

7

The Complexity of Tax Simplification: Russia

Alexander I. Pogorletskiy, Elena V. Kilinkarova and Nadezhda N. Bashkirova

1 Introduction

Modern national tax systems must meet requirement of simplicity, clarity and stability that were introduced by the founders of economic theory. The result of the evolution of the Russian tax system in the 1990s, 2000s and 2010s became a significant simplification of the national tax legislation, decreasing number of taxes and the level of tax burden. Tax Code introduced in 1999–2001 replaced the previous numerous and diverse legal documents governing the taxation and optimised structure of taxes. Instead of the original, which imposed more than 50 taxes, the current Russian tax system imposes only 14. Tax rates significantly decreased in accordance with the requirements of the stimulating nature of taxes and economies of scale for budget revenues. The severity of the tax burden was gradually moved in the direction of taxation of producers and exporters of raw materials (this contributed to the emergence in 2002 of the special tax on extraction of mineral resources). Finally, the Russian tax reform implemented at the turn of the 21st century is still considered to be one of the most successful in the world and the most consistent among series of reforms implemented by Russian authorities.

In this chapter we will assess processes of tax simplification in Russia with regard to national tax system, tax legislation and tax administration. Section 2 deals with simplification of Russian tax system, Section 3 discusses simplification of tax legislation, Section 4 analyses simplification of tax administration and taxpayer communications and Section 5 examines long-time approaches for tax simplification in Russia. Finally some conclusions are drawn.

2 Simplification of Russian tax system

2.1 Russian tax system of 1990s: complexity of first years of implementation

The modern tax system originated in the Russian Federation in 1992 just after the dissolution of the Soviet Union in conditions of transition towards a market-oriented economy. The tax system existing under the Soviet Union was hardly comparable to the tax system of a market economy, and a fundamental overhaul of existing tax system and tax law was required.

The Russian tax system experienced a number of radical changes in the 1990–2000s. Since its establishment, the tax system of the Russian Federation is based on the experience of several leading countries of the world. Thus, the structure of the Russian tax (and budget) system is focused on such federal states as Germany and the US. It involves the division of taxes at the federal, regional and local level. The system of revenue allocation of tax between the Federal budget and budgets of subjects of the Federation has been copied from Germany (for instance, revenues from the corporate profit tax in Russia are distributed between federal and regional budgets, exactly as in Germany). The United States served as an example of moderate tax policy, stimulating the development of entrepreneurship. For this reason, the postulates of supply-side economics, including Arthur Laffer's tax curve, have become especially popular among Russian tax reformers. However, Russia also partly used the experience of the organisation of the tax systems of unitary state. France has served as a model of centralisation in tax policy decisions. To improve tax collection in a country with initially low tax morale and the lack of a proper legal and ethical culture of taxpayers, a repressive character of tax administration and a tax police as special tax service were adopted, in the model of Italy.¹

During the first years of their existence, Russian tax system and tax legislation were considerably complicated and eclectic. In 1990s miscellaneous taxes and fees were introduced, and the total number of imposed payments exceeded fifty.² Tax legislation consisted of numerous laws adopted on all levels of state and local authority. Tax revenues remained low (60–70%, and for some types of taxes even 40% of the planned revenues³). Notwithstanding the total amount of taxes and fees, tax compliance was very poor.

Among many types of taxes used in that period, only five taxes (corporate profit tax, value added tax (VAT), individual income tax, resource fees and excises) were effective, giving 95% of tax revenues.⁴

The effectiveness of other taxes was immaterial. The situation in the fiscal sphere was complicated by so-called 'parade of sovereignties' that emerged in the soil redistribution of the powers of the Federal centre and subjects of Federation, and led to the fact of a real tax separatism in Russia in the mid-1990s. A number of regions refused to transfer the collected taxes to the Federal budget, paralysing the implementation of many social programs. This situation has led to the fact that in 1995 and 1996, on the background of the uncertain political situation (unclear re-election prospects of the first President of Russia Boris Yeltsin for the second term), tax revenues fell to a record low of 20% of GDP.⁵ The financial crisis of August 1998 in Russia (which counted low level of tax collection among the main reasons for the crisis) summed up the first stage of formation of the Russian tax system, mostly with a negative tinge, and made experts think about change for the better. A new tax system for Russia needed to be simpler and easier for taxpayers, to have a sound legal basis in the form of the Tax Code, and taxes had to focus not only on fiscal appetites of the government, but on the task of regulating and stimulating business activity.

2.2 Modification of the Russian tax system in 2000s: simplicity, clarity, efficiency

Serious tax reform resulted in the enactment of the Tax Code of the Russian Federation – the first part of the code in 1999, and the second part in 2001. This process was initiated by President Boris Yeltsin and his team, and it was continued by the next Russian president, Vladimir Putin. New legislation led to significant simplification of the Russian tax system and creation of a unified tax system with significantly reduced amount of taxes and fees.

Under the Constitution of the Russian Federation, each person shall be obliged to pay legally imposed taxes and fees. The unified tax system was created by provision of the Tax Code, which states that only taxes and fees mentioned in the Code can be imposed.

The Tax Code of the Russian Federation gave legal definitions of tax and fee and introduced division of taxes and fees into three categories – federal, regional and local. This legally binding classification is based on two main criteria: the territory on which taxes and fees are payable, and which level of authority that has the right to impose the payments. Federal taxes and fees are payable on the entire territory of the Russian Federation and are imposed only by the Tax Code of the Russian Federation. Regional taxes and fees are payable on the territory of the subject of the Russian Federation and are imposed by both the Tax Code

of the Russian Federation and the laws of the corresponding subject of the Russian Federation. Local taxes and fees are payable on the territory of the municipality and are imposed by both the Tax Code of the Russian Federation and acts issued by the corresponding local authorities (with exceptions for local taxes in Moscow and Saint Petersburg, which are imposed at the level of the subject of the Russian Federation – Moscow and Saint Petersburg, correspondingly). However legislative taxing powers of the subject of the Russian Federation and local authorities are strictly limited; they can regulate several elements of regional and local taxes only if the Tax Code of the Russian Federation doesn't regulate these elements.

