

ADMINISTRATIVE AND FINANCIAL LAW

АДМИНИСТРАТИВНОЕ И ФИНАНСОВОЕ ПРАВО

<https://doi.org/10.22363/2313-2337-2025-29-2-365-381>

EDN: XTQPKU

Research Article / Научная статья

Advance Tax Rulings in the System of Tax Administration: International practices

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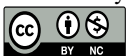
Abstract. The research aims to assess the role of tax rulings in ensuring legal certainty, protecting taxpayers' rights, and reducing tax dispute risks, while balancing private and public interests. The paper analyzes the conceptual and practical aspects of advance tax rulings, including definitions, legal nature, types, objectives, and functions. Using comparative law, it investigates tax ruling practices in various jurisdictions, highlighting potential shortcomings and limitations. It compares rulings with the Russian practice of written tax law explanations from the Ministry of Finance and reasoned opinions from tax authorities, identifying the specifics of tax rulings as a tax and legal regulation instrument within tax administration. The research identifies the key characteristics of advance tax rulings, determines their legal nature, and analyzes the main types and functional purposes. It classifies tax rulings as private, public, and hybrid. The study reveals conceptual differences between tax rulings and reasoned opinions and written explanations of tax legislation in Russian tax law. Finally, it formulates proposals for modernizing Russian tax legislation, incorporating best international practices for advance tax ruling regulation.

Key words: advance tax rulings, public rulings, private rulings, legal certainty, tax administration

Conflict of interest. The authors declare no conflict of interest.

The authors' contribution: *Nadtochiy M.D.* – conceptualization of the idea, data collection, preparation and writing of the manuscript; *Makarchuk Z.V.* – analysis, systematization and scientific development of the collected materials, scientific supervision of the research planning and implementation process; *Zelentsov A.B.* – review and editing of the manuscript. All authors have read and approved the final version of the article.

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Received: 24th April 2024

Accepted: 15th April 2025

For citation:

Nadtochiy, M.D., Makarchuk, Z.V., Zelentsov, A.B. (2025) Advance Tax Rulings in the System of Tax Administration: International practices. *RUDN Journal of Law*. 29 (2), 365–381. <https://doi.org/10.22363/2313-2337-2025-29-2-365-381>

Налоговые рулинги в системе налогового администрирования: опыт зарубежных стран

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Аннотация. Цель исследования – всесторонняя оценка роли налоговых рулингов в обеспечении правовой определенности, защите прав налогоплательщиков и снижении рисков налоговых споров с учетом баланса частных и публичных интересов. В работе проводится детальный анализ концептуальных и практических аспектов налоговых рулингов, включая определение понятия, правовую природу, виды рулингов, их цели и функции. С использованием метода сравнительного правоведения исследуются особенности налоговых рулингов в различных юрисдикциях. Особое внимание уделяется потенциальным недостаткам и ограничениям данного института. Авторы проводят сравнение института рулингов с российской практикой предоставления письменных разъяснений налогового законодательства Министерством финансов и мотивированных мнений налоговых органов, выявляя специфику налоговых рулингов как инструмента налогово-правового регулирования в системе налогового администрирования. В результате исследования выявлены ключевые характеристики института налоговых рулингов, определена его правовая природа, проанализированы основные виды рулингов и их функциональное назначение. Приведена классификация налоговых рулингов на частные, публичные и гибридные. Выявлены концептуальные отличия налоговых рулингов от мотивированных мнений и письменных разъяснений налогового законодательства в российском налоговом праве.

Ключевые слова: налоговые рулинги, публичные рулинги, частные рулинги, заблаговременные решения, налоговое администрирование

Конфликт интересов. Авторы заявляют об отсутствии конфликта интересов.

Вклад авторов: *Надточий М.Д.* – формулирование идеи, сбор материала, подготовка и написание рукописи; *Макаrchук З.В.* – анализ, систематизация и научная проработка собранных материалов, научное руководство процессом планирования и выполнения исследования; *Зеленцов А.Б.* – рецензирование и редактирование рукописи. Все авторы ознакомились с окончательной версией статьи и одобрили ее.

Поступила в редакцию: 24 апреля 2024 г.

Принята к печати: 15 апреля 2025 г.

