

Ludmila Anisimova

An Overview of Normative Documents on Taxation Issues for December 2012 - January 2013

Over the period under consideration, Russia's economic problems more than once became the focus of public discussion with the participation of the country's leadership and eminent Russian and foreign experts – at the Gaidar Forum hosted by the Russian Presidential Academy of National Economy and Public Administration and the annual meeting of the World Economic Forum (WEF) at Davos. Tax issues were scrutinized in the context of a search for potential ways for overcoming economic stagnation and in view of Russia's request for accession to the OECD.

Chairman of the RF Government Dmitry Medvedev disagreed with the development scenarios suggested to the Russian Federation for the next few years by the experts' meeting at Davos. They voted 75% in favor of the first scenario – Regional Rebalancing. This scenario is geared for a situation that may emerge as a result of declining prices for oil and natural gas, stagnation in the central bodies of authority and economic and political changes at regions' level. Medvedev said: 'The Russian economy's dependence on raw materials exports is great, but is also exaggerated'. In this connection, Russia's Prime Minister believes that external risks are by no means a major factor. The key threats, in fact, are presented by the inadequate competitive capacity of Russian businesses, low labor productivity and high energy inputs. Thus, 'the government's priorities are to improve the authority's performance level, promote competition and carry on a dialogue with civil society'¹. In the experts' opinion, so far no sectors have become visible in the Russian economy that could really be regarded as the locomotives of competition and labor productivity.² The experts are similarly cautious in their estimates concerning the role of the defense industry in providing solutions to that problem – in view of the recent exposure of financial violations committed by the RF Ministry of Defense coupled with the fact that the bulk of funding to be received by the defense industry is earmarked for the period of 2016–2020, i.e., beyond that of the currently approved budget. So, they believe that, at present, as far as the task of promoting the economy's competitive capacity is concerned, the RF Government has indeed no option other than to allocate money to modernizing the existing infrastructure in an attempt to bring down the cost of doing business in Russia.

Russia is also faced with some serious problems in connection with her planned accession to the OECD in 2014. Speaking at the Gaidar Forum 2013, Secretary-General of the Organization for Economic Cooperation and Development (OECD)³ Angel Gurría suggested

¹ E. Karpenko. *Pravda Medvedeva* [Medvedev's Truth]. See www.gazeta.ru, 23 January 2013.

² *Vlasti ishchut tormoz ekonomiki. Tsentrobank okhladil pyl pravitel'stva po povodu rosta VVP.* [The Authorities Are Trying to Pinpoint the Culprit Behind the Slackening of Economic Growth. The Central Bank Has Cooled Down the Government's Enthusiasm About GDP Growth.] See www.ng.ru of 17 January 2013.

³ A. Bashkatova, I. Naumov. *Rossii vypisali retsept bor'by s bednost'iy. Put' v elitnyi klub lezhit cherez progressivnoe nalogooblozhenie.* [Russia Was Issued a Prescription for Tackling Poverty. The Way to the Elite Club Lies through Progressive Taxation.] See www.ng.ru of 21 January 2013.

that, in order to comply with the membership criteria, Russia should bring down the poverty level⁴, abandon a flat tax scale, and increase the volume of healthcare expenditure.

The response to this proposal among the economists' community has been by no means unanimous. Some believe that Russia must very carefully consider the recommendations of the OECD's Secretary-General, although they really are no more than 'remarks offered by way of advice'. According to Igor Nikolaev, Director of FBK's Strategic Analysis Department, this is actually the case when 'a piece of advice' may be more important than the formally established conditions for a country's entry into the OECD. Other experts – for example, *Sberbank CIB*'s Chief Economist Evgeny Gavrilentov noted that the proposal concerning the introduction of a progressive tax scale voiced by the OECD's Secretary-General was 'by no means binding'. Gavrilentov added that the situation in the tax sphere cannot be considered outside of the whole context, including, first of all, the quality of the country's institutions of state authority.

