Tax Reform Remains High on Russia's Policy Agenda

By Alvin Rabushka

On April, 2002, I posted to this site an article entitled "Further Extending Russia's Tax Reforms." It described the Russian government's new proposal to radically simplify and reduce the tax treatment of small businesses. Under the plan, small business firms could choose to remit the lesser of a 20% flat tax on profits or an 8% flat tax on revenues. Firms that qualify—those with no more than 20 staff and turnover under R10 million ($320,000)—would also be exempt from value-added tax, sales tax, property tax, and social insurance taxes.

Thus far, Russia's 13% flat tax on personal income (see "The Flat Tax at Work in Russia"), which took effect in 2001, has met its two major objectives of improving incentives and compliance. Building on it, the Russian government reduced corporate income tax rates from 35% to 24% in 2002. On May 21, 2002, the government further enhanced its small business proposal.

It widened the definition of a small business to include firms with turnover up to R15 million ($469,000), a 50% increase over the initial proposal of a few months ago. Small business firms could choose to remit the lesser of a 15% flat tax on profits or a 6% flat tax on turnover.

Note that the 15% flat tax on small business profits is close to the 13% flat tax on personal income, which encompasses sole proprietors. By reducing the 20% rate to 15%, the Russian government will make it easier in the future to equalize the tax treatment of small business income, eliminating the distinction between sole proprietor and small firms of 2-20 employees.