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The opinions expressed in this paper are those of the authors and do not necessarily reflect the views of the Bank of Finland.

## The Taxation of Banks in Russia

This article is abridged version of a study "The Taxation of Banks in Russia" written by Jury V. Mishalchenko, doctor of law, St.Petersburg University of Economics and Finance.

The article consists of three parts. Part one focuses on some of the main economic and legal questions involving the Russian tax system in general. The basic principles and legal framework of the tax system are analyzed. Part two concentrates on the taxation of banks in more detail. The main types of taxes levied on banks are discussed. Finally, part three contains some suggestions for improving the efficiency of the Russian tax system in the future.

### Introduction

The stabilization of the Russian economy and reforms connected with transition from a central planning system to a market economy involve a great amount of government imposed policies. In particular, the role and significance of taxation increase sharply. Taxation is seen as a regulator of the market economy and a way to develop and stimulate different areas of the nation's economy. Furthermore, a particularly important role is played by banks, as they use and coordinate the funds of enterprises and private individuals. Taxes in a banking system serve as instruments of the government's finance and credit policy. Through taxation, government can directly or indirectly affect the allocation of banks' financial and credit resources. Through taxation, the government can also influence the strategic directions of state economic policy in general.

# 1 Taxation

According to the Russian constitution the tax system must serve the following principles: First, it must reflect economic efficiency by encouraging entrepreneurship. The tax system is also required to be profitable and relatively stable. Taxation should be flexible enough to react and adapt timely to economic changes. The principle of definition states that taxes must be clearly defined so that the taxpayer is fully aware of what taxes, how much and when he must pay. Finally, the tax system should be based on justice and convenience. All juridical and natural persons must be treated fairly and equally.

The Russian "market-economy tax system" was initiated in December 1991, when a group of tax laws was approved. Among these were laws on profits taxes on enterprises and organizations, value-added taxes, bank income taxes, taxes on property of enterprises, and state duties and income taxes. Since then, although several changes have been made, the basic structure of taxes and tax system principles have not changed significantly.

It has been argued that the Russian tax system is inefficient. Several facts support the argument. First, on average, about 60 % of all imposed taxes are actually collected. One of the reasons for the ineffective tax collection is that the tax burden is spread unequally. This in turn increases tax avoidance, especially among those whose taxes are exceptionally high. Second, the tax system includes a large number of minor, unclearly defined taxes. In addition, tax laws are changed frequently, which makes the information flow and enforcement tasks even more difficult. Finally, state tax policy does not take into account hyperinflation, which is necessary for the formation of the state budget. This, naturally, can have dramatic consequences from the budget-balance point of view.

## 2 Taxation of Banks

### 2.1 Profits tax

The profits tax is the most important tax imposed on juridical persons, including banks. Up until 1994 the profits tax in Russia was not directly applied to banks. According to the "Law of the Russian Federation", dated December 1991, the entities liable to the profits tax were rather broadly defined to include juridical persons and their affiliated branches. At the beginning of January 1994 "The President's decree on certain changes in taxation and interrelationship of budgets on different levels" laid down a new order of taxation. The new focusing point was the taxation of the profits of banks, credit institutions and insurance organizations. From the beginning of 1994 the profits tax was imposed, among others, on the Central Bank and its institutions. The other entities newly subject to profit tax were: the Bank of Foreign Trade of the Russian Federation, the Savings Bank, commercial banks (including banks operating with foreign capital), foreign banks licensed by the Central Bank, branches of both national and foreign banks, insurance companies and other licensed credit institutions.

Details on the base for the profits tax applied to banks and other credit institutions are given in the so-called "Government Resolution" of May 1994. In general, All expenses, when measuring the taxable income, are divided into the categories according to economic content. The standard costs include the following: material expenses, wage costs, deductions for social needs, depreciation of basic funds and other expenses.