Для цитирования:

Надточий М.Д., Макаrchук З.В., Зеленцов А.Б. Налоговые рюлинги в системе налогового администрирования: опыт зарубежных стран // *RUDN Journal of Law*. 2025. Т. 29. № 2. С. 365–381. <https://doi.org/10.22363/2313-2337-2025-29-2-365-381>

Introduction

Traditional tax compliance models, based on expected utility theory (Allingham & Sandmo, 1972), have faced increasing criticism. Empirical evidence suggests that factors beyond economic incentives, such as tax law uncertainty and perceptions of fairness, significantly influence taxpayer behavior (Kirchler, 2007). These findings have prompted rethinking of tax obligations and the role of tax authorities in promoting compliance.

A central element to this reconceptualization is the notion of “horizontal” relationships between taxpayers and tax administrations. In contrast to the traditional “vertical” paradigm of hierarchy and coercion, the horizontal approach emphasizes shared responsibility and mutual benefit. This is exemplified by cooperative compliance programs, where taxpayers voluntarily provide tax authorities with real-time data in exchange for increased certainty and reduced administrative burdens.

Tax rulings, the focus of this study, exemplify this shift towards more horizontal relationships. By offering taxpayers advanced official guidance on interpreting and applying tax laws, rulings reduce uncertainty and promote voluntary compliance (Romano, 2002). Unlike post-hoc audits or penalties, rulings are a proactive approach based on dialogue and information exchange.

However, despite this promising framework, empirical evidence on rulings’ impact on taxpayer behavior is mixed. Research suggests that clear guidance enhances perceived fairness and legitimacy, correlating with increased compliance (Kirchler, 2007). Furthermore, engaging with tax authorities for a ruling may foster positive, cooperative relationships.

Conversely, the effectiveness of rulings can be undermined by accessibility, consistency, and equity issues. Burdensome or costly processes may deter taxpayers, especially small businesses or individuals. Inconsistent or biased rulings may amplify unfairness and erode trust in the tax system.

In light of these considerations, this study aims to contribute to understanding the role of tax rulings in modern tax administration. The following sections will explore the conceptual and practical aspects of rulings, beginning with a definition of the term. It will analyze the legal nature of rulings, their place within the broader system of tax law and administration, and the various types or categories that exist.

Furthermore, the study will explore the stated objectives and functions of rulings from both tax authority and taxpayer perspectives. This includes examining how rulings can contribute to increased certainty, reduced compliance costs, dispute prevention, and the promotion of voluntary compliance. At the same time,

it will examine potential drawbacks or limitations of rulings, such as the risk of misuse, inconsistent application, or overreliance.

The Concept and Legal Nature of Tax Rulings in Foreign Countries

The development of tax rulings in foreign countries has evolved through several stages, each with distinct objectives and roles. Initially, in the first half of the 20th century, the emergence of private tax clarifications was primarily viewed as assistance with calculations for complex, non-standard transactions, focusing on informing and advising on technical aspects of tax calculation. In the second half of the 20th century, the focus shifted to protecting the taxpayers' rights and legitimate interests by providing official guidance on tax law interpretation and application to minimize errors and guarantee predictable tax consequences for transactions.

The modern stage of tax ruling development, particularly within the context of digitalization, takes a comprehensive approach to defining their goals and roles. Emphasis is placed on assisting taxpayers in fulfilling their tax obligations, ensuring tax system stability, promoting uniform law enforcement, protecting taxpayer rights, and increasing the transparency of tax authority actions. Thus, the understanding of this institution has constantly evolved.

The term “ruling”, specifically as “advance ruling” is widely used in international practice and tax law literature. While this term has not been applied in Russian legislation, with the exception of customs regulation (Articles 23, 32, 38 of the Customs Code of the Eurasian Economic Union¹), the translation of “advance ruling” as “preliminary decision” does not fully capture its essence. A more accurate interpretation would be “advance decision”. Given the established use of “ruling” in Russian tax law literature, using the transliterated form is justified.

The OECD² defines an “advance ruling” as: “A written decision that the tax authorities direct to a taxpayer in connection with the interpretation and application of tax legislation to a certain set of facts.”

This definition highlights key features of tax rulings as a tax administration tool. First, a ruling provides an official written interpretation by tax authorities on applying legislation to a taxpayer's specific situation, ensuring transparency and certainty regarding tax consequences. Second, a private ruling is individual, issued at taxpayer's request and based on their facts and circumstances, unlike general clarifications of tax legislation.

India's experience with tax rulings is of particular interest. With the introduction of its ruling system in 1993, the concept of a tax ruling expanded significantly. The definitions of a tax ruling in the Finance Act of 1993 and the Income

¹ Customs Code of the Eurasian Economic Union (as amended on May 29, 2019) (Appendix No. 1 to the Treaty on the Customs Code of the Eurasian Economic Union). Available at: https://www.consultant.ru/document/cons_doc_LAW_215315/?ysclid=m03kv52ojh715606232 (accessed: 12.05.2024).