There is no correspondence between the type of tax and budget in which it is payable. For example, federal tax can be the source of the revenue for the budget of the subject of the Russian Federation.

Above-mentioned federal, regional and local taxes were introduced as a part of a so-called general regime of taxation. At the same time, the Tax Code of the Russian Federation contains provisions on special regimes of taxation that can be regarded as a mechanism of simplification of taxation for certain categories of taxpayers. Under special regimes of taxation, several taxes (usually VAT and corporate or individual income and property taxes) are replaced by a single payment. Application of a special regime of taxation can be voluntary or obligatory for a taxpayer.

At the moment of its enactment on 1 January 1999, the Code allowed to impose 16 federal taxes and fees, seven regional taxes and fees and five local taxes and fees. Since 1999, the list of taxes and fees imposed according to the Tax Code of the Russian Federation has been changed significantly and Russian tax system has become simpler. The current tax system of the Russian Federation includes six federal taxes and two federal fees, three regional taxes, two municipal taxes and one municipal fee (see Table 7.1). The total number of taxes and fees, therefore, is 14, which is almost four times less than the number of tax payments in 1990s.

The described reduction of the amount of taxes is one of the characteristics of tax system, and from this perspective we can say that Russia has made significant steps towards simplification of its tax system. However, we should note that taxes are not the only type of compulsory contributions imposed in Russia. According to the Constitution of the Russian Federation, each person shall be obliged to pay legally imposed taxes and fees. Only three fees are mentioned in the Tax Code of the Russian Federation, and there are many more fees imposed by other laws. The legal regulation of fees imposed by other laws is insufficient

Table 7.1 Types of taxes and levies in the Russian Federation, 2015

Level of taxation	Types of taxes and levies according to the Tax Code of the Russian Federation
Federal taxes	<ul style="list-style-type: none"> • value added tax; • excises; • individual income tax; • corporate profit tax; • tax on extraction of mineral resources; • water tax; • fees for the use of objects of fauna and for the use of objects of aquatic biological resources; • state duty
Regional taxes	<ul style="list-style-type: none"> • tax on property of organisations; • tax on gambling business; • transport tax
Municipal taxes	<ul style="list-style-type: none"> • land tax; • tax on property of individuals; • trade fee

Source: Tax Code of the Russian Federation. Articles 13, 14, 15.

and inconsistent and cannot be called simple. Even regulation of fees in the Tax Code is quite contradictory. For example, if we analyse elements of the trade fee that was introduced at the end of 2014, we will understand that, although it is called ‘trade fee,’ its legal construction is much closer to tax.

We should assess the level of simplicity of tax system not only by the total number of taxes but also with the help of other factors such as complexity of applicable legal constructions, level of tax burden, etc. Regarding simplicity of legal regulation and applicable legal constructions, it is too early to speak about significant simplification. For example, one of the most crucial notions for income taxation – notion of income – is rather vague and sometimes contradictory. Much more successful is the simplification of the tax system in respect to level of tax burden and to efficiency of tax administration.

Tax reform in the early 2000s led to a significant reduction in rates of the main taxes, increase of their collection, as well as improvements in tax administration.⁶ In addition, in 2002 a new tax appeared that was very important in the Russian context: the tax on extraction of mineral resources, with a rate connected to the world market prices for oil and gas. Moreover, social taxes and charges were extremely important for the formation of extra-budgetary funds, and contribution system for pensions and medical insurance fees was also modified. Further

improvement of the Russian tax system was typical for the period of the global financial crisis of 2008–2009, which operated until 2008 tax rates were again corrected. Those changes primarily affected the income tax and social taxes and charges. Table 7.2 provides information on basic tax

Table 7.2 Dynamics of main Russian taxes rates, 1990–2010s

Type of tax	Time period and appropriate tax rates		
	1990s	2000s	2010s
Corporate profit tax	1992–1993: 32% – basic rate; 45% – profit from intermediary activity 1994: 35% – profit from intermediary activity; 38% – basic rate; 43% – profit of financial companies 1995–1999: 35% -basic rate; 43% – profit of financial companies and profit from intermediary activity	2000–2001: 35% – basic rate; 43% – profit of financial companies and profit from intermediary activity 2002–2008: 24% since 2009: 20%	20%
Individual income tax	Progressive scale with rates of 12, 20, 25, 30 and 35%	since 2000: basic rate – 13% (flat rate); 30% income of nonresidents of the Russian Federation from Russian based sources; 35% gambling income and extra-interest on banking deposits	basic rate – 13% (flat rate); 30% income of nonresidents of the Russian Federation from Russian based sources; 35% gambling income and extra-interest on banking deposits
Value added tax (standard rate)	1992: 28% since 1993: 20%	till 2003: 20% since 2004: 18%	18%

Sources: URL: <http://vestnik-evropy.squarespace.com/all-articles/2011/3/9/19912008.html>
<http://www.tradingeconomics.com/russia/>
http://www.budgetrf.ru/Publications/Analysis/iet/an_iet_250902/an_iet_250902150.htm

rates for income taxes and VAT in Russia in their dynamics starting from the period of 1990s. The table shows the trend toward simplification of the tax system of Russia in terms of the applicable tax rates.

