

NEED FOR ABOLISHING REDUCED VAT RATE IN THE RUSSIAN FEDERATION

Elena Iadrennikova

Abstract

Value added tax is one of the key elements of the taxation system in most countries of the world. The article looks at the role and importance of value-added tax (VAT) in a national taxation system. The author examines VAT rates in Russia and other countries and prerequisites for applying different rates of VAT to various goods and services. The article analyzes the system of VAT rates in Russia that includes a standard rate of 18%, a reduced rate of 10% and a special (zero) rate. The types of transactions that the reduced VAT rate is applicable to are analyzed. Positive and negative effects that occur as a result of charging different rates and a single positive rate of VAT are studied. The author proves the need to abolish the reduced VAT rate in Russia and switch over to a single positive rate of 18%. Mechanisms of compensating low-income citizens and producers of socially essential goods for the losses brought about by abolition of the reduced tax rate are proposed. The author concludes that the implementation of the reform will streamline the process of calculating and regulating the tax, reduce tax evasion, increase VAT revenue and improve the efficiency of VAT collection. The study aims to work out ways of improving the VAT collection system in Russia through the abolition of the reduced VAT rate of 10% in order to simplify the mechanism of tax calculation and administration and increasing the fiscal significance of the tax.

Key words: value-added tax (VAT), different tax rates, reduced tax rate, single positive VAT rate, public revenue.

JEL Code: H25, H21.

Introduction

At present, value added tax is used in over 140 countries where it usually accounts for 20 and more percent of total tax revenue (Keen & Lockwood, 2010). Spreading adoption of VAT has been observed over the past 20 to 30 years. Previously VAT was largely the prerogative of

developed countries in Europe and Latin America, while today value added tax is becoming a key component of tax systems in developed and developing countries alike.

The countries that use a VAT apply a uniform tax rate as well as multiple rates. From the point of view of optimal tax theory, the excess burden of taxation is the lowest when a uniform VAT rate is applied on all goods and services (Ebrill et al, 2011). The use of multiple rates also increases the cost of tax compliance, makes it easier to evade the tax and reduces the fiscal impact of VAT (Agha & Haughton, 1996).

Over the past decade there has been a trend toward higher standard VAT rates in many countries that use the tax. For example, between 2006 and 2016 the average VAT rate in the EU member states (EU-28) grew from 19.5% to 21.5% (Taxation trends in the European Union, 2016). In Russia, VAT was introduced in 1992, with a standard rate that was gradually reduced from 28% to the current 18%, a reduced rate of 10%, and a special (zero) rate being charged. Improving the VAT system in Russia by abolishing the reduced rate of 10% will allow for keeping the standard VAT at 18% while ensuring higher revenue from VAT for the national treasury.

1 Research methods

The author used a variety of theoretical and empirical scientific methods that included analysis, synthesis, generalization and classification. An analysis of revenue from VAT showed that the multiple rate system of VAT that is used in Russia makes it possible to quite effectively fulfill its fiscal function, but is not optimal.

The empirical methods included observation and comparison and were employed for identifying economic trends, for substantiating and selecting the number and value of the VAT rates in Russia.

2 Results and Discussions

Value added tax holds the central place among the indirect taxes charged in the Russian Federation. The role and significance of VAT in the public revenue system of the Russian Federation can be seen from its share in the total national revenue (summarized in Table 1). The total amount of consolidated budget revenues includes revenues of state non-budgetary funds.