² Organisation for Economic Co-operation and Development (OECD) Official Website. Available at: <https://www.oecd.org/ctp/glossaryoftaxterms.htm> (accessed: 26.02.2024).

Tax Act of India³ share several key features. First, a ruling is a determination, decision, or conclusion by an authorized body on legal or factual issues related to a specific taxpayer transaction. Second, a ruling can relate to both completed and proposed transactions, allowing taxpayers to clarify the tax consequences in advance. Third, both definitions emphasize the “individual nature” of the ruling, since it is issued for a specific applicant’s transaction.

A distinctive feature of the Income Tax Act is its emphasis on the international aspect of rulings, separately highlighting situations where the applicant is a non-resident or a resident engaging in transactions with a non-resident. Another important addition is the possibility of obtaining a ruling on the methodology for calculating taxable income. Thus, the definition of a tax ruling in India’s Income Tax Act is more detailed and considers the specifics of cross-border transactions.

When defining “tax ruling” (“advance tax ruling”), it is important to address some inaccuracies in terminology. The term “ruling” generally denotes an official opinion or decision made by an authority. What is commonly referred to as a ruling or tax ruling is actually an “advance ruling” or “advance tax ruling”. The distinction lies in the timing: a ruling is made after verifying a completed transaction, while an “advance ruling” is made after studying a planned transaction. An advance ruling is like a preliminary compliance assessment for a building project; after construction, an inspection yields a final ruling on compliance with the approved project.

Given that the definition of “ruling” is not legislatively defined, and finding a suitable analogue in Russian is challenging due to its polysemy, the authors believe it is correct to use “ruling” in Russian to mean “advance ruling”.

The very name of the tax ruling in Russian jurisprudences remains debated. Scientific literature includes terms like: 1) tax ruling; 2) preliminary decision; 3) preliminary tax clarification; 4) motivated opinion; 5) preliminary tax regulation, etc.

The term “fiscal rescript” is also used in Russian literature to denote tax rulings. A.V. Demin notes that taxpayers can request a motivated opinion for both future and completed transactions, aligning this process with the international practice of fiscal rescripts (Demin, 2017).

Studying the legal nature of tax rulings is complex task due to varying interpretations across jurisdictions. C. Romano rightly notes that a ruling can be seen as an act of public administration or a civil or public law contract, indicating ambiguity in its legal status (Romano, 2002). This variability underscores the need for detailed study of specific legal systems to understand the concept’s evolution.

Several scholars, including M. Ślifirczyk, E. Van de Velde, and D. Marks argue that tax rulings are more than just legal acts of the tax administration (Ślifirczyk, 2023; Van de Velde, 2019; Marks, 1998). They view tax rulings as essentially a contract between the tax administration and the taxpayer, determining the procedure for fulfilling tax obligations in each specific case.

³ Section 245N of the Income Tax Act of India, 1993. Available at: <https://incometaxindia.gov.in/pages/acts/income-tax-act.aspx> (accessed: 26.02.2024).

In his study “Tax rulings in the EU Member States” (2015), E. Van de Velde defines the term “tax ruling” as a general concept that covers all types of tax arrangements between tax authorities and taxpayers (E. Van de Velde, 2015).

The Netherlands’ experience is particularly interesting, as the legal nature of tax rulings has significantly changed there over the past decades. Analyzing this evolution reveals a shift in understanding the essence of a ruling: from obligations of tax authorities in the 80s to mandatory opinions, and then to a settlement agreement governed by the Dutch Civil Code. This transformation reflects a broader trend in administrative law toward using flexible instruments that combine elements of public and private law.

In the 80s, tax rulings in the Netherlands were viewed as obligations of tax authorities. However, the period from 1990 to 2001 was characterized by legal uncertainty and disputes between various government branches. The Ministry of Finance argued that rulings were preliminary acts without administrative act status under the General Administrative Law Act. In contrast, courts, including the Supreme Court, interpreted rulings as agreements between the taxpayer and the tax authority, governed by the Civil Code. This conflict reflected a deeper contradiction between the traditional administrative law approach and the tendency to use civil law instruments in the public sphere.

A turning point came in 2001, with a significant reassessment of the nature of tax rulings. The interpretation of rulings as unilateral acts was rejected in favor of recognizing them as bilateral agreements binding on both parties. This transition to regulating rulings within the framework of civil law can be seen as an attempt to balance the flexibility necessary for effective tax administration with the legal certainty required to protect taxpayers’ interests.