Flat rate individual income taxation in Russia: Example of progressive tax simplification

The current Russian system of individual income taxation has become one of the easiest and most efficient in the world. Instead of the progressive scale of the 1990s, with five rates ranging from 12 to 35%, from 2000 onward there has been only one basic rate of tax on income of individuals – residents of the Russian Federation. The rate is 13% and is levied on all types and sizes of revenues, excluding lottery winnings and gambling, as well as financial windfall (which has a rate of 35%). Why does the ‘unlucky’ number 13 appear in the base rate of the Russian individual income tax? The fact is that the modification of the system of individual income tax in 2000 was based on the previous minimum rate of progressive tax (12%), to which was added the rate of social contributions on wages of citizens, which were levied in Russia at the source of payment in the period from 1993 to 1999 (1%). Nonresident individuals pay tax on income earned in Russia at a rate of 30% (dividends and interest in this case are taxed at the rate of 15%). In addition, individuals – residents of the Russian Federation are obliged to file tax returns only in the following cases: if the tax has not been withheld at source; if income was earned abroad; if taxpayers want to get a social or property tax deduction. This system is simple both for taxpayers and for the public tax administrators. It encourages taxpayers not to evade tax, and it promotes high tax collection. Receipts from individual income tax are one of the main sources of income of the budgets of the region and generate 20% of the consolidated budget of the Russian Federation. Immediately after introduction of the flat rate, proceeds from the individual income tax to the Russian budget increased by 25%.⁷

It should be noted that Russia has become the first major economy in the world that has introduced a proportional individual income tax rate in the tax system. In turn, the already successful Russian experience has led to numerous discussions about the possibility of transition to flat rate taxation of incomes of individuals in OECD countries, and some countries of Central and Eastern Europe followed the example of Russia (in particular, Belarus, Bulgaria, Hungary, Latvia and Czech Republic). Table 7.3 contains data on individual income taxation in some countries of the world. We can draw attention to the fact that most of these tax rates are significantly higher than in the Russian Federation, but in this

Table 7.3 Individual Income Tax Rates around the World, 2015

Country	Individual Income Tax Rates	Country	Individual Income Tax Rates	Country	Individual Income Tax Rates
Argentina	9–35%	Finland	6.5–31.75%	Latvia	24%
Australia	17–45%	France	5.5–41%	Mexico	0–30%
Austria	21–50%	Germany	14–45%	Netherlands	5.85–52%
Belarus	12%	Greece	0–42%	New Zealand	0–39%
Belgium	25–50%	Hungary	16%	Norway	28–49%
Brazil	7.5–27.5%	India	10–30%	Russia	13%
Bulgaria	10%	Indonesia	5–30%	Spain	24.75–52%
Canada	15–29%	Ireland	20–41%	Sweden	0–57%
	(federal tax)				
China	3–45%	Israel	10–50%	Turkey	15–35%
Czech Republic	22%	Italy	23–43%	United Kingdom	0–45%
Denmark	38–65%	Japan	5–50%	USA	0–39.6%

Source: Tax Rates around the World 2015. URL: <http://www.worldwide-tax.com/>

case there is the problem of collection of individual income taxes due to the high degree of evasion of payment (at least this is true for Greece, Italy and Spain).

Currently in Russia, discussions regard the appropriateness of the flat rate tax. Periodically there are proposals on the necessity of transition to a progressive scale of taxation of incomes of individuals. How is it justified? In our opinion, both Russian experience and the experience of other countries show that it all depends on priorities in the ongoing policy of the state: economic feasibility or social fairness. From the point of view of pragmatism, a flat tax scale seems to be the best solution, including the degree of simplicity of the tax system and methods of tax administration.⁸

2.3 Evaluation of the contemporary Russian tax system: Ease of taxation ranking and level of tax burden

The simplicity of the contemporary Russian tax system can also be assessed by the level of attractiveness of doing business in Russia on the basis of the World Bank Group's Doing Business Reports. As can be seen from the Table 7.4, the position of the Russian Federation has significantly improved since 2006 when the World Bank ranked countries on the attractiveness of tax systems for business for the first time. So after a 2009 finish in 134th place in the ranking of the attractiveness of the

Table 7.4 The dynamics of Russia's position in the World Bank's Doing Business Ranking, the 'Paying Taxes' Criteria, 2005–2015.

Indicators	Reporting Years									
	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Ease of Doing Business Ranking	79	96	106	120	120	123	120	112	92	62
Paying Taxes Ranking	...	98	130	134	103	105	105	64	56	49
Tax Payments (Number per Year)	27	23	22	22	11	11	9	7	7	7
Time Spending for Tax Accountancy and Tax Paying (Hours per Year)	256	256	448	448	320	320	290	177	177	168
Total Tax Rate (% of Profit)	40.8	54.2	51.4	48.7	48.3	46.5	46.9	54.1	50.7	48.9

Sources: Doing Business Reports 2006–2015, World Bank. URL: <http://www.doingbusiness.org/reports/global-reports/>

tax system for business (the corresponding position of the country was even worse than its 120th place in the overall ranking of ease of doing business) Russia has made a significant step forward and has reached 49th place for its tax criteria in 2015, which is considerably higher than its 62nd place in the overall ranking.

Indeed, from the estimation of components for its attractiveness to business, the Russian tax system shows a sufficient simplification of tax administration: reduction in the number of tax payments per year (from 27 in 2006 to 7 in 2015) and in the total time for completing tax reporting (from 448 hours in 2008–2009 to 168 hours in 2015). The effective tax burden on business also slightly decreased: The general level of taxes on profits of companies achieved 48.9% in the Doing Business Report 2015 (compared to 54% in 2007 and 2013). The conclusion is that the general direction of the Russian government's tax policy is set to simplify the tax system in the country, particularly from the point of view of improvement of tax administration for Russian businesses and foreign residents who receive income from sources in the territory of the Russian Federation.

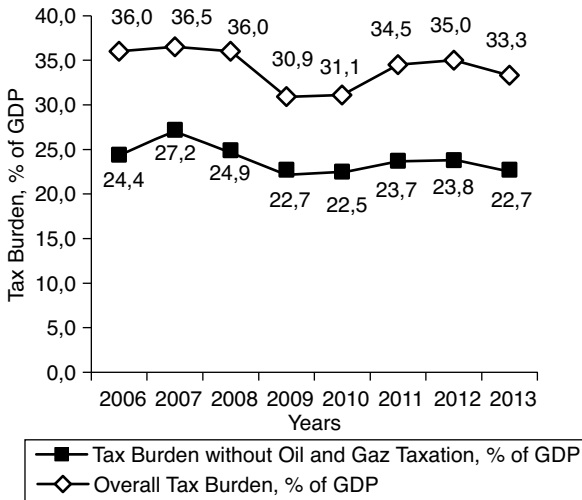


Figure 7.1 Dynamics of tax burden in Russia, 2006–2013

Source: Ministry of Finance of Russian Federation (Main directions of tax policy of the Russian Federation for 2014 and for the planning period 2015 and 2016; Main directions of tax policy of the Russian Federation for 2015 and for the planning period 2016 and 2017).

