

A Culture of Corruption Defies Efforts at Reform

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Moscow's 28th Tax Inspectorate repeatedly fends off corruption probes, most famously by Sergei Magnitsky. **Denis Sinyakov**

Wounded in Afghanistan and an 18-year veteran of the elite Alfa counter-terrorist forces, Sergei Vasilenko considers himself a patriot.

Which is why, when his bosses at the Federal Security Service asked him in 2010 to investigate corruption, he jumped at the chance.

The problem, Vasilenko now says, was that his new chiefs at the Federal Tax Service didn't want him to do his job properly.

Vasilenko's experience opens a window into what even Prime Minister Vladimir Putin, bidding for a third Kremlin term, calls Russia's "systemic" corruption. It's a malaise that Putin's political opponents say has flourished during the prime minister and former president's 12 years as the country's most powerful leader.

Vasilenko says his investigation, into suspected fraud involving tax officials in Moscow, met a wall of silence and he was soon out of a job. The Federal Tax Office said it had investigated Vasilenko's allegations but declined further comment.

Now the former soldier works with Analysis and Security, a local anti-

corruption campaign group run by former tax officials, security professionals and managers of firms that have been on the wrong end of the kind of shakedowns the group seeks to expose.

"I fought, was wounded and decorated, and it has come to this?" Vasilenko said at Analysis and Security's cramped, unmarked office in a nondescript building on Leningradsky Prospekt. "I want to make a difference."

Giving Up the Fight

Senior government officials admit that tax, customs and financial fraud cost the country tens of billions of dollars a year, much of which leaves Russia in the form of capital flight. Net capital outflows from Russia totaled \$84 billion last year, the second-highest in the 20 years since the breakup of the Soviet Union and nearly 5 percent of gross domestic product.

The outflows show "investors believe that the Russian state has given up the fight against corruption," said Sergei Guriev, rector of Moscow's New Economic School. "The Russian state is not capable of solving problems — it is the problem itself."

Guriev's comments, made to a recent financial conference at which Putin spoke, reflect growing dismay among the educated, urban citizens that have fueled large-scale protests over alleged fraud in last December's State Duma elections.

Putin has promised a cleanup, but protests continue, with slogans demanding the departure of the ruling clique of "crooks and thieves." Analysis and Security doubts the demonstrations will achieve much and focuses instead on "outing" corrupt officials.

"We just keep hitting on the same spot until we get a result," says Ruslan Milchenko, a former tax policeman who heads the group. For funding, it relies on firms it helps out of tight spots; it receives no foreign donations.

One Day in the Life

Russia has a reputation for authoritarian rule, but it is the country's liberal corporate law that makes it possible for one of the best-known swindles — the value-added tax, or VAT, scam — to work.

Shell companies — known as *odnodnevki*, or "one-day" firms — can be quickly registered in the names of convicted criminals or using stolen passport data, corruption experts say. The companies take advantage of the fact that Moscow alone has 50 tax offices. Each of Russia's 89 regions has 30 to 50 inspectorates.

The shells file fraudulent claims for VAT rebates on goods and services that are never supplied and turn the proceeds into cash by a range of laundering methods. They then reregister in

another tax district to evade investigators.

Such one-day firms spirited an estimated \$33 billion in ill-gotten gains out of Russia last year, with a similar sum illegally laundered inside the country, according to the findings of a government investigation presented last month by First Deputy Prime Minister Viktor Zubkov to President Dmitry Medvedev.

“This has a negative impact on the country’s economic development, acts as a deterrent to investment and creates a serious threat to national security,” Zubkov said.

In his 2010 report to his superiors Vasilenko wrote that officials in one Moscow tax office had used the scam to carry out “clearly criminal” schemes to cheat the state of at least \$100 million.

The tax office — the 28th Inspectorate — had approved VAT rebates of at least 500 million rubles (\$17 million) apiece to seven firms, six of which then switched their tax residency to the Tver region.

Vasilenko reported that the companies that moved to Tver had no real business activity, only a handful of staff, and could provide no evidence that

they had shipped any stock. The firms then merged and moved again, effectively disappearing.

The 28th Tax Inspectorate alone approved illegal rebates of 5 billion rubles to 10 billion rubles (\$170 million to \$341 million) a year, Vasilenko wrote in a separate letter to his former superiors.

Vasilenko says his bosses were not interested in his findings, and he was fired at a meeting with the head of the Federal Tax Service, Mikhail Mishustin.

“Mishustin just told me: That’s it,” Vasilenko said.

The Federal Tax Service declined to comment on how Vasilenko was fired.

