

THE POSSIBLE IMPLICATIONS OF TAX REFORM IN RUSSIA

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Abstract: *The upcoming three-year period is marked for Russian tax system as a period of crucial reforms and restructuring. Computational-analytical method was used as the main one. Possible fiscal consequences for the country economy were calculated on the basis of three options of the proposed changes in tax rates. The study was conducted on the example of four taxes: value added tax, corporate income tax, personal income tax and insurance premiums. Based on the calculations the possible consequences of changes in tax rates are determined taking into account possible changes in consumer behavior, systems approach to the investigation of the tax system, and the appearance of the feedback loop effect. Keywords: tax reform, tax, system approach, consumer behavior, feedback loop effect.*

KEYWORDS: TAX REFORM, TAX SYSTEM APPROACH, CONSUMER BEHAVIOR, THE EFFECT OF THE FEEDBACK LOOP.

1. Introduction

The upcoming three-year period is marked for the Russian tax system as a period of crucial reforms and restructuring. By 2019 the national tax reform of value-added tax (hereinafter VAT) and insurance premiums is expected to be completed. Three options of the proposed changes in tax rates will be considered in this article, as well as possible fiscal consequences for the country economy will be calculated.

Option 1. Compulsory payments to the social insurance system at the rate of 22% with levying from the entire payroll (cancellation of "thresholds") with an increase of the VAT rate to 20% and abolition of preferential rates in the 10% (hereinafter "option 1");

Option 2. Aggregate payments to the social insurance system at a rate of 21% with levying from the entire payroll (cancellation of "thresholds") with VAT 21% and cancellation of preferential rates in the 10% change (hereinafter "option 2");

Option 3. Aggregate payments to the social insurance system at a rate of 21% with levying from the entire payroll (cancellation of "thresholds") with VAT 20%, while maintaining preferential rates, applying of a trade fee in all regions and raising the personal income tax up to 15% (hereinafter "option 3").

Purpose of the article: to assess the fiscal effect of these three options for tax reform conducted until 2019.

2. Results and Discussion

From the standpoint of the need for a theoretical justification for the chosen forecasting methodology, the authors of this study used the following starting points.

1. When choosing the industries for the study, the size of employees' wages was taken into account.

2. The organizations of the researched industries are not payers of the trade fee, in this connection this fiscal payment was excluded from the calculation of the effectiveness of the third option of the tax reform.

3. During the calculations, the analyzed indicators were indexed for the inflation rate planned for 2017 - 4%.

4. Evaluation of tax reform options effectiveness was estimated by the computational-analytical method, actively used in conditions of multi-optional planned events and insufficient verifiability of the information base.

Thus, according to option 1, due to the payments to the Pension Fund of Russia (PFR), Social Insurance Fund (SIF), Federal Compulsory Medical Insurance Fund (FCMIF), the total volume of falling out revenues of the six selected industries will amount 19.27 billion euro, due to the corporate income tax- 3.86 billion euro; While the volume of additional revenues from the value-added tax, taking into account the changes proposed in option 1, will amount 55.56 billion euro.

Consequently, the total amount of budget losses will amount up to 17.56 billion euro or 16.4% of the tax revenues for the sectors selected.

The conducted calculations of the option 2 demonstrated that the total volume of falling out revenues for the studied economy industries as a result of the changes in the tariffs of insurance premiums of PFR, SIF, FCMIF would be 21.68 billion euro, corporate income tax - 4.34 billion euro; while the volume of

additional revenues from the value-added tax would amount up to 7.15 billion euro. Thus, the total amount of budget losses would account 18.87 billion euro or 17.6% of the tax revenue for the industries selected.

The assessment of the cumulative economic effect of option 3 allowed to determine that:

- The amount of the falling out income for the six industries analyzed due to the payments to PFR, SIF, FCMIF will be 21.68 billion euro;

- The drop in income from corporate income tax, formed because of the increase in the costs accepted for calculating this tax in the form of insurance premiums, will be up to 4.34 billion euro;

- The volume of additional revenues from the value-added tax will account 0.934 billion euro;

- The volume of additional income from the income tax will be 6.022 billion euro.