We will now try to answer the question of how strong the tax burden in Russia is, not according to surveys of entrepreneurs on the basis of which conclusions are drawn in the rankings of Doing Business Reports, but using official statistics from the Russian Ministry of Finance. The level of tax burden in Russia (the share of tax revenues in percent of GDP) is presented in Figure 7.1, and it is quite moderate.

As can be seen from the graphs, the tax burden has reached one-third of GDP at the present time, which is about average for OECD countries (34.9% in 2012). If the value of the tax burden does not take into account taxes and other payments associated with the taxation of oil, gas and petroleum products, the tax burden in Russia is now more than moderate (averaging data for 2013 was only 22.7%). This is one of the lowest rates for member States of the OECD. Thus, it is possible to draw a conclusion about the quite liberal character of Russian taxes as a whole, especially in the non-oil and non-gas sectors of the economy.

2.4 Complexity of type of taxes: Structure of tax revenues in federal budget and consolidated budget of Russia

The structure of tax revenues of the Russian budget system is presented in Figures 7.2 and 7.3. For the Federal budget, the most important

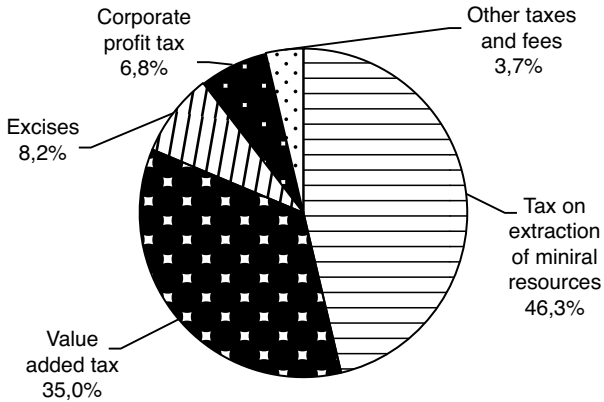


Figure 7.2 Structure of tax revenues of the Federal budget of Russia, January–October 2014

Source: Federal Tax Service of Russia, URL: <http://analytic.nalog.ru/portal/index.ru-RU.htm>

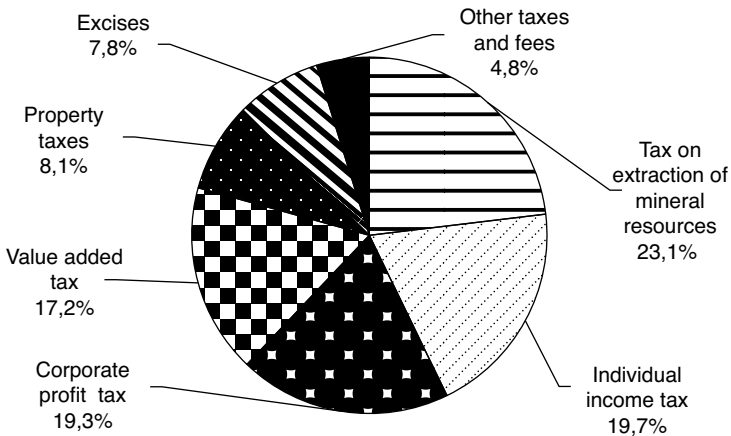


Figure 7.3 Structure of tax revenues of the consolidated budget of Russia, January–October 2014

Source: Federal Tax Service of Russia, URL: <http://analytic.nalog.ru/portal/index.ru-RU.htm>

(collectively more than 80% of tax revenues of the Federal budget) taxes are: tax on the extraction of mineral resources and VAT. From the point of view of the consolidated budget, the most important taxes are: tax on the extraction of mineral resources, individual income tax, corporate profit tax and VAT. Those taxes together comprise nearly 80% of tax

revenues of the consolidated budget. So, the basis of the Russian tax system consists of six taxes – tax on the extraction of mineral resources, individual income tax, corporate profit tax, VAT, property tax and excises (comprise 95% of tax revenues of the consolidated budget).

The conclusion is that the main difference between the Russian system of taxation from the tax systems of the major developed countries lies in the fact that the tax on the extraction of mineral resources is the main source of tax revenues in both the Federal and in the consolidated budget. This makes the tax system of the Russian Federation quite vulnerable to fluctuations in raw material prices.

3 Simplifying tax law

A simplified tax system won't work effectively in conditions of complex legal regulation of taxation, which is why it is very important to simplify tax law. Several steps towards simplification of tax law were made in Russia: codification of tax legislation and introduction of special rules of amending tax legislation.

The sources of tax law are similar in all countries, however we should take into consideration differences in their relative role that depend on the legal system in general and tax culture in particular. In Russia sources of tax law are legislation, treaties and regulations. Judicial decisions are not formally binding sources of tax law, but there is a place for discussion about the role of decisions of supreme courts, especially the Constitutional Court of the Russian Federation.

The main source of tax law is tax legislation that includes federal and regional laws and acts of representative body of local authorities. Powers of executive authorities to issue normative acts on taxation are seriously restricted. Three levels of tax legislation are predetermined by stated in the Constitution of the Russian Federation federalism and independence of local authorities. However, although there are three levels of tax legislation, federal legislation is the dominant element in the system of tax law sources.

In the 1990s, taxes were regulated by numerous federal and regional laws. Federal tax legislation was codified at the turn of the 21st century: The first part of the Tax Code of the Russian Federation was enacted in 1999, and the second part in 2001.