Tab 1. Share of VAT in total national revenue in Russia (Statistics Russia, 2017)

Indicators	Years	2010	2011	2012	2013	2014	2015
1. Percentage of VAT in total national revenue of Russia		15.6	15.6	15.1	14.5	14.7	15.7
2. VAT revenue growth year-on-year, %		121.9	130.1	109.1	99.8	111.3	107.4
3. Growth rate of consolidated budget revenue compared to previous year, %		117.9	130.1	112.4	104.3	109.5	100.6

Source: Statistics Russia (2017). Reading allowed: Russian Statistics Annual Report. Retrieved from http://www.gks.ru/bgd/regl/b15_13/Main.htm., author's calculations

The analysis showed that between 2010 and 2015 the share of VAT in the total national revenue was the highest among other taxes, varying between 14.5 percent and 15.7 percent. During the six-year period between 2010 and 2015, the revenue collected from VAT increased by 69.4 percent, slightly outpacing the total revenue growth (167.9 percent).

Year-by-year growth rates for VAT over the period of analysis are practically the same as the growth rates for the total budget revenue. The only observed exception was the year 2015 when the budget revenues increased by a mere 0.6 percent (or 155.96bn rubles in absolute value), while the VAT revenue was up 7.4 percent (293.3bn rubles). The considerable increase in the VAT receipts was largely due to improvements in VAT administration. An automated VAT refund control system has been in place in Russia since 1 January 2015. It enables tax service workers to automatically track down the entire distribution chain of goods and services, register the occurrence and the amount of added value, compare information obtained from a taxpayer and his business partners. This makes it much more easier to detect tax evasion and to more accurately pick businesses for a tax audit.

2.1 Prerequisites for the introduction of multiple VAT rates and analysis of the differentiated VAT rates currently in place in Russia

The countries that use VAT apply a uniform tax rate as well as multiple rates. A special rate of 0% on exports or VAT exemption on exports are typical of all countries using VAT. The zero VAT rate will therefore be ignored in this discussion. Evidence from international practice shows that 53 percent of countries using VAT have a uniform positive VAT rate. The majority of the countries that introduced a VAT after 1990 opted for a uniform standard positive rate with minimum exemptions (Bersenev, 2005). Nevertheless, there are many

countries using multiple VAT rates, that is, a standard rate along with a reduced and an increased tax rate.

The use of differentiated and reduced tax rates is due to the fact that VAT is a universal levy that must be charged on all goods and services (Mayburov et al, 2016). Some of them are particularly important for welfare (usually, these are food, medicines, publications, fuel (energy), public transport), which is the reason for them to be taxed at a reduced rate. By means of applying reduced tax rates the state seeks to create incentives for consumption of goods and services (publications, public transport), or to fulfill the distribution (social) function of taxation and bring down the prices of socially essential goods (food, childcare goods, medicines).

In Russia, there are differential VAT rates (standard, reduced and zero) that are applied on various goods, works and services (Table 2).

Tab 2. Differential positive VAT rates in Russia

Rate	Taxable transactions
18%	Basic (standard) rate. Applied to all taxable transactions excluding those eligible for the reduced or zero rate, that is, to the majority of goods, works and services sold in Russia or imported in Russia and its territories
10%	Reduced rate. Applied to the following goods and services sold or imported in Russia and its territories: <ul style="list-style-type: none"> ✓ food staples (meat, giblets, processed meat, milk and dairy products, eggs, vegetable oil, sugar, salt, bread and baked goods, cereals, flour, pasta, fish, vegetables, baby food); ✓ child supplies (clothing, shoes prams, toys, etc.); ✓ periodicals, books excluding advertising and erotic ones; ✓ medical supplies, made both in Russia and abroad; ✓ domestic flights

Of the European Union member states, only Denmark has a single positive VAT of 25%. Other European countries use one or two reduced rates (varying from 5% to 18 %). Five countries (Ireland, Spain, France, Italy, Luxembourg) apply super-reduced rates of 2.1% to 4.8% (European Commission. Taxation and customs union, 2016). It has to be noted that across the countries applying reduced rates the lists of eligible goods are practically the same and include foodstuffs, agricultural produce, children's supplies, pharmaceutical supplies, passenger transport, newspapers and books.

2.2 Analysis of positive and negative effects of differential VAT rates and a single positive rate

There has been a lot of discussion in the scholarly community in Russia and abroad about the prospects of applying a uniform positive VAT rate. An analysis of the positive and negative sides of differential rates and a single positive VAT is presented in Table 3.