The provisions of the Dutch Civil Code, particularly Articles 900 and 906 of Section 7.15, played a key role in this transformation. Article 900 defines a settlement agreement as a tool for establishing a new legal status between the parties. Article 906 extends the application of these provisions to other relationships, thereby creating a legal basis for a new interpretation of tax rulings.

Regarding the form of tax rulings, paragraph 2 of Art. 900 of the Dutch Civil Code stipulates that “the assessment and establishment of their new legal status can be carried out by means of a joint decision of the parties involved, either by a decision of one of them, or by a decision of a third party.” Tax rulings made by a decision of the tax administration only have legal force if they are accepted by the taxpayer (Nadtochiy, 2024).

H. Pijl and W. Hahlen note that, within the context of Article 900 of the Dutch Civil Code, tax rulings are considered as an agreement on determining a tax obligation, aimed at avoiding uncertainty or conflict regarding the legal relationship between the taxpayer and the tax administration. Through this agreement both parties undertake to determine their legal relationship (Pijl & Hahlen, 2001). The taxpayer must disclose all the details (facts) for analyzing specific circumstances, and the tax service, after issuing a ruling, must adhere to it, evaluating the facts and circumstances exactly as indicated in the ruling.

The evolution of the Supreme Court of the Netherlands' position regarding the use of private law instruments to achieve public goals is also noteworthy. Initial support for this approach in the absence of an explicit prohibition was replaced by a more cautious stance. The Court began to limit the use of private law instruments to situations where public law does not offer equivalent measures with greater guarantees for citizens. This evolution reflects a growing awareness of the need to balance the efficiency of administrative management with the protection of citizens' rights.

Analyzing the Dutch experience in determining the legal nature of tax rulings leads to the conclusion that this process is complex and multifaceted. The transformation from an administrative-legal to a civil-legal approach reflects broader trends in the development of modern law, where the boundaries between various branches are becoming more permeable. However, this process also raises important questions about the limits of using private law instruments in the public sphere and the need to ensure adequate guarantees for protecting public interests.

Scholars such as C. Romano, R. Bartes, and V. Moravsky view tax rulings as acts of public administration governed by public law. C. Romano emphasizes that administrative law principles provide the greatest protection for taxpayers' rights and legitimate interests. Furthermore, Romano argues against classifying tax rulings as public law agreements, since these agreements lack reciprocal satisfaction. According to Romano, advance pricing agreements (APA) cannot be classified as administrative contracts, since the taxpayer only provides mandatory consent (Romano, 2002).

To analyze the legal nature of tax rulings, it is helpful to consider their compliance with the key features of administrative acts. This approach allows for a systematic study and determines the place of tax rulings within the administrative law system.

The first essential feature of an administrative act is its issuance by a public administration body. Tax rulings fully satisfy this criterion, since they are issued by tax authorities, which are integral to the executive branch. These bodies, performing state functions in taxation, undoubtedly belong to public administration.

The second significant aspect is the issuance of an act within the body's powers. The competence of tax authorities to issue rulings is usually clearly enshrined in tax legislation. This ensures the legitimacy of their actions and compliance with the fundamental principle of legality in administrative law. This emphasizes the legitimacy of tax rulings and their alignment with powers of tax authorities as established by law.

The third key feature is compliance with current legislation (legality). Tax rulings fully meet this criterion, as they are based on current tax law. In essence, they represent an official interpretation and application of legal norms to specific situations, fully upholding the principle of the rule of law, which is the cornerstone of a legal system.

The fourth essential feature of an administrative act is the pursuit of a public goal. Tax rulings fully satisfy this criterion. Their main purpose is to assist taxpayers in properly fulfilling their tax obligations, which directly serves the public

interest. This includes promoting uniformity and increasing legal certainty for taxpayers, which helps reduce tax disputes and improve the overall efficiency of tax administration.

However, the concept of a “tax ruling as an administrative act” cannot fully explain why the issued tax ruling is binding on only one party, while the other party has the right not to comply with it. Although the bindingness of rulings may vary by jurisdiction, they are typically binding on tax authorities and can create certain (contractual) rights and obligations for taxpayers.

Analyzing the legal nature of tax rulings through the lens of “offer and acceptance” reveals their unique characteristics and regulatory potential. In tax law relations, the state, acting as an offeror, pursues a public law goal: assisting taxpayers in fulfilling their fiscal duties. A tax ruling, framed as an offer, is not just a proposal but a form of “invitation to cooperate” aimed at ensuring stability and certainty in applying tax legislation. By accepting the offer through actual compliance with the ruling’s prescriptions, the taxpayer enters a special relationship with the public administration, similar to an administrative contract. This “contract” creates mutual rights and obligations, and serves as an effective tool for preventing and resolving potential tax disputes.