The Tax Code of the Russian Federation is an example of almost total codification of federal tax legislation. The first part of the Tax Code deals with general aspects of tax assessment, including system of sources of tax law, notions, types and lists of taxes and fees, rights and obligations of

taxpayers and tax authorities, general rules of tax procedures, including tax control, enforced collection of unpaid taxes, administrative dispute resolutions. The second part of the Tax Code includes chapters that regulate certain taxes and fees imposed as a part of general and special regimes of taxation. The last crucial amendments to the second part of the Tax Code were adopted in 2014 – chapters on individual property tax and trade fees were added. After the adoption of chapter on individual property tax and abolishment of separate federal law that regulated this tax since 1991, it is only the Tax Code of the Russian Federation that imposes certain taxes on the federal level.

Russian Tax Code is one of the leaders in Russian legal system in terms of number of amendments per year. Since its enactment in 1999, more than 300 federal laws were adopted with amendments to the Tax Code of the Russian Federation, which is approximately 20 laws per year. 2014 was not an exception – 40 federal laws were adopted with amendments to both parts of the Code. This amount of amendments doesn't help to simplify tax law. That is why it is important to mention a new rule that was introduced in 2013 – a federal law that amends federal tax legislation can contain only tax related provisions.

A more deliberate approach to the procedure of amendment of tax legislation can be regarded as a step towards tax law simplification. However, it is not the procedure but the content of the amendments that matters. And the content of the Tax Code of the Russian Federation doesn't seem to simplify. On the contrary, rules become more and more complicated. For example, we can mention the introduction of transfer pricing rules, special rules of taxation of consolidated groups of companies and controlled foreign companies, and tax monitoring. In comparison with its original content at the beginning of the 2000s, the Tax Code of the Russian Federation has become more and more complicated.

4 Simplifying tax administration and taxpayer communications

4.1 Tax administration in Russia: General characteristics

At the moment, recent changes to Russia's Tax Code, while generally seen as beneficial, are still in progress. The Federal Tax Service of the Russian Federation (FTS) nowadays tries to create the most comfortable conditions for the taxpayer and to improve standards for services provided by official authorities. Tax authorities have been executing

ambitious plans to create a high-tech digital infrastructure, the general idea being to increase tax revenue and provide better services for taxpayers. Some new services and procedures have been implemented in Russian practice, for example, the institution of tax monitoring can replace tax review by alternative methods of control, due to online data exchange on an ongoing basis. Tax authorities attempted a difficult task to decrease administrative pressure on the business and to increase the service role of the FTS. The main purpose of FTS is not tax collection, but rather control on fulfillment of the taxpayers' duties.

Nowadays, FTS has become more efficient. The effect of the reorganisation within the FTS is most clearly seen in the number of tax audits conducted each year and the amount of tax revenue recovered as a result of these audits. According to the Russian Statistics Committee, the Russian GDP has increased 9.8% from 2010. And in-payments to the consolidated budget have increased 16.8%.⁹ The difference of 7% has been achieved due to more efficient tax collection based on major changes in approaches to the tax administration in Russia.

While there is still much work to do, the country is already beginning to experience results that are being recognised by outside observers. Russia moved up 41 places in the tax administration ranking of the World Bank and IFC's report, *Doing Business 2013*¹⁰: *Smarter Regulations for Small- and Medium-Sized Enterprises*, from 105th in 2011 to 64th in 2012, which is the fastest progress made by any country in the world over the course of the last year. And the progress continued in later years as well. According to the World Bank and IFC's report, *Doing Business 2014* Russia has improved the business environment for five of the 10 indicators considered in the research. The result of the new report was the best ones for the country in the entire history of ranking and observations. Key indicators of the Russian Federation are as follows: In terms of the simplicity of business registration, the country is ranked 88th in the world; in terms of the level of taxation, it is ranked 56th correspondently. It was mentioned in the report that tax legislation and administration reform in Russia is in progress, and Russia's ambitious target is to achieve 20th place in 2018.

But if positive changes being driven from the top of the FTS are a relative strength, the experience at the level of the local tax office can still lag behind, and tax legislation itself requires further improvement. Many Russian businessmen consider the current stage of tax regime as a containing barrier to investment, with Russian tax legislation overly complex in some areas and too vague in others. Also, overly prescriptive and excessive demands regarding documentation continue to be a challenge to the business community.

4.2 Main achievements in tax administration simplification

The general idea of tax administration reform in Russia is to construct and develop a system that is flexible when possible and strict where necessary. In order to achieve this purpose, the following directives were developed:

1. Pre-trial adjustment of disputes aimed to eliminate a conflict before the sitting of the court;
2. Horizontal monitoring aimed to prevent a conflict;
3. Online services aimed at realising a program of partnership between tax authorities and taxpayers in order to simplify all tax procedures;
4. Publicly available standards for tax risk assessment aimed to update the process of tax audit and control.

Both pre-trial adjustment of disputes and horizontal monitoring can reasonably be considered as various stages of alternative methods of prevention and exclusion of tax mitigation; alternative forms of dispute resolution are employed in all developed countries: the United States, the United Kingdom, Australia, Canada, France, Germany and others.

The most frequently cited reasons for increased tax liabilities were alleged lack of economic justification of expenditures and inadequate documentation. A number of such cases involved a disputed sum totalling more than \$1m per year.¹¹ Notwithstanding this, the taxpayers participating in the survey continued to be very successful when challenging the tax authorities in court, obtaining a positive decision in more than two-thirds of the cases. The reasons for such results were:

- weak evidence base and documentary information of tax authorities participating in cases;
- insufficient qualifications of tax authority representatives;
- courts overcharging for tax cases.

The Federal Tax Services of the Russian Federation has significantly changed their approach to the tax administration. The major breakthrough in the field of legal certainty became the 2009 implementation of the system of the compulsory trial adjustment of disputes. Utilisation of alternative dispute resolution methods has been efficient and has brought quick results. Tax authorities became more successful in court, obtaining a positive decision in about half of their cases, due to

elimination of losing cases at the stage of alternative dispute resolution and more careful training for the rest of the cases.

