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# Tax Risks in Enterprise Activity

## Introduction

Under the current conditions of the radical changes of the Ukrainian tax legislation principles – implementation of the Tax Code, changes and amendments to the Code – there exists a number of the risk issues in the taxation at the national level as well as at the level of the business entities (tax payers).

Risks are the integral part of the all aspects of the taxation, they are inherent to each of its structural elements and any field of the tax legal relationship development; theirs' influence is caused by the objective-subjective nature of the uncertainty of the tax system. All taxation processes are difficult to predict and control because of the influence of the risks. This leads to the further uncertainty of the tax system development and expected results of it's reforming. Taking into consideration the present conditions of the frequent changes to the current tax legislation principles this issue requires a permanent research and implementation of the certain adjustments concerning the management issues and prevention of the risks in the taxation.

Research Goals, Tasks, Objects and Methods

*The goal of the research* is scientifically grounded proposals about the nature of tax risks in entrepreneurial activity and ways to prevent them in the current economic conditions in Ukraine. Implementation of this objective is concerned with the following *tasks*:

- to define the concept of tax risk in the context of entrepreneurial activity implementation;
- to consider the size of the amount of tax debt for all types of tax liabilities in the period up to 3 years;
- to analyze specifics of taxation of entrepreneurial establishments in Ukraine on January, 1, 2012;
- to assess the possibility of administration of tax payments in the current conditions.

*The object of the research* is tax risks in entrepreneurial activity and methods of prevention, control and administration of tax payments.

*The research methods.* In the process of writing the article there was used the general scientific dialectical method as well as the method of the system-structural analysis, comparative method, and the method of logical (formal and dogmatic) analysis.

## The Results of the Research

There are many definitions of the risk as the notion in practice. Specifically, the risk is an economic category which reflects the particular characteristics of the perception by the interested entities of the economical, particularly tax, relationships of the objectively existing uncertainty and proneness to conflict which are inherent to the processes of the target formation, management, decision making, evaluation, followed by the potential threats and unimproved opportunities for the state as well as for the taxpayer.

On the other hand, the risk is a possibility of the event occurrence of which leads to the financial or other type of losses of the members and/or the participants of the payment system.

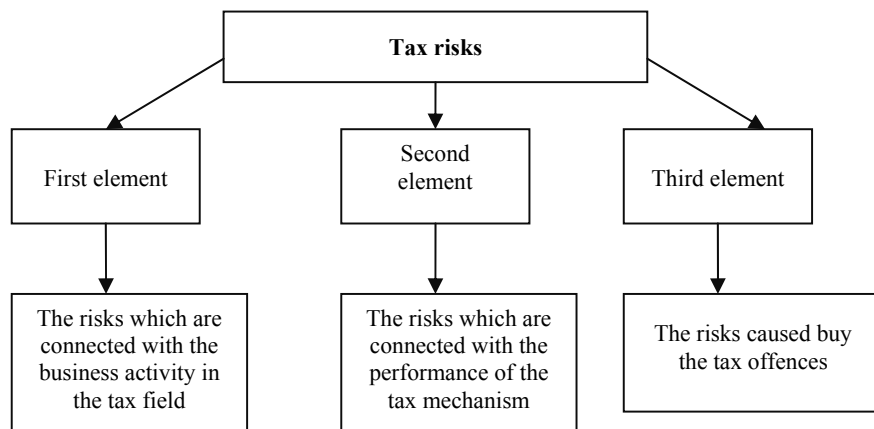
Based on the general definition, the term “risk” refers to the degree of the potential possibility for the entity to incur the financial or the other type of the losses as the consequence of the negative deviations by the side of the expected results which are based on the applicable law regulations and taken into consideration by the entity while making the decision.

As for the “tax risk”, the following definition is the basis: “The tax risk should be understandable as the theoretical possibility of that situation then after the certain actions of the taxpayer some payments may be submitted to the budget incompletely or untimely” [Forum on Tax Administration 2009, p. 17]. Also there is the following definition in the methodological recommendations of the State tax administration: “The tax risk is the probable possibility of the tax violations which may lead to the possible budget losses” [Pelekh 2012, p. 2].

In the Tax Code the risk is interpreted as the possibility of no-declaration of the (partly declaration) tax liabilities by the tax payer, non-performance of the other legislation by the taxpayer, control of which is assigned to the state tax authorities [The Tax Code of Ukraine 2010, p.12].