It should be reminded that Russia's accession to the OECD, as explained by the RF Ministry of Finance, is expected to yield some practical benefits in addition to raising Russia's international prestige. If, however, Russia fails to comply with the established criteria, it will be treated by the OECD member countries in their mutual deals as an offshore territory.

So, the conditions for the accession to the OECD include increased government expenditure earmarked for the health care sector and the introduction of a progressive personal income tax scale, similar to the standards applied in the European countries. Indeed, the RF Government will have to make a tricky choice between accepting Russia's status if an offshore zone for the developed countries 'club', or giving up the currently enjoyed competitive advantages for the sake of acceding to the OECD.

The existing situation can be analyzed as follows. In order to increase, in nominal terms, the share of health care expenditures to the European level it will be necessary either to revise the by-sector distribution of government expenditure, or to additionally increase the tax load. The recommendations concerning government expenditure cuts in regard of state corporations or power structures belong to spheres beyond the subject of our present discussion. It can hardly be possible to change the existing tax load on commodity producers. The experience of altering, in 2010, the rates of insurance contributions to the RF Pension Fund has demonstrated that, if the level of costs incurred by domestic commodity producers is pushed up as a compulsory measure, then the prices of their products also go up above their existing market level. As a result, domestic producers are ousted from the market and their businesses are ruined, while the market is being taken over by imported commodities. So it is unlikely that the RF Government will actually make an attempt to experiment in a similar way with the rates of insurance contributions to the Federal Fund for Compulsory Medical Insurance (FFCMI).

⁴ The OECD's Secretary-General recommended Russia to vigorously target poverty and to address the issue of personal and regional income inequality. According to the OECD's data, 17% of the population in the Russian Federation are poor, whereas in the OECD member countries this index, on the average, amounts to only 10%. The introduction of a progressive tax scale, when the rate of tax increases in proportion to the size of a taxpayer's income, represents one of the mechanisms whereby the gap between the income levels of different population groups can be narrowed. Besides, Angel Gurría mentioned another social issue existing in Russia – the insufficient funding of the health care system. The authorities must increase the size of government allocations earmarked for the funding of that sphere.

It would be equally useless, from the point of view of economics, to increase the taxes on consumption (by raising the rate of VAT or introducing a sales tax) in combination with an administrative decision to increase the allocations to health care. By simply increasing the VAT rate (or by introducing, in addition to VAT, also a sales tax) and letting the health care officials handle the resources thus made available, the government may actually disrupt the existing balance on the market for medical services. If the medical services introduced in this manner meet no demand on the consumer market, the ‘simple equivalence’ in the exchange of goods (or work, or services) will be destroyed⁵, and so there will emerge an almost forgotten phenomenon – the presence on the market of the so-called ‘unwanted’ commodity items (goods, or work, or services for which no demand is displayed by the population, but which nevertheless are produced under previously approved plans for some specific purpose)⁶. As a result, if the pattern of effective demand is altered in an enforced procedure (by introducing tax measures), the market (that is, the environment directly involved in free trade) will begin to shrink in response to the upset balance in the supply of goods (or work, or services), while prices will begin to rise (because market demand gives way to non-market demand). The volume of demand will remain the same, but the ‘equivalent’ for its ‘replaced’ component will be lost. Without ‘equivalence’ there will be no free trade, which means that the supply of goods (or work, or services) on such a market will inevitably be declining, while prices will be on the rise. If a market can offer nothing for an equivalent exchange, products will flow away to other markets, while the market in question will begin to experience deficit – a phenomenon that many of the older readers are actually familiar with, when demand for certain goods (or work, or services) is there, but the wanted items are actually lacking. The deficit of goods on a free market is compensated for by their growing prices, one example of which is the situation typical of the Russian market in the 1990s.