Later in 2013, the new form of the tax administration was introduced by the Federal Tax Services – expanded informational interaction, or horizontal monitoring. The main purpose of the horizontal monitoring is the informational exchange between the tax authorities and taxpayers, aimed at observation of tax legislation, increase of predictability of the tax regulation and improvement of the quality of tax control. Such approach to the control for the fulfillment by the taxpayers of their duties extends to varieties of methods for the adjustments of disputes before the trial. For Russia, horizontal monitoring is a new method of extended informational interaction between the tax authorities and taxpayers based on confidence and trust. This method of tax control implies cooperation between taxpayers and tax authorities. In the process of such cooperation, taxpayers receive an opportunity to inform tax authorities about their current and potential tax risks in an attempt to avoid some mistakes and mitigate tax risk consequences. Horizontal monitoring can be implemented only by special agreement between the tax authorities and the taxpayer.

In general, implementation of horizontal monitoring reduces cost of analysis and control for the taxpayers. The idea was to reapportion financial, technical and human resources of tax authorities to strengthen control of tax compliance and tax discipline. Nowadays, FTS in Russia is close to working out the precise criteria for horizontal monitoring efficiency as well as criteria for selection of taxpayers who are able to participate in this program. It is absolutely essential now to determine priority-driven guidelines in developing and updating the tax legislation regarding horizontal monitoring regime application.

Creating a high-tech digital infrastructure with about 40 online services has become an important step on the way to the mutual understanding, effective cooperation and feedback between tax authorities and taxpayers. Digital infrastructure with online services appears to be not only a simple and comfortable tool for relations between tax authorities and taxpayers, but it also helps to improve clarity and reduce the documentation burden on taxpayers. Implementation of this system could be considered an effective method of avoiding the possibility for human error, as well as a personal agreement between taxpayers and tax representatives. If all procedures are transparent, clear and understandable, there is a real opportunity to diminish corruption and increase tax discipline. It is logically clear that high-tech digital infrastructure is more important than some law enforcement duty.

Generally, the major target of the new form of tax administration is to increase predictability of tax regulation and quality and efficiency of tax control. Some positive achievements have been made in the area of tax control modernisation. Publicly available standards for tax risk assessment have been worked out and officially announced. The criteria has been developed to help the taxpayers self-assess the tax risks stemming from the interpretation of the legislation which they adhered to in making the business decisions affecting their tax positions. Following those criteria, the taxpayer obtains an opportunity of the self-assessment of the tax review probability. In practice, tax review in Russia is a long-term stressful event – and time-consuming process for the taxpayers under review. Predictability of the tax review probability facilitates harmonising the relationships between tax authorities and taxpayers. Business indicates that, whereas before, companies would be audited once every two years, now they are being audited on average once every three years, with the primary focus being on profits tax and VAT. The following figures demonstrate an evidently positive dynamic: Say, in 2003, the FTS audited 11.5% of companies and recovered an average of RUB 517,000 (approximately \$17,233) per field audit. By 2013, the FTS was auditing less than 1% of companies, but in that year alone, it recovered an average of RUB 4,328,000 (approximately \$144,267) per on-site tax inspection.¹²

4.3 Transformation of the Russian federal tax service

Russia's entry into the WTO, as well as the ongoing discussion regarding OECD accession, is driving further reform efforts. Ongoing reform attempts will help Russia become a more attractive place for doing business. Particular attention should be paid to addressing current deficiencies in both legislation and ground-level administration. Since 2001, consolidation within the FTS has reduced the total number of tax inspectorates by 60%. Despite the reduced numbers, careful reorganisation has enabled the FTS to retain its presence in almost all areas where it was previously active.

Technology has played a key role in the optimisation of the FTS. In the 1990s, the FTS was troubled by poor logistics on the national level. The absence of computers and automated processes meant that many operations were performed manually. During the past 10 years, the FTS has become a leader among Russian public authorities in adopting new information technology. The breakthrough began in 2000, when the tax authorities introduced unique software for local tax authorities, and it continued with the development of complex software for system and

data processing. Over the past few years, the FTS has been implementing digital means for submitting tax returns.

As a result of the technology restructuring, the FTS has improved its ability to implement tax legislation and inform taxpayers of developments. New technologies such as e-filing are also helping to reduce the workload for taxpayers, although much greater progress would be made by enabling full filing electronically (often, documentation that has to be submitted with tax returns must still be lodged in hard copy).

An absolutely new form of communication with taxpayers for Russian FTS is the client-oriented approach in which tax authorities try to be more open, positive and friendly with businesses. One of the newly implemented services is an online repository of 'frequently asked questions' where tax authorities provide taxpayers with explanations regarding complicated situations in the tax legislation. It should be specifically marked that there are no tax consultants in the structure of Russian FTS. Work performed by tax authorities' representatives is rather in the area of informing than explanation and never consulting. Generally, since the moment of creating and developing of the tax system in Russia, the dynamics of the role of tax authorities in the performing of tax consultancy has been clearly determined. In 1992, by the Order of State Tax Services, tax authorities were not allowed to provide taxpayers with tax consulting. But just at that time, a special Educational and Communicatory Centre was opened under the Moscow Tax Inspectorate. The priority-driven task of the centre was restricted clarification of the tax legislation and limited informational support.

Later in 1999, the Order prohibiting tax consultancy work performed by the tax authorities was repealed, and the Tax Code of the Russian Federation, which came into authority in 1999, charged tax authorities with the following duties¹³:

- explaining the application of tax legislation;
- providing free information regarding current taxes and duties;
- providing taxpayers with forms of tax returns, explanatory work for order of filing and submission them, explanations of order of calculation and paying taxes.

In the course of the administrative reform, the functions of legal regulatory work and control-and-supervision have been separated. Explanatory work regarding application of the taxes and duties legislation was deputed to the Ministry of Finance. In general, the Ministry of Finance

must provide clear and useful direction to taxpayers and tax authorities requesting clarification of the interpretation of tax law. Informational support of taxpayers was delegated to the tax authorities. But there is a huge difference between informational support, explanatory work and consulting itself.

