Improving Russia's 13% Flat Tax

By Alvin Rabushka

On February 21, 2002, I posted to this site an article entitled "The Flat Tax at Work in Russia." In that article, I pointed out an anomaly in Russia's 13% flat tax, namely, there are two sources of income that are taxed at higher rates. The first source is dividends and the income of non-residents, which are taxed at 30%. The second consists of five different kinds of income, which are taxed at 35%. These are (1) gains and prizes from contests and games for the purpose of advertising, (2) winnings of lotteries and pari-mutual bets, (3) net insurance receipts, (4) bank taxable interest, and (5) gains from loans at below-market rates. As mentioned in "The Flat Tax at Work in Russia," for all practical purposes, the latter three kinds of income are either lightly taxed or not taxed at all.

There is, in my view, no apparent reason for these two higher rates, especially the 35% rate, which serve only to complicate the simplicity and administration of Russia's otherwise transparent 13% flat tax.

In apparent agreement with this view, the Russian government is currently preparing a Bill on Lotteries that would reduce the 35% tax rate on lotteries to the standard flat rate of 13%. (See http://www.rbcnews.com/free/20020307152617.shtml) The organizer of a lottery would have to pay 10% of the profit derived from the lottery after deducting all expenses and awarding prizes. The bill will define lotteries aimed at the promotion of specific goods on the market as a kind of lottery and taxed at 13%.

It will be worth watching the Russian government in the coming months to see if it continues to simplify its flat tax on personal income by dropping the remaining kinds of income taxed at the third rate. The reduction in the corporate tax rate from 35% to 24%, which took effect on January 1, 2002, should also prompt the government to reduce that 30% tax rate on dividends in the near future.