The measure recommended by the OECD officials – to increase the volume of expenditure on health care for the low-income strata by applying a progressive personal income tax scale to the high-income groups of the population and thus redistributing part of their income in favor of the former – is aimed, first of all, at removing ‘luxury commodities’ from the market. But the scale of income redistribution needed for complying with the aforesaid criteria is such that it will also (and inevitably) affect the savings and investments made by society’s middle strata. This, in its turn, may have some very undesirable effects from the point of view of the prospects of developing a modern market in this country. It should be remembered that a fixed low rate of income tax represents one of Russia’s most important competitive advantages on the investment market. Besides, a low rate of personal income tax (PIT) helps, to a certain extent, to bridge the existing gap between the levels of personal incomes in Russia and the European economies, thus bringing down the outflow of qualified workforce from Russia. One vivid negative example was the surge in the specialist outflow from East Europe to the West. Besides, a low rate of PIT makes it possible – provided that the size of net earnings per employee (after

⁵ The market represents the environment where free exchange of commodities is carried out, and where labor also behaves as a commodity and thus is assigned a free market price. A basic component of market exchange is the balance between supply and effective demand, because one and the same subject in the framework of each commodity exchange transactions simultaneously acts (either directly or through an absolute equivalent) as a buyer and a seller.

⁶ In this particular case – for the purpose of complying with the criteria for Russia’s accession to the OECD.

PIT) is comparable (that is, competitive) – to bring down the prices of goods (or work, or services), thus increasing their market competitive capacity. And this difference in the tax levels will by no means be regarded as a subsidy granted in the framework of the World Trade Organization (WTO), because the Russian Federation makes no exceptions for its tax residents who are citizens of other states.

Thus, there will be no one-time and painless solution to the problem posed by the need to increase the share of health care expenditures in GDP. This task can only be accomplished by gradually changing the structure of government expenditure. Any other solutions imply the introduction of tax reforms, the necessity of which at present is by no means obvious.

In view of the difficulties involved in the process of elaborating the federal budget and providing the sources of financing to cover budget expenditure in 2013, coupled with the accelerated growth (by comparison with that of the inflation rate) of Russia's foreign debt⁷ by 15.4% (to \$ 624bn, mostly contributed to by the private banking sector) and the growth of domestic bond debt by 14.6% (to Rb 4.06 trillion)⁸, it is not easy to understand the logic behind the acts of Russia's financial agency, which grants financial aid to certain member states of the European Union in violation of the agreement concerning their accession to the EU. One example is Cyprus, a member country of the European Union since 2004, which at the moment of its accession thereto assumed certain responsibilities. By issuing government loans to Cyprus⁹ without due regard to the European Union's standpoint on this issue, Russia runs the risk of altogether losing her money. In fact, the authorities of the European Union are refusing to consider the issue of granting financial aid to Cyprus until Russia revokes or annuls her loans to that country, because any financial aid received by Cyprus may effectively be used for redeeming Cyprus's debts to third countries, in this case – to the Russian Federation. And since the European authorities are denying any financial aid to Cyprus, the prospect of redemption of Russia's loans to Cyprus is also questionable. The amount of money given (in all evidence, irrevocably) by Russia to Cyprus (€ 2.5bn, or Rb 100bn) would have been more than enough to repay the debt of Riazan Oblast (Rb 22bn, or 75% of the regional budget)¹⁰ – and also the debts of some other regions. Although Russia's federal budget for 2013 and the planning period of 2014–2015 is formed on the basis of the budget rule, and so it has a rather high 'safety margin' as a precaution against unforeseen expenditures, as well as some additional reserves that can play a compensatory role in an event of losses from inefficient placement of budget resources on external markets¹¹, it must not be forgotten that the only compelling reason behind the RF Government's decision to launch pension reform and carry forward the expenditures envisaged in the RF President's Edicts beyond a current budget period was the lack of sufficient funds to meet domestic obligations. Against this background, Russia's potential losses as a result of

⁷ See www.rg.ru of 11 January 2013.

⁸ In 2012, Russia's domestic government debt rose by 14.6%. See Kommersant.ru of 17 January 2013.