4.4 Changing tax environment

Russia's tax legislation continues to be subject to change. Laws are updated, amended, streamlined and replaced, with some changes having a significant effect on companies and others little to no effect. The transfer pricing law which took effect on 1 January 2012 has had a major impact on companies. The new law necessitated a top-to-bottom review of covered transactions and a reengineering of internal business processes to involve tax at the early stage of pricing decisions. For many, the transition has been a challenge. Overall, companies view the tax regime in Russia as having a neutral effect on investment flows into Russia. However, a sizeable percentage sees the tax regime as having a negative or, for a small percentage, very negative effect on the investment attractiveness of the country. Investors continue to push for simplified tax legislation and documentation requirements, saying that an improvement in these two areas would have a positive effect on Russia's overall investment attractiveness.

Despite the breakthrough results Russia has achieved in the field of tax administration, the country still ranks 64th in the world – a sign that much remains to be done. In 2012, the most notable change in the area of tax administration was a shortening of the time period for VAT reimbursement, which previously was a significant problem for most companies dealing with cross-border transactions. While this is certainly a welcome development for companies doing business in Russia, further progress in improving the country's tax climate will depend more on the experience of business people on the local level.

Taxpayers in Russia continue to experience a difference between the tax system on paper, which is comparatively favourable to doing business, and the tax system that they experience on a day-to-day basis. In order to improve the situation, the government will need to focus on bringing consistency to the tax code and achieving a better, more consistent, service experience for taxpayers on the local tax administration level.

According to the Chief of Russian FTS Michael Mishustin's opinion,¹⁴ the resource of the tax administration has been exhausted. In this case, the only option to increase tax funds is to work over tax discipline

improvement, including development of tax culture of not only taxpayers but also tax and governmental authorities.

5 Prospects of development of the Russian tax system: Middle and longer term approaches

The second half of 2014 and the beginning of 2015 revealed a clear trend of decrease in world oil prices, which is extremely unpleasant for the Russian economy and fiscal system. As we know, the main source of tax revenues both for Federal and for consolidated budget (see Figures 7.2 and 7.3) is the tax on the extraction of mineral resources, which depends on the dollar prices for oil and gas. In addition, the dramatic consequences of the Ukrainian crisis contributed to the growth of the influence of geopolitical factors on the development of the Russian economy, including its financial and tax components. Evidently the prices of major Russian export commodities (oil, gas) and geopolitical contradictions between Russia and the West may predetermine the development of the Russian tax system in the medium- and long-term perspective.

5.1 Changes in Russian tax policy due to lower oil prices

In order to characterise the dependence of the Russian tax system on oil/gas price volatility we should admit the current absence of clear strategies of the Russian government to get out of this difficult situation. It is obvious that for the Russian economy in the long-term it is not possible to get rid of excessive dependence on raw materials, which would require a radical change in its sectorial structure in the direction of the development process priority, especially by stimulating high-tech industries as well as services (tourism, transport, financial services). Accordingly, the tax strategy of the government should clearly define priorities involving the creation of tax incentives for producers of related goods and services, as well as simple, clear and stable rules of taxation. This strategy of the Russian government was, in early 2015, still in the development stage, although the above priorities have been announced many times by Russian President Vladimir Putin, Prime Minister of Russia Dmitry Medvedev and members of the Russian government. In particular, the proposal of the Ministry of Economic Development of the Russian Federation assumed a serious reduction in the tax burden on businesses until 2018, with lower rates of social contributions, the wide application of the simplified taxation system for small and medium-sized businesses, the introduction of tax incentives for investment projects and import-substituting production.¹⁵

5.2 Geopolitical factors in contemporary Russian tax policy

How do new geopolitical challenges affect tax policy and tax systems of Russia? It seems we need to pay attention to the main geopolitical factor, which affects public finances and taxes of the Russian Federation – the exchange of economic and trade sanctions between Russia and Western nations (sanctions against financial, energy and defence sectors of the Russian economy due with the events in Ukraine in 2014 were introduced by the US, 28 EU member States, Japan, Canada, Australia, New Zealand, Norway, Switzerland, Ukraine and Moldova).

Trade and economic sanctions entered against Russia now are most clearly manifested in the financial sector, causing a significant devaluation of the Russian national currency (ruble) and a massive flight of capital abroad. Highlighting the possible effects that the policy of sanctions imposed as the result of a new round of geopolitical confrontation between Russia and Western countries, the Russian tax policy is to pay attention to the following:

- the use of tax incentives to compensate exporters' losses¹⁶ (Russian authorities have already adopted the relevant draft law on tax maneuver in the oil and gas industry, involving the resetting of the tax on extraction of mineral resources for new deposits, as well as supporting the construction of the gas pipeline 'Power of Siberia' to boost export supplies of alternative energy consumers¹⁷);
- the implementation of tax regulators in the financial market to weaken speculative attacks on national currency (in Russia were already put forward proposals for the introduction of a tax on the export of capital¹⁸ or the use of an analogue of the Tobin tax on currency transactions¹⁹);
- the strengthening of anti-offshore policy concerning the Russian tax residents, having controlled foreign companies²⁰;
- the limitation of benefits of using a consolidated group of taxpayers to prevent loss of tax revenues of regional budgets from holding structures registered in low tax jurisdictions.²¹

It should be noted that the regime of sanctions and counter-sanctions will bring a negative impact on the Russian economy, whose forthcoming prospects are not so optimistic. So, the fall in GDP will be at least 3% in 2015 and will continue in future²² Incomes and business activity will reduce, and problems in public finances due to the reduction of tax revenues will increase. Therefore, at the present stage of development of

the Russian Federation, we need to balance fiscal and regulatory (stimulating) roles of taxes and, if possible, not to complicate tax systems that were well-reputed in the previous period. The contraction in revenues (due to reduction in tax revenues from the manufacturers and exporters of goods and services under the sanctions) requires adequate substitution by redistributing the tax burden on business and population. On the other side, the increase of the tax burden in the period of stagnation and recession is not the best decision of the government. It is not by accident that in present-day Russia there are some critics of the possibility of raising taxes on the background of the exchange of sanctions.