In general, both home and foreign incomes are liable to the profits tax of the Russian Federation. Taxable income includes interest receipts on credits, commissions and other transfer payments, and service fees received in connection with payments and settlement (both home and foreign), maintaining accounts plus other services. Further, returns on banks' investments, business operations (banks' operations in the share market, rents for bank property etc.) and incomes received from non-operational transactions are also included in taxable income and are thus subject to the profits tax. Finally, profits tax breaks apply to banks just as they apply to enterprises. The taxable profit decreases when incomes are used for special purposes. This includes mainly income that is used to finance capital investments for productive and non-productive use, income used to carry out research-and-development work, and income used for capital investments for environmental protection.

The profits tax in Russia can vary from 30–45 % depending on the type of income received. The tax is paid in roubles. Foreign banks can pay profits taxes either in roubles or in foreign currency. Foreign currency is converted into roubles at the rate quoted by the Central Bank on the day of the tax payment.

## 2.2 Other taxes levied on banks

In addition to the profits tax, there are several other taxes imposed on banks operating in Russia. Some of the most important are value-added tax, special tax, tax on securities, real estate tax and tax on land.

The State Tax Service of the Russian Federation and the Ministry of Finance determine specifically which operations and services of banks and credit institutions are subject to the value-added tax. The main taxable bank services include consultation, information, expertise, brokerage and intermediation services. Value-added tax breaks are applied to certain operations: extension and handing of loans, money deposits, operations connected with the circulation of currency, money, banknotes, securities, bonds etc. The current value-added tax rate in Russia is 20 %, but the intent is to raise the rate to 21 % from January 1996.

A special tax is applied to financial support in the main economic sectors, including banking. In other words, financial support received by banks is subject to the special tax. Taxation is based on the 1995 law on "The special tax for enterprises, institutions and organizations receiving financial support". However, credits received in foreign currency are not liable to the value-added tax nor the special tax. Currently, the special tax rate is 1.5 %.

Banks' operations in the security markets are subject to taxes. According to the law on securities, the taxbase is the contract price and the registration prospectus of the security issue. The registration follows rules set by the Central Bank. During the registration the tax is set at 0.5 % of the declared nominal value of the issue and is considered as the payment for registration. When buying securities the tax rate is 1 rouble per 1 000 roubles worth of securities. Finally, the tax on securities operations is charged to each participant of the deal at the rate of 3 roubles per 1 000 roubles. The base for the tax and the rate are defined mainly in two laws: "Rules of security issue and registration by commercial banks on the Russian Federation territory", dated October 1992, and "The letter of the Central Bank of the Russian federation", dated March 1993.

Russian and foreign banks, credit institutions and their branches, situated in the territory of the Russian federation, are subject to the property tax. The base for the tax includes the fixed, current and financial assets of banks and financial institutions. The specific tax rates are determined by each Republic independently and are usually about 1–2 %. The property of banks and other credit institutions is tax free for one year following registration. In addition, foreign banks property used for social and economic programmes is not liable to property tax. Tax breaks are also applied to payments received from international organizations, foreign juridical and natural persons and payments received under intergovernmental agreements.

Finally, The use and exploitation of land in Russia is taxed according to the law on the "Land payment". The tax rates are determined on the basis of average size and value. The specific tax rate is confirmed by the state authority at the location. The average tax on land in 1994 was 5 roubles for 1 sq.m.

### 3 Suggestions for the future

The Russian tax system includes a large number of different taxes. Most of the taxes levied on regular business activities are also levied on the operations of banks and financial institutions. It has been argued that to some extent present taxation of banks in Russia reduces the efficiency of banking. A large number of taxes, frequent changes in tax laws and inefficient tax collection makes both the tax system and banking business stiff and inflexible. After all, the tax system should have a stimulating and encouraging effect rather than prohibitive effect. As a consequence, certain changes are needed to improve the tax system. It is necessary to clearly define the specific rights of regional and local authorities to establish new types of taxes and tax breaks. It is also desirable to arrange tax free zones and other special economic zones to promote investment. It is also essential to adjust tax revenues in accordance with inflation. In addition, the parliament should issue a Tax Code which would form a solid base of tax system. Finally, the tax system should effectively avoid constant changes of laws and standards through more careful planning and preparatory work.

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