⁹ A. Bashkatova. *Minfin s ponimaniem otnessia k problemam Kipra*. [The RF Ministry of Finance Treated Cyprus's Problems with Understanding.] See www.ng.ru of 14 January 2013.

¹⁰ N. Bashlykova. *Riazanskuiu oblast' zhdiet sud'ba Gretsii i Ispanii. Regionu grozit bankrotstvo*. [Riazan Oblast Will Share the Destiny of Greece and Spain. The Region Is Faced with the Threat of Bankruptcy.] See Kommersant.ru, No 4/P 5035, of 14 January 2013.

¹¹ P. Netreba. *Ne nado stroit' vozdushnye zamki. Ministr finansov Anton Siluanov o finansovykh perspektivakh 2013 goda*. [No Castles in the Air to Be Built. Minister of Finance Anton Siluanov Speaks of the Financial Prospects for 2013.] See Kommersant.ru of 25.12.2012.

granting financial aid to Cyprus appear to be untimely. Moreover, the RF Ministry of Finance is delaying the transfer of financial resources to the regions in the amount of Rb 1 trillion (promised by former RF President Dmitry Medvedev), reasoning that there is no real possibility to effectuate any cuts in federal budget expenditure, and that it can only be feasible, for technical reasons, to transfer any resources to the regions only if they are coupled with corresponding liabilities¹².

Among the documents adopted over the period under consideration, the most noteworthy are the following ones.

1. Over that period, Russia adopted Federal Law of 29 December 2012, No 282-FZ ‘On Introducing Alterations into the Federal Law “On the Securities Market”, whereby some serious clarifications were introduced with regard to the issues of levying taxation on the securities of Russian issuers the rights to which are confirmed by foreign securities (meaning here foreign issuers’ depository receipts for shares issued by Russian organizations). The afore-mentioned issues need to be further regulated, but the mechanism envisaged in the new Law may indeed be qualified as an important step towards the final accomplishment of the comprehensive task of determining the tax base for each type of income from securities of Russian issuers, the rights to which are confirmed by securities of foreign issuers. It appears that so far the procedure for estimating tax bases with regard to sales of shares in privatized enterprises where subsequently IPOs were held has remained unregulated. However, bearing in mind that the Agreements for Elimination of Double Taxation have preserved the right of the Russian Federation to the taxes levied on the sale of shares of Russian issuers secured by Russian immovable property in the amount of 50% or more (tax is levied on the income generated by the sale of such shares in accordance with the rules established for the sale of immovable property – that is, at the place where the relevant immovable property is situated), and that the new Law has established the responsibility to disclose, to the Register keeper, information on the holders of shares of Russian issuers, it is highly likely that the principal risks for the Russian budget associated with the possibility of revenue losses as a result of tax-free disposal of incomes generated by the right of ownership with regard to the mineral resources situated in RF territory have finally been eliminated.

By the newly introduced Law, some serious amendments were made to a number of laws designed to protect the economic interests of the Russian Federation: the law on banks and banking activities; the law on securities and financial markets, the law on the State registration of juridical persons and individual entrepreneurs; the law on the Bank of Russia; and some other laws. In particular, it is established that, if as a result of one or several transactions carried out by one and the same juridical or physical person a stake in a bank’s capital is acquired in the amount of 1%, and/or transactions carried out by a group of persons (recognized to be a group in accordance with Federal Law of 26 July 2006, No 135-FZ “On the Protection of Competition”) and resulting in the acquisition of control over shareholders owning a total of more than 1% of shares (or stakes) in a bank, the Bank of Russia should be notified of such transactions, and if the acquired share exceeds 20% – a preliminary consent of the Bank of Russia should be obtained.

¹² Ibid.