However, the validity of this “administrative contract” depends on the taxpayer’s good faith in disclosing all the material circumstances of the proposed transaction. Concealing or distorting information renders the ruling invalid from the beginning (*ab initio*), aligning with the civil law doctrine of defective contractual consent. This circumstance emphasizes the complex nature of tax rulings, integrating both public law and private law elements.

“Reasoned opinions” in Russian tax law: A “quasi-ruling” approach

In Russian tax law, the clarifications issued by the Ministry of Finance and the reasoned opinions of tax authorities could, in principle, be considered distant analogues to the institution of tax rulings.

However, the Ministry of Finance’s letter dated July 24, 2019⁴, states that its clarifications are merely advisory and not binding on either the tax authority or the taxpayer. Therefore, these clarifications currently fail to provide sufficient clarity in regulating tax relations and do not foster stable, favorable conditions for entrepreneurial activity.

The clarifications issued by the Ministry of Finance in their current form cannot be binding due to several shortcomings:

1. Clarifications are issued without mandatory reference to specific factual scenarios, resembling general written consultation on the possible application of tax legislation.

⁴ Ministry of Finance of the Russian Federation. (2019). On the Status of Clarifications of the Ministry of Finance of the Russian Federation on the Application of the Legislation of the Russian Federation on Taxes and Fees (Letter No. 03-02-08/55114 dated July 24, 2019).

2. There is no established mandatory form (internal and external structure) for either the clarification itself or application requesting it.

3. The Ministry of Finance is not obligated to publish all clarifications, resulting in selective publications.

4. There is no system for tracking the status of clarifications, including changes or cancellations of previously issued clarifications.

5. There is no specific list of issues on which such clarifications can be issued, leading to an unlimited range of topics.

6. There is no centralized publication of clarifications, which is essential to ensure uniformity and legal certainty⁵.

Thus, the clarifications issued by the Ministry of Finance of the Russian Federation differ significantly from the established institution of tax rulings.

In Russia, a reasoned opinion issued by the tax authority represents the official position of the tax service regarding the correctness of the calculation (withholding), as well as the full and timely payment (transfer) of taxes, fees and insurance premiums. This opinion is provided to organizations participating in tax monitoring⁶.

The introduction of reasoned opinions was foreshadowed in 2014 when the Russian Federation Government approved the Roadmap for the Improvement of Tax Administration. This roadmap included a task to study the possibility of introducing a “preliminary tax clarification” (tax ruling) for assessing business situations⁷.

Furthermore, in subparagraph 7.1, Section III of the Main Directions of the Tax Policy of the Russian Federation for 2016 and the planning period of 2017 and 2018, the government stated its intention to create a mechanism for preliminary tax clarification (tax ruling) as part preliminary tax control initiatives. The document noted that this would allow taxpayers to know the tax consequences of planned transactions in advance, a practice successfully applied in other countries⁸.

Thus, in Russia, the tax ruling was initially defined and implemented as an integral component of tax monitoring. However, it is important to

⁵ In accordance with Article 21 of the Tax Code of the Russian Federation, the authority to provide written explanations is not limited to the Ministry of Finance and the Federal Tax Service but extends to other authorized bodies. In the authors' opinion, this practice hinders the achievement of uniformity in interpreting and applying tax legislation. The lack of a clearly defined list of issues on which written explanations can be obtained from specific responsible authorities further complicates the situation.

⁶ Tax Code of the Russian Federation (Article 105.30). Legal Navigation Service ‘Codes and Laws of the Russian Federation’: [Website]. Available at: <https://www.zakonrf.info/nk/32/> (Accessed: September 25, 2023).

⁷ Government of the Russian Federation. (2014, February 10). Order No. 162-r On Approval of the Action Plan (roadmap) 'Improvement of tax administration'. Action Plan, Section II, Item 3. Government of the Russian Federation: [Website]. Available at: <http://static.government.ru/media/files/41d4be34b5250e8848fd.pdf> (Accessed: September 25, 2023).

⁸ Government of the Russian Federation. (2015). Main Directions of the Tax Policy of the Russian Federation for 2016 and the Planning Period of 2017 and 2018. ConsultantPlus Information and Reference System: [Website]. Available at: https://www.consultant.ru/document/cons_doc_LAW_183748/300c431e68f43f4f4df2ef645fe04337d1a5d576/ (Accessed: September 25, 2023).

recognize that a tax ruling is an independent legal institution with its own distinct development history.

