of administrative or civil nature, could not sufficiently ensure the policy implementation and whether criminal law could address the problems more effectively<sup>46</sup>. Furthermore, the legislation on the EU level only sets out the minimum rules, as described in Article 83, which means that the Member states have the right to provide for stricter regulation than the minimum rules, taking into account the specificities of national law. Although one could argue that the minimal rules are established about the principle of *ultima ratio* and a stricter regulation could be considered as infringing said principle.

The conclusion of last paragraph could be illustrated by comparing the EU level regulation, as described in the Directive 2017/1371, with aforementioned national legal framework. As stated in the Directive 2017/1371, offences against the common VAT system should be considered to be serious where they are connected with the territory of two or more Member States, result from a fraudulent scheme whereby those offences are committed in a structured way with the aim of taking undue advantage of the common VAT system and the total damage caused by the offences is at least EUR 10 000 000 and for the damage or advantage resulting from the criminal offences referred to in points (a), (b) and (c) of Article 3(2) and in Article 4 shall be presumed to be considerable where the damage or advantage involves more than EUR 100 000<sup>47</sup>. When we compare the legal framework set out in the Directive 2017/1371, we can clearly see that the national threshold for tax evasion is twenty times lower (5000 Eur) and for serious cases it is also almost thirty times lower (37 500 Eur). The comparative analysis established a huge difference between the national and EU level legislation regarding tax evasion, which could be a reasonable ground for systematic reassessment of current threshold for tax evasion, implemented in the national criminal law framework.

## Recommendations and conclusions

1. The principle of *ultima ratio* bears high significands to both legislator and the judiciary. Said principle should be regarded as one of the core legal grounds when considering the criminalization and decriminalization of criminal offences and the legislation, which follows from the aforementioned process that is not in line with the principle of *ultima ratio* principle, could be considered unconstitutional.
2. The constituent element (object) of criminal offenses set out in Articles 220 and 221 of the Criminal Code – the amount of tax evaded by the aforementioned criminal offence, sets a very small threshold for criminal liability. The aforementioned constituent element, which defines States reaction to tax evasion, does not comply with the principle of criminal liability as a last resort, since most of the offences, related to tax evasion, are by default considered as a criminal offence.

<sup>45</sup> Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions – Towards an EU Criminal Policy: Ensuring the effective implementation of EU policies through criminal law, COM(2011) 573.

<sup>46</sup> Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions – Towards an EU Criminal Policy <...>.

<sup>47</sup> Directive (EU) 2017/1371 of the European Parliament and of the Council of 5 July 2017 on the fight against fraud to the Union’s financial interests by means of criminal law, *Official Journal of the European Union* L 198/29.

3. The comparative analysis of European Union legal framework on criminalization, especially the criminalization of tax evasion, show that current national threshold for criminal liability for tax evasion does not comply with legal standards of the European Union.

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### Ultima ratio Principle in the Criminalization of Tax Evasion

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S u m m a r y

This article evaluates the significance of the principle of *ultima ratio* for the national process of criminalization. It also assesses the criminalization of tax evasion in the Criminal Code of the Republic of Lithuania using the criminalization criteria established in both national and international legal regulation, case law and criminal law doctrine.

Analyzing the work of national and international criminal and financial law scholars, the article looks for scientifically sound criteria that confirm the need to impose criminal liability for tax evasion in criminal law. In order to find the answer to the question under discussion, the article distinguishes tax evasion from tax avoidance and tax optimization, and clarifies the essential features that make tax evasion a criminal offense. The evaluation of the European Union legal framework also attempts to set limits on criminal liability for tax evasion, which would meet the requirements of criminal liability as a last resort and the principles of proportionality.

### Mokesčių slėpimo kriminalizavimas *ultima ratio* principo kontekste

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S a n t r a u k a

Šiame straipsnyje yra įvertinama baudžiamosios atsakomybės, kaip griežčiausios priemonės (lot. *ultima ratio*), principo reikšmė kriminalizuojant naujas nusikalstamas veikas. Taip pat pasitelkiant nacionalinio ir tarptautinio teisinio reglamentavimo, teismų praktikos ir baudžiamosios teisės doktrinos įtvirtintus kriminalizavimo kriterijus vertinamas mokesčių slėpimo kriminalizavimas Lietuvos Respublikos baudžiamajame kodekse.

Straipsnyje analizuojant nacionalinių ir tarptautinių baudžiamosios bei finansų teisės mokslininkų darbus, ieškoma moksliai pagrįstų kriterijų, kurie patvirtintų būtinybę baudžiamajame įstatyme numatyti atsakomybę už mokesčių slėpimą. Siekiant rasti atsakymą į aptariamą klausimą, straipsnyje yra atskiriamas mokesčių slėpimas nuo mokesčių vengimo bei mokesčių optimizavimo, nurodomi esminiai požymiai, kurie leidžia laikyti mokesčių slėpimą nusikalstama veika. Taip pat įvertinant Europos Sąjungos teisinį reguliavimą yra bandoma nustatyti baudžiamosios atsakomybės už mokesčių slėpimą ribą, kuri atitiktų baudžiamosios atsakomybės, kaip griežčiausios priemonės, ir proporcingumo principų reikalavimus.