By Federal Law of 29 December 2012, No 282-FZ some details were specified with regard to the procedure for the disclosure of information on foreign holders of securities of Russian issuers and the payment of income from the equity securities kept at the Depository, the latter being charged with the mandatory task of keeping such securities on a centralized basis. It is established that the Register keeper should compile, as of a certain date, the list of persons exercising the rights to the aforesaid securities, or the list of registered persons. In this connection, the Depository, in the capacity of a person acting in the interests of other persons, is not allowed to issue orders concerning the placement of securities of Russian issuers emitted in RF territory on an account opened for the Depository with a foreign organization. The persons for whom a depo account for depository programs is opened may exercise the right to participate in a general shareholder meeting with regard to shares, the rights to which are confirmed by securities of a foreign issuer, only on condition that the holders of the aforesaid securities of a foreign issuer and other persons exercising the rights to those securities of a foreign issuer have instructed those persons as to how to vote at the general shareholder meeting, and the Russian issuer have been informed concerning those persons and the number of shares, the rights to which are confirmed by securities of a foreign issuer, held by each of those persons.

With due regard for the responsibility to disclose information on foreign holders of rights to Russian securities, the RF Tax Code has been augmented by norms whereby it is established that, if the information on the holders of rights to Russian securities is not disclosed, tax on the income paid to such holders will be levied at a maximum rate, the ceiling for which for physical persons is established by Item 2 of Article 224 of the RF Tax Code and amounts to 35%; and for organizations – by Item 3 of Article 224 of the RF Tax Code and amounts to 30%. The specific features of the taxation of income paid to foreign organizations acting in the interests of third parties with regard to securities of Russian issuers are established as follows: for physical persons – by the newly introduced Article 214.6 of the RF Tax Code; and for organizations – by the newly introduced Article 310.1.

The amount of the State duty to be charged for the preliminary consideration of documents necessary for the State registration of an issue (or an additional issue) of securities – Rb 100,000, and for the State registration of the main part of a securities prospectus – Rb 200,000 (amendments to Subitem 53 of Item 1 of Article 333.33 of the RF Tax Code).

2. By Federal Law of 29 December 2012, No 279-FZ many significant alterations are introduced in Chapter 23 of the RF Tax Code concerning the procedure of paying personal income tax (PIT).

In accordance with Item 16 of Article 214.1 and Article 220.1 of the RF Tax Code, the losses incurred on operations with marketable securities and financial instruments traded on an organized financial market can be carried forward, which is not allowed for the losses on non-marketable securities and financial instruments. For its part, the new Law specifies that it is necessary to keep separate records of the financial results for marketable and non-marketable securities and instruments, as well as for closing short positions in repo operations. Thus, the rules for forming tax bases for operations with securities carried on by physical persons have been made uniform.

The new Law envisages more liberal application of some ‘social’ deductions: the tax exemptions established for the payments made by employers from their ‘after taxes’ profit to

cover the cost of medical care for their employees (including the cost of pharmaceuticals), the employees' spouses, parents, and children are now also extended to adopted children.

The 'social' tax deductions (if the cost of medical care, including voluntary individual medical insurance, was covered by taxpayers on their own, and not by their employers) are now extended to adopted children and their wards, but within an established limit of Rb 120,000 over a given tax period.

It is now legislatively established that 'social' deductions may be granted in respect of medical care provided not only by a medical institution, but also by an individual entrepreneur with a license issued in accordance with Russian legislation for services included in the list of medical services approved by the RF Government. Previously, the right to grant such deductions was established by Ruling of the RF Constitutional Court, of 14 December 2004, No 447-O.

The amount of tax deduction in respect of expensive types of medical care provided by medical institutions and individual entrepreneurs is to be equal to the actual cost of the aforesaid medical care, i.e., in excess of the standard 'social' deduction. The list of expensive types of medical care is to be established by the RF Government's decree.