While it is projected that 573 companies will participate in tax monitoring in 2024⁹, as of early January 2024, 6.347 million small and medium-sized businesses were registered in Russia¹⁰. This means that reasoned opinions from the tax authorities will be accessible to less than 0.001% of entrepreneurs in 2024, highlighting the limited scope of this tool.

The central challenge is leveraging reasoned opinions to protect the rights and interests of bona fide taxpayers who encounter issues stemming from contradictions or gaps in the legislation.

This raises a dilemma: how can reasoned opinions be used to protect the rights of individual taxpayers while simultaneously ensuring equal conditions for all? The primary goal of reasoned opinions should be to prevent discriminatory practices and advantages for companies with access to private rulings (including reasoned opinions).

While reasoned opinions from tax authorities share certain elements with tax rulings, these “quasi-rulings” have key conceptual differences:

1. Issuing Authority: Tax rulings are issued by a central or specialized body, whereas reasoned opinions are issued by territorial tax authorities conducting tax monitoring. Centralized issuance of tax ruling ensures: (1) uniformity of the interpretation and application of tax legislation and (2) limitation of administrative discretion by territorial bodies.

2. Publication: Tax rulings are typically subject to publication, unlike reasoned opinions. Publicly available tax rulings provide public oversight of the uniformity in interpreting and enforcing tax legislation.

3. Fees: A fee is generally required for issuing tax rulings, while no fees are associated with issuing a reasoned opinion.

4. Eligibility: A broad range of applicants can apply for tax rulings, while reasoned opinions are available only to taxpayers participating in tax monitoring.

5. Binding nature: A tax ruling is not binding on the applicant but is binding on the tax authorities if the addressee adheres to it. In contrast, a reasoned opinion is binding on both the taxpayer and the tax authority. The taxpayer must inform the tax authority about the execution of the reasoned opinion within the prescribed timeframe.

The correlation between the concepts of tax ruling and tax control is of particular theoretical interest, offering at least two perspectives. On the one hand, a ruling can be viewed as a specific form of preventive tax control, designed to preempt tax violations and disputes. On the other hand, fundamental differences exist between a ruling and traditional tax control:

⁹ 573 companies to participate in tax monitoring in 2024. (2023, February 25). Official website of the Federal Tax Service of the Russian Federation. Retrieved February 25, 2024, from https://www.nalog.gov.ru/rn77/news/activities_fts/14134946/

¹⁰ Demographics of small and medium-sized enterprises. (n.d.). Corporation "SME", JSC. Retrieved February 25, 2024, from <https://xn--1lagf.xn--plai/analytics/>

- A ruling is issued at the taxpayer’s request, whereas tax control is generally initiated by the tax authorities.
- A ruling addresses legal issues, while tax control also examines factual circumstances.
- A tax ruling does not result in additional tax charges or liability, unlike actions resulting from tax control.

The development of new control mechanisms, such as tax monitoring, bridges the gap between rulings and traditional control, but does not eliminate their core distinctions. Therefore, a tax ruling remains an independent legal institution that complements, rather than replaces, tax control. They are autonomous yet interconnected components of the tax administration system.

Types of Tax Rulings in Foreign Countries

The umbrella term “tax ruling” (or “advance tax ruling”) encompasses several distinct concepts: a) public rulings (also known as “general ruling”); b) private rulings; and c) hybrid rulings. These concepts have significant differences, making a single, all-encompassing definition either overloaded or misleading.

Private rulings are issued upon the request of a specific taxpayer and pertain to their unique situation. They aim to clarify the application of tax regulations to a taxpayer's particular business scenario, thereby minimizing tax risks and uncertainty (Romano, 2002).

For example, a company contemplating a major business reorganization or a complex cross-border asset acquisition may request guidance from the tax authority regarding the tax implications of such an undertaking. Armed with tailored advice in the form of a private ruling, the company can pay taxes in accordance with the provided clarification, thereby avoiding potential tax disputes.

To obtain a private ruling, a taxpayer submits a request to the tax service, clearly outlining the scope of the inquiry, providing a detailed account of the relevant circumstances, and articulating their proposed approach. The tax authority then reviews the request, analyzes the circumstances, formulates its position on how specific tax regulations should be applied, and subsequently issues the taxpayer with individualized guidance in the form of a private ruling. A request for a private ruling may be rejected on formal grounds, due to insufficient data, or inadequate presentation of the issue.