In our opinion, the tax risks should be determined by the three elements which are pictured in Figure 1.

The risks hereto related to the business activity in the field of taxation – are those risks that arise as the consequence of providing by the state, through the legislative and executive bodies, the tax policy, as well as, the consequence of the activity of the tax bodies and the tax payers. The risks of the tax policy cover



**Figure 1**  
Types of the Tax Risks

Source: Author's presentation.

the legislative risks and the organizational management risks. The former arise from the possibility of amendments into the regulatory legal acts in the field of taxation, the latter are caused by the difficulties of tax policy implementation by the executive bodies. They are complicated and cover different types of the risks which differ by the reasons (the factors) of incurrence, the field of detection and etc. This group includes the risks directly associated with the implementation of functions by the tax authorities and professional duties by their staff. They are caused by the imperfection of the record-keeping system of the tax payers, ineffective control over their business activity and others. The risks associated with the tax activity of the tax payers may arise on the state level because of using various schemes by the tax payers to avoid taxation.

The second element combines those risks which are associated with the performance of the tax mechanism and its components. They are caused by the ineffective composition of the tax system and the structure of the taxation system; insufficient level of the legal and economic qualification of the staff of the tax authorities; biased assessment of the information; insufficient use of the prevention methods against the violators of the tax legislation; unauthorized access to the information which is available for use of the tax authorities, as well as information leakage; insufficient protection of the employees of the tax authorities; lack of the coordination in the actions of the tax authorities in the field of taxation and so on.

This element combines the genuine tax risks which are fully dependent on the activity or inactivity of the parties of the tax relations. The essence of the tax

risks we propose to understand according to the basis of the general scientific principles interpretation of the category “risk”, provisions of the regulatory legal acts and the financial and legal sources, as well as, approaches of the tax authorities of Ukraine and other countries of the world. Consequently, the tax risks is the possibility of arising the negative financial implications due to the inefficient development and operation of the tax mechanism, the approach or the strategy of the tax activity and the breach of the law in the field of taxation by the parties of the tax relations.

The third element contains the risks associated with the commitment of the tax offences in the field of taxation by the all parties of the tax relationships. These risks are caused by the failure to perform the duties by the tax payers as well as the employees of the tax and other governmental bodies which regulate the taxation process in the state. Among these risks are: moral hazards caused by the negative attitude of the tax payers to the tax system in the state; the social risks caused by the reluctance of the tax payers to fulfill the tax obligations under the conditions of the excessive burden of taxation or the individual relativism in the society; the liability risks caused by the inefficiency of the current penalty system for the violation of the tax legislation; professional risks associated with the non-performance by the employees of the tax bodies of their functional duties, corruptness and so on.

The proposed systematization of the features allows applying it as the basis for developing the classification system of the all types of potential risks from the perspective of their carrier, the reasons and the circumstances of the origination. This approach to the criteria generalization of the tax risks classification is very important as, in the first instance, it provides the possibility to disclose the necessary essential sides of each of them, at the second, to disclosure the field and the reason of the risk origination, in the third place, practically apply the provided information in order to estimate and minimize the present risks.

One of the most important aspects is the tax risk of the state which is defined as the economic category which determines the uncertainty of the eventual outcome of the activity regarding the provision of submitting the money to the budget of all levels, state specialized funds as the result of the possible influence (effect) on it a number of the objective and/or the subjective factors, ineffective tax administration and violation of the tax legislation. The tax risk of the state is the complex risk, i.e. the risk that includes other risks, particularly, the risks that are impossible to manage fully or partially by the Ukrainian state taxation service authorities. Obviously, these are – the climatic risks (natural disasters) and the political and economic risks (the change or the reorganization of the political or the economical system). Among the risks which may be managed by the Ukrainian STS (thereinafter – the State Taxation Service) authorities are: the risks of the

violation of the tax legislation, operational and organizational and the management risks. The sum of the gap of the tax payments to the budget is represented in the Figure 1.

The tax risk of the tax payer refers to the type of the business risks. The reasons of its origination may be: the tax policy shift which can increase the tax burden, and consequently, the tax liabilities will grow; the possibility of the additional charges and payments and penalties for the unintentional violations of the current legislation by the entity; the errors and shortcomings in the planning, project conception and organization of the business (Table 1).