Consequently, the total budget loss of option 3 will account 19.06 billion euro or 17.75% of the tax revenue for the industries selected. The conducted calculations showed that option 2 would lead to the biggest loss of the budget.

The general trend of changes in tax rates leads to the conclusion: prevalence of indirect taxation ultimately increases the tax burden on the end user. During the first phase of implementation the increase of indirect taxes has a positive impact on producers, releasing free cash flows necessary for production development, making the country economy more attractive for investors.

During tax reforms, two rules of the systems management theory must be remembered:

1. Taxes and taxation is a system, the essence of which is in the fact that it can sustain itself and function as a single unit, as a result, of its parts interaction;

2. There is the effect of the feedback loop, which can be both positive and negative.

In the context of the three options, it might be concluded that it is balancing feedback. The mechanism of balancing feedback adjusts the difference between the actual and the desired state of the system. After two years of the test application, the revenues will be the same as if the tax rates are not changed at all. It will just change the source of tax payments: after implementation of the tax reform, tax burden will increase for the end user or the population of the country but the main goal - economic development - will not be achieved, while the way of people's thinking will be different.

The behavior of Russian end user can be classified as traditional, and the behavior of the taxpayer - can be classified as optimizing. Due to the income reduction (an increase of personal income tax rate by 2%) and an increase of prices (the application of a trade charge and the increase of VAT up to 20-21%), there will appear a common habit of increased money saving. It will lead to further growth of market competition and difficulties in sales markets. Negative consequences will also be connected with low efficiency of marketing tools applied by Russian producers, in compare with Western companies, as well as due to the short-term period of habit formation (3 months). Moreover, after 8-10 months the habits are transformed into a routine (used by R. Nelson and S. Winter) - established practice, the established order of activities.

It should be noticed, that the practice of transferring the tax burden from production to consumption is a general trend for over the past 10-15 years. However, in contrast to Russia, the tax

maneuver includes VAT and corporate income taxes, but not the insurance premiums, which are the main pension systems worldwide. For instance, corporate income tax rate is constantly decreasing in Switzerland during last years. Typical rates of corporate income tax in different cantons (regions) of Switzerland varies from 8 to 10.5%¹, that makes it highly competitive in compare with other European countries. In many OECD countries, personal and corporate tax rates are reduced, while the taxation base and the contributions to social security system are increased. At the same time, there was a general tendency to VAT rates increase since 2006, and it allowed obtaining certain positive effects. However, all OECD countries, excluding Australia and New Zealand, levied compulsory social insurance contributions on labor incomes in which there is a general upward trend².

3. Conclusion

According to the above written it can be concluded: changes in tax rates will influence 97.7% of the working population in the country and it will change their behavior model. The new behavior model will reduce the capacity of the market, reducing the consumption of domestic products of low quality and high price, replacing them with cheaper foreign counterparts. These changes will eventually lead to deprivation of Russian companies of a significant number of its customers.

Moreover the temporary effect of VAT rate increase (the first option of the budget revenue growth 5.56 billion euro, the second - 7.15 billion euro, the third – 0.934 billion euro) will be fully or partially lost due to lower level of consumption and market contraction.

Thus, we believe that the transfer of the tax burden from production to consumption is premature, unjustified, and ineffective. Still the process is inevitable, so the change in tax rates should be gradual. For instance, an increase or decrease of interest rates by 1-2%, choice of one or two taxes a year as the object of changes, and such changes should be held every two years in order to determine the effect of the feedback loop from the accepted changes and adjust further action.

4. References

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¹ INTERNATIONAL CORPORATE TAX: Investment in Switzerland, KPMG, Edition 2012. – pp. 77.

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