According to Revenue Procedure No. 2024-01, a “private letter ruling” is “a written determination issued to a taxpayer by an authorized body in response to a taxpayer's written request submitted before filing returns or reports that are required by tax legislation; about their status for tax purposes or about the tax consequences of their actions or operations. A private ruling interprets tax legislation and applies it to the specific facts of the taxpayer”¹¹.

¹¹ Internal Revenue Bulletin 2024-1. (2024). Official website of the Internal Revenue Service. Retrieved February 26, 2024, from https://www.irs.gov/irb/2024-01_IRB#REV-PROC-2024-1

In the United States, the Internal Revenue Service (IRS) issues private letter rulings in response to written requests from taxpayers. These rulings provide an interpretation of the tax consequences of transactions or operations planned by the taxpayer, considering all pertinent factual circumstances. Private rulings are legally binding only for the taxpayer who requested them and serve to ensure legal certainty in that specific situation. The procedure for providing applicants with comprehensive information is outlined in the tax code¹² and in the IRS regulations¹³.

Public rulings aim to ensure uniform law enforcement practice among tax authorities regarding typical, common business situations and tax issues. They are always issued proactively by the tax authority, are published in an official publication, and are provided to taxpayers free of charge.

A public ruling is issued to generalize law enforcement practice or provide initial guidance on interpretation and applying a new tax regulation. For instance, a tax authority may issue a ruling clarifying the VAT payment procedure for foreign companies working with an online platform. This ruling is published on the official website and is binding for all territorial tax authorities.

In the USA, a public ruling (“revenue ruling”) is defined as “an official interpretation of federal tax legislation in the Internal Revenue Bulletin for the information and guidance of taxpayers, tax service employees, and other interested parties. Although binding on the tax service and taxpayers, their application is limited to the specific factual situations to which they relate” (Romano, 2002).

In the USA, public rulings are published by the Tax Administration in the official bulletin and provide clarifications on applying tax legislation to common scenarios. Issued proactively by the IRS, they aim to clarify tax legislation provisions and establish a uniform application practice for a broad range of taxpayers. Public rulings generally have binding legal force throughout the USA but serve as guidance for taxpayers, while remaining mandatory for tax authorities (Romano, 2002).

Hybrid rulings blend characteristics of both private and public rulings, offering general guidance for a specific group of taxpayers or for a future counterparty that cannot be identified when the application is filed. These rulings can be issued either at the request of the interested party or proactively by the tax authority.

“Class rulings” and “product rulings,” used in several countries, exemplify hybrid rulings.

– New Zealand: “Class rulings” are issued upon request for a group of taxpayers sharing common characteristics or for a specific category of transactions. They offer general guidance on how tax legislation will apply to that specific group or transaction type.

¹² U.S. Internal Revenue Code, Section 6110. Cornell Law School: [Website]. Available at: <https://www.law.cornell.edu/uscode/text/26/6110> (Accessed: February 25, 2023).

¹³ Internal Revenue Service. Revenue Procedure 2022-1. Internal Revenue Service: [Website]. Available at: <https://www.irs.gov/pub/irs-drop/rp-22-1.pdf> (Accessed: February 25, 2023).

– South Africa: “Class rulings” are issued at the applicant’s request regarding a proposed transaction to be carried out by a specific class of taxpayers, providing an interpretation of the tax consequences of that transaction.

– Australia: “Product rulings” clarify of the tax implications of investments in a specific financial product (e.g., an investment scheme or insurance policy), issued at the product issuer’s request. These rulings provide investors with certainty regarding the tax treatment of their investments.

In summary, hybrid rulings strike a balance between the individualized approach of private rulings and the broad scope of public rulings, enabling guidance for an entire group of taxpayers or a category of transactions.

The issuance of private, public, and hybrid rulings is highly beneficial for tax authorities as it ensures uniformity and consistency in applying tax legislation. Moreover, the availability of official guidelines reduces disputes between taxpayers and tax authorities, lessening the burden on the judicial system and improving the overall efficiency of tax administration.

Private rulings are particularly important for taxpayers, since they minimize the risks of error and potential penalties when paying taxes in non-standard situations. By leveraging these rulings, companies and individuals can conserve resources by avoiding unnecessary conflicts with tax authorities.

Goals and Functions of Tax Rulings in Foreign Countries

The functions of a tax ruling, as an instrument of tax law, are derived from its primary goals and objectives within tax regulation and law enforcement.

The main objectives of tax rulings are: first, to provide taxpayer with reliable guarantees when undertaking transaction or investment activities; second, to eliminate ambiguity in the interpretation of tax regulations for a specific planned operation at the taxpayer’s request; and third, to promote uniformity in tax practice¹⁴.