Only time will tell how the tax system of Russia will develop in the new geopolitical conditions and how simple it will be in the future. However, we already see a rapid reaction of the Russian government on the above-mentioned geopolitical factors in the national tax policy. The most difficult decision for the authorities is how to achieve proper balance between the fiscal and regulatory (stimulating) roles of taxes in terms of the slowdown in the national economy due to the influence of geopolitics.

6 Conclusions

Summarising the characteristics of the evolution, current state and prospects of the tax system of the Russian Federation, it is possible to make following conclusions:

- taxation in Russia at the turn of the 21st century can be characterised by a transition from a bulky and complex tax system with ever-changing tax regulations, high tax rates, and a large number of taxes and fees to a simple and effective program for the state and for business taxation in the early 2000s;
- the reform of the Russian tax system in 1990s and 2000s was based on the advanced experience of foreign countries, however, Russia independently, relying on the criterion of simplicity of taxation, made a number of unique transformations in the national tax system;
- from the point of view of ease of doing business according to the 'taxation' criterion in the World Bank's Doing Business Report for the period from 2009 to 2015, Russia significantly improved its position from 134 to 49;
- the level of the tax burden in Russia corresponds to the average for OECD countries, and even lower, except the taxation of raw material sectors of the economy;

- Russian practice of tax administration is one of the most significant in the world in its simplicity, benevolence for taxpayers and efficiency from the point of view of the guarantee of tax revenues to the budgets of different levels;
- Russian tax legislation has undergone significant changes over the period 1990–2010, changed first from complexity to simplicity, and then from simplicity to a new level of complexity;
- in today's global turbulence, volatility in oil prices and geopolitical uncertainty, the tax system of Russia will be modified to accommodate these factors and to respond to the most pressing problems.

Notes

1. Экономика переходного периода. Очерки экономической политики посткоммунистической России. 1998–2002. М.: Дело, 2003. (Economika perekhodnogo perioda. Ocherki ehkonomicheskoy politiki postkommunisticheskoy Rossii. 1998–2002. M.: Delo, 2003. In Russian)
2. URL: <http://www.forbes.ru/mneniya-column/gosplan/261661-rossiiskie-finansy-nazad-v-1990-e>
3. Egorova, E. and Petrov, Y. (1997) 'A Comparative Study of Taxation in Foreign Countries and the Reform of the Russian Tax System', *Economic Systems*, 21.(4), 362; Gavrilentov, E. (2000) 'Permanent Crisis in Russia: Selected Problems of Macroeconomic Performance', in Welfens, P.J.J. and Gavrilentov, E. (eds.) *Restructuring, Stabilizing and Modernizing the New Russia* Berlin: Springer, p. 459; Popova T. and Tekoniemi M. (1998) 'Challenges to Reforming Russia's Tax System', *Review of Economics in Transition*, 1, 14.
4. URL: <http://zos.ru/nalogbuild.net.ru/www/3.html>
5. Назаров, В.С. Налоговая система России в 1991–2008 годах. Nazarov V.S. Nalogovaya sistema Rossii v 1991–2008 godah. In Russian) URL: <http://vestnik-evropy.squarespace.com/all-articles/2011/3/9/19912008.html>
6. See: Pogorletskiy, A. and Söllner, F. (2002) 'The Russian Tax Reform' *Intereconomics* 3(May/June), pp. 156–161.
7. URL: <http://bankir.ru/novosti/s/ploskaya-shkala-podohodnogo-naloga-netak-horosha-1125045/>
8. See: Pogorletskiy, A. (2014) 'Tendencies in individual income taxation in contemporary world: Questions of theory and practice', *Vestnik Sankt-Peterburgskogo universiteta. Seriya 5: Ekonomika*, 1, 105–122. In Russian URL: http://www.econ.spbu.ru/faculty/vestnik_st_petersburg_state_university_series_Economies/archive/2014/n1/2014_1_full.pdf
9. URL: <http://www.vedomosti.ru/library/news/33280021/sejchas-nalogi-mozhno-platit-ne-shodya-s-divana-mihail>
10. URL: <http://www.gtmarket.ru/rating/doing-bisnuss>
11. URL: http://www.nalog.ru/rn77/news/activities_fts/5316883
12. URL: <http://www.worldfinance.com/wealth-management/tax/russias-two-track-tax-challenge>
13. Tax Code of the Russian Federation, Part I, art. 32.

14. URL: <http://www.vedomosti.ru/library/news/33280021/sejchas-nalogi-mozhno-platit-ne-shodya-s-divana-mihail>
15. URL: <http://www.finmarket.ru/news/3946213>
16. In Russia taxes on oil and gas exports to the EU account for almost 50% of Federal budget revenues (see: Yurgens I. (2014) The West vs. Russia: The Unintended Consequences of Targeted Sanctions. The National Interest. October 8. URL: <http://nationalinterest.org/feature/the-west-vs-russia-the-unintended-consequences-targeted-11427>).
17. URL: <http://www.finmarket.ru/news/3860705>
18. URL: http://www.ng.ru/economics/2014-10-13/4_nabiullina.html
19. URL: http://www.ng.ru/economics/2014-10-06/1_stabilize.html
20. URL: <http://top.rbc.ru/economics/11/11/2014/546217c8cbb20f1e26c33e5d>
21. URL: <http://top.rbc.ru/economics/10/11/2014/545a3dc7cbb20f10092dbcc7>
22. World Economic Outlook Update: Global Growth Revised Down, Despite Cheaper Oil, Faster U.S. Growth. IMF Survey. URL: <http://www.imf.org/external/pubs/ft/survey/so/2015/NEW012015A.htm>; URL: <http://www.finmarket.ru/news/3946213>