“In 18 years of service in Alfa, I learned to be the sharp blade of the sword of state, to feel the pain of hostages more strongly than my own and to put the interests of society first,” he wrote in the letter to his former bosses.

“I received military decorations; I lay in hospitals. But after three months’ service in the Federal Tax Service, I came to doubt strongly that this country, whose interests I defended, values its citizens.”

The head of the 28th Tax Inspectorate at the time, Olga Stepanova, received a mild reprimand in the case, Vasilenko says. She moved in late 2010 to a job in the procurement section of the Defense Ministry but has since resigned.

Stepanova’s lawyer, Larisa Move, said she had not heard Vasilenko’s allegations and declined to comment on them.

Still in Business

The 28th Tax Inspectorate was at the center of the most notorious recent alleged fraud involving Russian officials: the case of investment fund Hermitage Capital.

London-based Hermitage, once the largest foreign portfolio investor in Russia, alleges that dozens of Russian officials were involved in an operation in 2007 to seize its company seals and file a fraudulent tax rebate for \$230 million.

Hermitage's lawyer, Sergei Magnitsky, investigated the case and was arrested in late 2008 by the Interior Ministry officials he suspected of the alleged fraud. He was pressured while in detention to confess that he had stolen the money, Hermitage says.

Magnitsky's health deteriorated and, despite repeated requests, he was denied treatment for abdominal pains, diagnosed as pancreatitis, cholecystitis and gallstones requiring surgery, according to Hermitage. He died in November 2009, aged 37, after what Hermitage says was a severe beating — a finding confirmed by Medvedev's human rights council.

Medvedev, reviewing the council's report last July, said "some crimes were committed" in the "very sad" Magnitsky case. These conclusions were rejected outright by the Interior Ministry.

"There are 60 people who are responsible, one way or another, either directly or indirectly, in the death of Sergei Magnitsky. We all know who they are," Hermitage founder Bill Browder said. "The Russian government is protecting them, and none of them have been prosecuted."

The Interior Ministry and Prosecutor General's Office found no evidence of wrongdoing in Magnitsky's death. Some of the officials named by Hermitage were promoted and received state honors. Interior Ministry investigators plan to seek a posthumous conviction of Magnitsky for theft, Hermitage now says.

Stepanova's lawyer said her client "may have" signed off on the Hermitage tax rebate on the instruction of her superiors, but denied that she had any role in the tax fraud alleged by Hermitage, or in the death of Magnitsky.

Breaking the Bonds

Putin has responded to the groundswell of public anger over corruption by promising judicial reforms to "break the accusatory bonds" of law enforcement, prosecutors and courts.

"We have to eliminate all the rudiments of Soviet justice from criminal law, all the hooks that make it possible to turn a business dispute into a criminal case against one of the participants," Putin wrote in an opinion article last month.

His critics say it is Putin himself who gave a green light to officials to shake down business through the state-driven breakup of Yukos in the mid-2000s.

Yukos, once Russia's top oil firm, was bankrupted by back-tax claims that exceeded its earnings. Its prime assets were then bought by state oil firm Rosneft.

Yukos' main owner, Mikhail Khodorkovsky, was convicted of fraud in 2005, in what many

viewed as a punishment for daring to challenge Putin politically.

Oligarch-turned-politician Mikhail Prokhorov, running on a liberal platform against Putin for president, says the Yukos case and jailing of Khodorkovsky set “a very bad precedent.”

“A lot of small businessmen suffered from the same methods all over the country,” he said. “It was a key story for the lower-ranking policemen, or judges, or ex-KGB guys to do the same.”

Putin has rejected criticism over the Yukos case, saying of Khodorkovsky that “a thief should sit in jail.” He made the comments in late 2010, just before Khodorkovsky was convicted for a second time, and his jail term extended to 2017.

The Interior Ministry’s economic security department, which has faced widespread allegations that it obstructed corruption investigations, was dissolved last summer by Medvedev. It was replaced by the main directorate for economic security and action against corruption, which has achieved some notable busts.

The department’s new chief, Major General Denis Sugrobov, fired 40 percent of the staff after they failed background checks. He has also tightened discipline.

“I am responsible for every colleague,” he told Kommersant in a recent interview. “Even if a low-ranking staffer who worked here for a couple of months is brought to criminal justice, that automatically reflects on me. That’s how it should be.”

Analysis and Security said Sugrobov is a strong investigator. But the group doubts he will be able to tackle corruption at the highest level.

“He’s the only one who has declared open war against corruption,” said Milchenko, the head of the anti-

corruption group. “But he can’t work against the whole system. He can only take action if he is allowed to.”

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