Among the primary functions of tax authorities when issuing a ruling, the following stand out:

1. Administrative guarantee for entrepreneurs. This function is crucial for the institution of tax rulings, particularly from investor’s perspective. A ruling obtained for a planned project essentially provides assurance and a guarantee from the tax authority that the transaction structure and taxation scheme chosen by the entrepreneur comply with requirements.

The entrepreneur receives customized guidance on interpreting and applying tax regulations. Relying on this guarantee, they can confidently proceed with project implementation, assured of the stability and security of their chosen tax position. The ruling acts as “insurance” against potential future claims and additional charges, reducing both tax risks and administrative costs of commercial activities.

¹⁴ Handbook on Advance Ruling under GST (Sec. 3). Income Tax Department of Ministry of Finance, Government of India: [Website]. Available at: <https://idtc-icai.s3.ap-southeast-1.amazonaws.com/download/pdf20/Handbook-on-Advance-Ruling-under-GST.pdf> (Accessed: February 12, 2024).

2. Anti-corruption function. Tax rulings play a significant role in fulfilling the anti-corruption function of tax administration. This is manifested in two key ways: First, rulings increase the transparency of the tax system, making the interpretation of legislation more open and accessible to a wider range of taxpayers. Second, they significantly limit the discretionary powers of officials, thereby minimizing opportunities for arbitrary, potentially corrupt decisions.

3. Ensuring the stability of tax legislation. A secondary benefit of using a ruling system is the reduced need to frequently update tax legislation. Countries employing ruling systems often use them to test new legislation. Regulatory authorities issue official clarifications, and based on law enforcement practices and expert feedback, the most viable regulations are developed, making the consequences of such regulations more predictable. While this approach may not always be appropriate, it can significantly reduce the number and frequency of amendments to legislative acts.

4. Reduce tax disputes in courts. The ruling system reduces tax disagreements through the following mechanisms:

First, rulings prevent potential disagreements between parties during the transaction planning phase. This ensures a clear understanding of the tax consequences.

Second, taxpayers who conduct their business in accordance with the previously obtained ruling minimize the risk of future additional tax charges and sanctions, thereby reducing the likelihood of disputes.

Moreover, tax authorities are legally restricted in their ability to revise a position officially stated in a ruling. Without a change in position, there is no basis for additional charges or disputes. Thus, the ruling system reduces conflict potential at all levels in the relationship between taxpayers and the state, leading to a decrease in tax disputes in courts.

Conclusion

The study of tax rulings in foreign countries allows us to draw several key conclusions regarding their legal nature, diversity, purpose and function.

Despite the lack of a universal definition, a tax ruling is generally understood as an official written clarification from authorized bodies on the application of tax legislation to a taxpayer's specific economic situation. Key features include its official form, binding nature for tax authorities, and focus on ensuring predictable tax consequences.

The legal nature of tax rulings remains a topic of debate in legal doctrine, with comparative analysis revealing approaches that view rulings as either individual administrative acts or public law contracts.

A significant result of this study is the identification and characterization of the main types of tax rulings, each with distinct functional purposes and scope. These include: private rulings for specific taxpayers clarifying tax implications of individual operations; public rulings initiated by tax authorities to create uniform enforcement practices; and hybrid rulings combining features of both, focused on specific taxpayer segments or transaction categories. Each type plays a unique

role in tax administration, balancing individualized approaches with unified tax regulation.

The functional purpose of tax rulings is geared towards ensuring tax system stability and predictability, protecting taxpayer rights, and minimizing tax dispute risks. Key functions include: providing administrative guarantees to taxpayers, ensuring uniform law enforcement, clarifying ambiguous tax legislation, and preventing tax offenses and conflicts. The expression and implementation of these functions vary based on the ruling type and national tax jurisdiction.

Considering tax rulings as an offer and acceptance mechanism reveals their specificity as a tool for implementing the state's fiscal function. In this context, the offer serves not only as a legal construct but also as a means of achieving public goals, particularly assisting taxpayers in fulfilling their tax obligations.

The conceptual differences between Ministry of Finance clarifications and tax authority reasoned opinions – manifest in their legal nature, subject composition, legal force, adoption, and publication – indicate the need for further modernization of domestic tax legislation, informed by proven foreign tax administration models.

In conclusion, the institution of tax rulings is an effective tool within the modern tax administration system, harmonizing the state's fiscal interests with the legitimate economic interests of taxpayers.

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