Data analysis Table 1 shows that virtually all types of tax amount owed has increased. The largest increase was for tax on personal income, income tax and value added tax (total debt increased almost 2-fold).

The business risk is the possibility of not achieving the goal, the expected outcomes of the taken decision or the implementation of the planned activity due to the objectively existing uncertainty. The risk is implemented by means of the company's assets loss, the income deficiency or origination of the tax expenses.

The effectiveness of the business risk management is determined by the classification of the risk factors which means their distribution to the specific groups with the certain characteristic features in order to achieve the set goals. The classification allows determining the place of the risk in their system and provides the possibility to effectively apply the appropriate risk management methods later on [Desytnuk 2008, p. 174].

The operational risk is implemented in the possibility of reducing the volume of the output, reducing of the quality level, increasing the company's expenses and recession of the productivity level, arising of the losses as the result of the production downtime, losses of the work time, deficient delivery of the output, raw materials, energy, etc.

The risk of damage of the property of the company, its movable and immovable property (machines and equipment, computer databases, inventories of the raw materials and material suppliers, finished goods in the stock, goods, cash funds, and so on) is due to the possibility of the theft, sabotage, negligence, surge of the technical and the technological systems, accident, fire, flood, mechanical or radiation exposure and other reasons.

The commercial risk is associated with the process of selling the goods and services which are produced and purchased by the company, and it is implemented in the reduction of the goods sale as the result of the changes in the market conditions and negative changes in the price level, increasing distribution costs, losses of goods in the process of its circulation/realization, etc.

In the recent years there is a significant increase in the importance of the financial risks for the companies which are associated with the probability of loss

**Table 1**

Tax Debt for the Tax Liabilities of Tax Payers to the Consolidated Budget of Ukraine in the Breakdown of Main Taxes for 2008-2010 Years, Thousand UAH\*

Name of the payment	01.01. 2009	01.01. 2010	01.01. 2011	from 1 to 2 years	from 2 to 3 years	More than 3 years
Individuals Income tax	186,522	342,565	533,708	111,089	47,520	28,684
Corporate income tax	1,938,815	2,264,981	3,766,315	475,357	350,345	121,503
Tax of the transport vehicle owners as well as other self-propelled machines and mechanisms	29,290	33,710	31,647	8,608.9	7,085.6	3,921.2
Fee for the geological exploration	416,732	669,140	941,900	137,611	287,094	978.9
Land fees	256,785	548,952	714,520	230,683	86,200	32,401.7
Value added tax	3,714,825	4,542,927	6,313,036	1,485,737	608,620	453,819
Excise taxes for the goods made in Ukraine	581,509	1,184,809	1,250,048	110,572.9	286,506	3.6
Excise taxes for the goods imported to the territory of Ukraine	1,939	1,939	1,939	0.0	1,939.6	0.0
License fee for the certain types of the business activity	229	0.0	0.0	0.0	0.0	0.0
Trade patent fee for the certain types of business activity	14,807	10,460	9,831	2,252.1	2,040.2	3,609.8
Import duty	1,352	1,215	1,072	0.0	1,022.7	42.9
Fixed agricultural tax	9,818	7,175	4,575	802,8	1,036.9	1,745.8
Single tax for the small business enterprises	12,159	16,636	18,517	5,048.6	2,867	2,293.6
Rental payment for the natural gas transit via territory of Ukraine	811,963	450,014	0.0	0.0	0.0	0.0
Administrative penalties and other sanctions	49,001	78,631	74,982	25,091	11,505.2	13,334.8
Fee for the environmental pollution	100,455	242,604	143,438	36,231	2,6676.6	3,824.7
Other taxes	1,003,433	1,356,894	2,239,699	321,181	253,512	129,900
Total	9,129,641	11,752,658	16,045,233	29,502,698	1,973,974	796,064

\* Exchange rate was 9.25 UAH/EUR in 2010

Source: Calculated according to the data of the Bulletin of the State Tax Service: <http://www.sta.gov.ua/control/uk/faq/fulllist?rubricId=47844&qliststind=21>.

of the financial resources. Among the group of the financial risks are the risks associated with the purchasing power of the money and the investment risks.