3. Over the period under consideration, one very important decision was made by the RF Constitutional Court. In the text of Item 4.2 of the RF Constitutional Court's Ruling of 17 January 2013, No 1-P on the case involving the verification of compliance with the RF Constitution of the provisions of Part 5 of Article 19.8 of the Code the Russian Federation on Administrative Offenses (CAO) in connection with the complaint filed by Limited Liability Company *Maslianskii khlebopriemnyi punkt* [Maslian Grain Collection Point] it is stated that Part 5 of Article 19.8 of the Code on Administrative Offenses, whereby it is envisaged that a juridical person may, without any alternative, be brought to administrative responsibility in the form of a fine whose floor is set at a rather high level (from Rb 300,000 to 500,000), is contrary to the international rules and the RF Constitutions, because 'it does not rule out the possibility of transforming that administrative fine from a measure designed to prevent administrative violations into an instrument for suppressing economic independence and initiative and for imposing excessive restrictions on both the freedom of entrepreneurial activity and the right of ownership'.

In Item 4.3, the RF Constitutional Court noted that 'the high floor established for the administrative fine in the existing legal regulation system, which does not allow that an administrative punishment should be imposed in an amount below the floor established for a relevant administrative sanction, makes it impossible to give full consideration to the committed administrative violation, the property and financial status of the juridical person, and other significant circumstances relevant for a given case, and thus does not ensure the imposition of a just and appropriate administrative punishment'.

We believe this Ruling of the RF Constitutional Court to be very important¹³ also in terms of preventing the recently emerged practice of the legislative authorities to establish fines

¹³ Many experts agree the Ruling of the RF Constitutional Court has created a precedent that will be very important for legal practice in the Russian Federation – their opinions are cited in E. Berezina. *Shtraf vne konkurentsii*. [An Incomparably High Fine]. *Rossiiskaia Biznes-gazeta* [The Russian Business Newspaper], No 880 (2). See www.rg.ru of 22 January 2013.

with a very high floor for other violations committed by physical persons. Such fines restrict the right of disposal of property not only for those individuals on whom administrative sanction are imposed, but also for their families, including children who do not have dispositive legal capacity. Thus, such fines effectively deprive those persons who are not directly involved in committing administrative violations but are next-of-kin to the guilty person, of their means of subsistence and opportunities for covering the cost of educational, medical and other social services provided to them (kindergartens, schools, the services of private nurses, etc.).

Another important component of the Ruling of the RF Constitutional Court is the recognition of the need to coordinate, from the point of view of economic, the size of an administrative fine with the consequences of the committed administrative violation. It is precisely this requirement, in conjunction with the necessity to give consideration to financial status and other relevant circumstances, that creates the fundamental difference between an administrative fine and tax.

4. In January 2013, the RF Federal Tax Service published, on its official website, the control figures describing the ratios between the indices applied in the established forms of tax and accounting reports used by tax agencies in their audits in order to verify the correctness and reliability of data entered by taxpayers and tax agents in their tax declarations. The corresponding mathematical and logical formulae for the twelve basic types of tax declarations are not available to taxpayers in the section 'Tax Reports', subsection 'Control Ratios for Tax Declarations'. The RF Federal Tax Service explains that it expects these formulae to be applied in the existing accounting software, so that taxpayers would be able to identify on their own their errors committed whilst preparing their tax reports, the probability of disputes arising in this connection could be brought to a minimum, and the cost of tax control the Russian Federation could be reduced. This decision can only be welcomed, as it is aimed at supporting honest taxpayers and lowering the administrative costs of doing business.

5. In the situation determined by Russia's accession to the WTO, it appears to be very reasonable to postpone (so far – until 1 November 2014) the entry into force of the provisions of Federal Law of 6 April 2011, No 68-FZ concerning the introduction of alterations in the RF Budget Code in the part of regulating the payments in compensation for the harm done to public motor roads of federal importance by transport vehicles with a mass of over 12 tons. This payment belongs to the category of 'pseudo'-taxes and has a distinctly fiscal purposes; it is established with no consideration for the potential ceiling for the tax load imposed on commodity producers and its multiplication effect. Thus, it will, first of all, result in an increased share of transport and circulation costs in the cost structure of domestic producers.