

## **CORPORATE TAXATION IN THE RUSSIAN FEDERATION**

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### **Introduction**

When considering new investments, investors compare potential profit with possible losses. Generally, this is an after-tax evaluation. Undoubtedly, one of the most important factors is the estimation of the amount of taxes that one will have to pay on the profit received from such investment. Consequently, it is important that the rules governing the tax system be accessible, and that the system itself be stable and capable of providing answers as to how a particular business can expect to be taxed under various scenarios. In most countries, it is relatively easy for an investor to determine the amount of taxes that are likely to be paid under different base cases before an investment is made. However, for the investor wishing to invest in Russia, this is not a simple undertaking.

In accordance with the December 1991 Russian Federation (RF) Law "On the Principles of the Tax System in the RF",<sup>1</sup> there are twelve federal taxes currently in force on the territory of the Russian Federation; six more regional taxes have been established by Russian legislation and are obligatory throughout the territory of the RF, although the specific rates are determined by local government bodies. Local governments may establish up to eighteen local taxes but may not impose taxes in addition to or rates thereunder in excess of those established by the 1991 Law "On the Principles of the Tax System in the RF".

The most important taxes levied on legal entities (regardless of their legal-organizational structure and form of ownership) are as follows:

- 1) Profit Tax
- 2) Property Tax (income tax)
- 3) Value-added-tax (VAT)
- 4) Excise Tax (on certain kinds of goods)
- 5) Land Tax
- 6) Highway Taxes

1. Law "On the Principles of the Tax System in the RF", 27 December 1991 No. 2118-1; *Rossiiskaia Gazeta*, 10 March 1992, and *Ved. RF* 1991 No. 11 item 527.

It is commonly acknowledged that the profit tax, value-added-tax, and excise taxes serve as the main source of revenue for the Russian budget. It is these taxes which also make up the majority of tax payments for almost every enterprise conducting business in Russia. This article attempts to summarize developments over the past two years in the different rules and regulations governing these taxes.

### 1. Value-Added-Tax

A value-added-tax (VAT) was first imposed on enterprises doing business on the territory of the Russian Federation in 1992.<sup>2</sup> This replaced the 5% "presidential" sales tax and turnover taxes. VAT is a way of exacting part of the value added at every stage of manufacturing as well as providing labor or rendering services and remitting it to the budget as they are sold (provided or rendered). Russian law permits recovery of VAT in respect to items (materials, supplies, and services), the costs of which are deductible for the purpose of calculating profit tax.

At first, all legal entities and natural persons – both Russian as well as foreign – engaged in manufacturing or commercial activities, regardless of their legal-organizational form, were required to pay VAT. As of 1 January 1994, natural persons engaged in business but without having formed a legal entity are exempt from VAT.

In 1992, the VAT rate was set at 28% and was levied only on the sale of goods, the provision of labor or rendering of services on the territory of the Russian Federation – imports and exports were not subject to VAT. This high rate of indirect taxation could be attributed to fiscal considerations, including the need to balance the state budget. But legislators who hoped for increased state revenues from VAT were largely disappointed. It should have been foreseen that setting such a high rate for a tax which covered virtually the entire turnover of an enterprise would lead to massive tax evasion, especially among small businesses. The Russian Tax Service was forced to admit the difficulty of keeping the 1992 budget deficit within acceptable levels, as the income received from VAT was much less than expected, and as a result the Tax Service was forced to compensate for this shortfall by extracting additional funds from revenues received from the tax on profits.<sup>3</sup> In mid-

2. Law "On Value-Added-Tax", 6 December 1991 No. 1992-1; *Rossiiskaia Gazeta*, 24 December 1991, and *Ved. RF* 1991 No. 52 item 1871.

3. The Director of the Administration of Tax Reform of the RF Ministry of Finances M. Shpilko, "Nalogi '93", *Ekonomika i Zhizn'* 1993 No. 2, 1.