Among the risks associated with the purchased power of the money are the inflationary and the currency risks. The presence of the inflationary risk indicates the situation when the income in process of inflation depreciates more than grows. The currency risk is associated with the possible losses as the result of the exchange rates changes. This type of the risk is often accompanied by the foreign trade operations.

The investment risks are the risks of the business investments associated with the risks of the direct investments of funds to the implementation of the specific investment project. The most significant in this group for the company may be the risks of the customer, the credit risk of the borrower, the risk of losses caused by the errors of the omissions related to the ownership registration of the acquired for the business purposes object, etc. The risk of the financial investments is implemented in the process of purchase the assets by the company in the form of the securities.

The management risks include the risk of lack of the strategic approach of planning and management in the company, the errors in the determining the goals of the company, predicting of the environmental development in the strategic planning, the risk of the management discrepancy between the volume and the nature of the activities of the company and so on. The management risks generally have the subjective character. Consequently, the entrepreneur defines the goals of the business activity, estimates the situation, forms the options for the solutions and makes the choice of the acceptable solution. The management risks influence the complex business risk in two ways: in addition to the direct influence they may provide the indirect influence, creating or, conversely, eliminating or reducing the certain economic or financial risks. That is why the management risks take the dominant position in the complex of the main risk groups of the company's activity.

Depending on the possible economic results we can outline the pure and the speculative risks. The pure risks reflect the possibility of receiving the negative or the zero result. This group includes the majority of risks of the industrial activity of the company based on the specific production. The speculative risks mean the possibility of receiving both the positive and negative result. They include the risks associated with the purchasing power of the money, investment and financial risks.

The risk is always associated with the duration of the business project that is why its assessment should be connected with the particular phase of the work, the particular period of the financial year while implementing the production program. In this respect it is appropriate to outline the calculation and the current

risks. The calculation risk can be estimated on the stage of the pipeline project. The current risk is estimated in the process of work, in the process of the project implementation. In the unfavourable circumstances the current risk can not only exceed the calculation risk but also exceed the maximum limits which in its turn will lead to the need to reject this project or even to refuse from the specific type of the business activity. Very often the risk can be divided into the long-term and the short-term by the time factor. Whereby, the long-term risk is connected with the development of the future and the short-term risk – with the efficient, conjuncture reasons [Andrushchenko 2010, p. 79].

Considering that the most important task of any entrepreneur which conducts the business activity in the unstable circumstances is to prevent the company from doing bankrupt, considering the aim to management the risk it is necessary to allocate the acceptable risk, the critical risk and the catastrophic risk. The acceptable risk is the risk of losses comparable to the losses of income from the project implementation or from the business activity in general. The critical risk – is the risk of losses comparable to the proceeds from the sale of goods (services). The catastrophic risk is the risk which is characterized by the risk of losses in the amount which is equal or more than the company's equity. The catastrophic risk usually leads to the bankruptcy of the company.

Providing the reforms of the taxation system of the business activity involves the use of the single tax payment. In accordance with the provisions of the Tax Code the size of the single tax payment is determined according to the group of the business owners. The distribution/general classification of the single tax payers to the groups is an innovation of the simplified system which is implemented by the current legislation. Whereby, the individuals – entrepreneurs with the purpose of the single taxation on their income received from the business activity are divided into three groups, and separately is defined the category of the entrepreneurs that have the short-term certifications, and the fourth group is the category of the entrepreneurs – legal entities single tax payers. Thus:

- the first group – individuals – entrepreneurs who do not use the hired labour of the employees, provide exclusively the retail sale of goods from the market places and/or carry out the economic activity in the field of the domestic/personal services for the people and their revenue for the calendar year does not exceed the 15 000 thousand;
- the second group – individuals – entrepreneurs, who conduct the business activity on providing the services, including the domestic/personal services, for the single taxpayers and/or the people, production and/or sale of goods, restaurant business and under condition that during the calendar year they comply with the following requirements: they do not use the hired labour or the quantity of the persons which are in the labour relations with them does



**Table 2**

Penalties for the Single Taxpayers According to the Types of the tax Violation and the Categories of the Entrepreneurs

