Further Extending Russia's Tax Reforms

By Alvin Rabushka

The Russian government is in the process of further extending its tax reforms. A first step was the introduction of a 13% flat tax on personal income (see "The Flat Tax at Work in Russia" and "Improving Russia's 13% Flat Tax"), which took effect in 2001. Second, it reduced the corporate tax rate from 35% to 24%, beginning January 1, 2002.

Now the Russian government is planning to simplify and reduce the tax burden on small businesses. Under the current proposal put forth by the Russian government, a small business is defined as having no more than 20 staff and annual turnover under R10 million (about $322,000 at the current exchange rate). The proposal would grant small businesses a choice between a 20% flat tax on profits or an 8% flat tax on revenues, whichever is lower, beginning January 1, 2003 (assuming Duma approval, which appears likely). This small business tax rate on profits partially splits the difference between the higher 24% corporate rate and the 13% personal rate.

Other changes in the tax treatment of small businesses will accompany the reduction in rates. Collection of the small business tax will shift from a monthly to quarterly basis, mirroring the reporting of estimated taxes for private entrepreneurs and professionals in the personal income tax. Accounting for tax purposes will change from an accrual to cash basis; taxes will no longer be collected on imputed or phantom income. Finally, small businesses will be able to expense their outlays on capital assets in place of the current depreciation system (along the lines of the Section 179 expensing provision in the U.S. Internal Revenue Code). These changes are expected to reduce accounting costs for small business enterprises.

The plan also exempts small businesses from value-added tax, sales tax, property tax, and social insurance taxes.

Assuming some version of this small business tax reform proposal is enacted by the Duma this year, Russia will have completed a major overhaul of its personal, corporate, and small business taxation within the short span of three years. Some opportunity for further simplifying the personal income tax remains (see "Improving Russia's 13% Flat Tax"), especially reducing the 30% tax rate on dividends now that the corporate profits tax rate has been cut to 24% and there is no capital gains tax on the sale of Russian equities.