

## A balanced approach

### Pledge priority of the tax authorities

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The Union of the Self-Regulatory Organisations of Arbitration Managers (the “RUSROAM”) has proposed providing tax authorities with collateral security of their claims for the purpose of the bankruptcy procedure. The national economic journal *Vedomosti* reports that the draft law has already been entered into the Russian parliament ([link to article](#)).

On the one hand, such priority of the tax authorities increases the tempos of the budget replenishment, but, on the other hand, it may lead to violations of the interests of other creditors in a bankruptcy proceeding.

### What kind of regulation has been proposed?

According to Clause 29, Sub-Clause d of the Federal Law *On Amending the Federal Law on Insolvency (Bankruptcy)* (the “Law”), it has been proposed to amend Article 138, Clause 7 of the Law with the following provision: “A commercial court shall establish the claims of a creditor as secured by a pledge in a bankruptcy proceeding if it has been established that such claims are based on obligations that arise from relations based on administrative or any other authority-based subordination of one party to the other, the existence of which or the amount of which in relation to the excess over the amount of the obligations known to the creditor within the legislatively established terms were concealed from the creditor asserting the claim, including if the existence and/or the correct amount of such obligations was not reported to the creditor in the manner and within the terms established by legislation.”

## What does the amendment mean in essence?



In accordance with Russian legislation, third-priority creditors to which the property of the debtor are pledged are satisfied at first in relation to creditors of other priorities, which includes, in particular, citizens to which the debtor is liable for causing harm to their life or health, citizens to which the debtor is in debt in relation to the severance pay and/or the payment for labour of individuals working under an employment contract. Such secured creditor in relation to creditors of other priorities receives firstly seventy per cent of the amount obtained from the sale of the pledged object.

Currently, before the enactment of the considered amendments, the tax authorities are considered as normal third-party creditors who are satisfied after creditors of any other priorities mentioned above. However, with the amendments to the law, if the claims of the tax authorities against the debtor have arisen in the course of conducting a tax audit, then a state arbitration court will declare these claims as secured by law, which will automatically cause a change in the priority of the satisfaction of the creditors' claims in favour of the state.



The date of the onset of the pledge in the draft law is considered to be the moment the tax authorities' claims are occurred.

Thus, as proposed by RSOAU, **certainty appears in the matter of distribution of funds among several secured creditors**. In accordance with Russian legislation, the claims of a subsequent pledgee are satisfied based on the cost of the property after the satisfaction of the claims of prior pledgees.



## Legal assessment of the amendments

This draft law has advantages, as well as a number of disadvantages, which undoubtedly exist as a result of the weaknesses of the amendments to the Law.

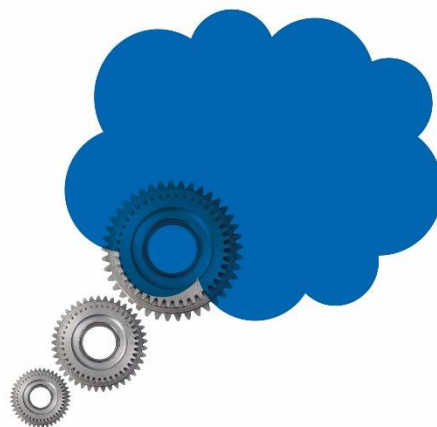
### Advantages

- + the state budget will be partially protected from incomplete revenues to the treasury – receipts to the budget will be increased by more than RUB 100 billion as the initiators of the draft law propose
- + the position of banks that are one of the primary creditors in the bankruptcy, which overlay pledges and meet claims in the priority, and the tax authorities that pursue public interest will be equalised
- + the amendments will motivate the debtors to pay taxes on time and will prevent the illegal output of property for the purpose of not paying taxes; each entity is required to satisfy its tax obligations, which leads to fulfilment of the public interest
- + the tax authorities do not have such private-law security mechanisms that private creditors have, such as, in particular, a commodity pledge; there is a high probability that unpledged property will be irrevocably output while conducting the tax audit

### Disadvantages

- the creation of legal uncertainty by virtue of the fact that the pledge arises in relation to the debtor's property retrospectively; the pledge may arise for any tax period in relation to a tax for which the tax audit is being carried out, although it must be within the three-year period preceding this tax period; a pledge in favour of the tax authorities that has arisen retroactively before the date of the pledge of the same property in favour of another creditor will have priority over the other creditor
- the breach of the principle of the formal equality of creditors; a non-tax creditor will automatically be placed in an unequal position with the tax creditor; non-tax creditors will be limited in their right to defend even more (in 2018, non-tax creditors received less than 10% of claims included in registers – with the strengthening of the position of the tax authorities, this amount will correspondingly decrease)
- the contradiction with the practice of the Constitutional Court of the Russian Federation, which has repeatedly written about the impermissibility of the improving the position of the state to the detriment of the position of other entities





## Our opinion

Proposed amendments will definitely lead to achieving of public goals that are particularly connected with the uninterrupted budget replenishment and the prevention of misbehaviour of tax payers. However, as mentioned above, there are numerous disadvantages that prevent to evaluate the draft law as positive in general. Undoubtedly, the strengthening of the role of the state in the field of bankruptcy will lead to reduction of "controlled" bankruptcies. However, this should not cause the worsening of the position of other economic participants and the breach of the principle of formal equality and legal certainty.

Just like the initiators of this draft law, we believe that it requires serious improvements to produce a balanced approach. In general, we believe that existing problems in regulation of bankruptcy must be remedied incrementally. For example, it would rather be expedient to begin resolving the problem of lags in the regulation of other security mechanisms of the tax authorities, such as an arrest in particular, than initiating the considered amendments.

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## Contacts

- Olga Chirkova, Principle Associate  
✉ [olga.chirkova@eversheds-sutherland.ru](mailto:olga.chirkova@eversheds-sutherland.ru)  
☎ +7 812 363-3377
- Daniil Akderli, Junior Associate  
✉ [daniil.akderli@eversheds-sutherland.ru](mailto:daniil.akderli@eversheds-sutherland.ru)  
☎ +7 812 363-3377



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