Type of the violation	The category of the companies regarding of which the penalty is applied	The size of the penalties	The actions after violation
Applying the other type of settlements other than the cash and cashless way	The payers of the I and the II categories	15% of the amount of the settlements with violation	To pay the penalty and do not apply any more
Applying the other type of settlements other than the cash and cashless way	The payers of the III and IV categories	30% of the amount of the settlements with violation	To pay the penalty and do not apply any more
Conducting the transaction regarding of which the simplified system is not applied	The payers of the I and the II categories	15% of the amount of the settlements with violation	To pay the penalty and move to the general taxation system
Conducting the transaction regarding of which the simplified system is not applied	The payers of the III and IV categories	30% of the amount of the settlements with violation	To pay the penalty and move to the general taxation system
Conducting the transaction which is not listed in the certificate of the single tax payer	The payers of the I and the II categories	15% of the amount of settlements with violation. In case of violation it is necessary to add	To pay the penalty, make amendments to the certificate or move to the general taxation system
Exceeding the limit amount of the income	The payers of the I and the II categories	15% of the amount which is exceeded the limit of income	To pay the penalty, make amendments to the certificate (move to the another category) or move to the general taxation system
Exceeding the limit amount of the income	The payers of the III category	30% of the amount of settlements with violation	To pay the penalty, move to the general taxation system
Exceeding the limit amount of the income	The payers of the IV category	30% of the amount of settlements with violation	To pay the penalty, move to the general taxation system
The selling of goods without buying the short-term certificate, with violation of the term of its validity or selling the goods which are not listed in the certificate			

Source: *The Tax Code of Ukraine*. ST «State tax administration», Kyiv 2010: <http://zakon3.rada.gov.ua/laws/show/2755-17>.

not exceed 10 persons at the same time, and the total amount of revenue does not exceed UAH 1,000,000.

- the third group – individuals – entrepreneurs, who during the calendar year comply with the following requirements: they do not use the hired labour or the quantity of the persons which are in the labour relations with them does not exceed 20 persons at the same time, and the total amount of revenue does not exceed UAH 3,000,000.
- the fourth group of the single tax payers – among them are only the legal entities-entrepreneurs which may receive the revenue in the amount up to UAH 5,000,000 per year and use the hired labour to 50 persons.

The business activity is associated with the certain risks which are caused, in particular, by the tax violation risks. Application of the Tax Code provides the certain types of penalties for the business owners who have chosen the simplified taxation system and are the single tax payers. Such types of the penalties are represented in Table 2.

Besides, the current legislation provides the penalties in the form of the administrative fines, financial sanctions (fine or penalty) and the criminal responsibility.

## Conclusions

Therefore, summarizing the abovementioned, we can say that the risks cover all the elements and the structural components in the field of taxation, they are common to all, without exception, parties of the taxation relationship. The risks of taxation are not the result of the random activity but are the objective reality of the tax system functioning which is being developed in the constantly changing environment.

Tax risks for businesses is the risk associated with failure to obtain (short-fall) of income, a significant level of tax burden and penalties, etc. To prevent and minimize the tax risks in the business to be adapted applicable tax laws of Ukraine to the current market conditions, availability of choice of the tax system for businesses. Formation of tax breaks and other incentives aspects of taxation, flexible administration of tax payments for businesses.

The objectivity of the tax risks display is based on the existence of the uncertainty in the tax field which is caused by the problems of choice, availability of alternatives, absence of possibility to make estimation of the functioning and the results of the reforming, the interests conflict, threats and hazards, lack of the comprehensive information as of the time of estimation and decision making.

The structure and the types of the risks change over the time under the influence of the external and internal environment of the tax system functioning as well as influence of the objective and subjective factors. Thus, there is a direct relationship between the reasons and the results in the field of taxation and the risks. The links are formed under the influence of the controlled and uncontrolled factors it is completely impossible to eliminate the risks but it is always possible to anticipate and reduce them.

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## Ryzyko podatkowe w działalności przedsiębiorstwa

### Streszczenie

W niniejszym artykule zostały omówione takie zagadnienia jak: definicja ryzyka w biznesie, istotne zagrożenia obejmujące przedsiębiorstwa, ryzyko naruszenia prawa podatkowego i ryzyko związane ze skutecznością mechanizmu podatkowego jako całości. Zostały omówione również uogólnione cechy charakterystyczne dla biznesu prowadzonego na Ukrainie. Na podstawie Ordynacji podatkowej określono także rodzaje sankcji stosowanych w przypadku popełnienia przestępstwa podatkowego.