Tab 3. Positive and negative effects of applying differential rates and a uniform positive VAT rate (Bersenev, 2005, Mayburov et al, 2016)

1	Differential (multiple) VAT rates
	1.1 Advantages
	+ reduced rates serve as an instrument of income redistribution and social justice
	1.2 Disadvantages
	- tax accounting complications; purchases and sales taxed at different rates have to be reported separately;
	- violation of the principle of tax neutrality;
	- reduced rates pass on the tax concession to well-off consumers, too;
	- there is no clear-cut classification of goods and services taxable at different rates; different rates allow for tax evasion or tax refund fraud;
	- tax administration complications and lower VAT collection effectiveness
2	Single positive VAT rate
	2.1 Advantages
	+ makes it easier for tax payers to perform tax accounting, prepare reports, keep sales and purchase ledgers, issue invoices;
	+ simpler tax forms;
	+ streamlines tax audits and VAT administration;
	+ fewer deliberate and inadvertent errors by tax payers who do not have to choose between the VAT rate to be applied to a specific taxable item;
	+ tax evasion and illegal tax refund schemes based on differential VAT rates are ruled out
	2.2 Disadvantages
	- higher prices of some socially essential goods that will negatively impact disadvantaged groups of the population

Source: Bersenev, A. (2005, August 24) Does it make sense to have uniform VAT rate? Buhgalteria. Retrieved from <http://www.buhgalteria.ru/article/2039>, Mayburov, I.A., Ivanov, Iu.B. (Ed.) (2016). Encyclopedia of the basic theory of taxation. Moscow: Iuniti-Dana., author calculations

As a supplement to the information in Table 3, we would like to note that differential VAT rates do not always help to get the income redistribution effect due to differences in spending patterns of wealthy and disadvantaged groups and in the absolute amount of their incomes. For example, even if well-off groups spend a small share of their income on goods that are taxed at reduced rates, the sum that they spend on these goods might be considerably higher than the expenditures of low-income individuals. The effectiveness of income redistribution powered by differential VAT rates also depends on the presence or absence of other redistribution instruments, such as an effective income tax system and increased excise duties on goods that are most often consumed by wealthy groups. When such instruments are available, it is not expedient to use differential VAT rates for sake of tax justice (Ebrill et al, 2011).

Apart from that, theoretical and empirical studies showed that differential tax rates have a negative impact on the effectiveness of taxation, while applying a uniform positive VAT rate on all targets of taxation leads to lower tax compliance costs and curtails tax evasion, hence higher fiscal effectiveness of VAT (Kaplow, 2011, Zhou & Zhou, 2013).

2.3 Targets of VAT perfection in the Russian Federation

Considering the above, it seems reasonable to propose a transition to a uniform positive VAT rate in Russia. A question arises about the value of the uniform rate. Before an economic crisis broke out in Russia, there was a debate about setting a uniform VAT rate at 12 or 14%, whereas today the idea is being actively discussed of a transition towards an increased uniform VAT rate of 20 to 21% along with lowering the uniform social security tax on payroll.

The results of earlier studies show that the demand for and supply of most VAT taxable goods is inelastic, which means that a VAT reduction will have little effect (Kosonen, 2015, Keen, 2008). Moreover, in many developed countries the opposite trend has been observed. Between 2012 and 2015, sixteen out of the 28 EU member states kept VAT rates unchanged; ten countries increased the standard rate, and only two of them (Latvia and Romania) lowered the VAT by 1% and 4% correspondingly (Taxation trends in the European Union, 2016).

The authors believe that in Russia the uniform positive VAT rate should be set at 18% which is acceptable to most goods, works and services. The tax increase and the ensuing price

growth will therefore only affect a number of foodstuffs and child supplies, publications, medical supplies and domestic flights. The losses of disadvantaged groups caused by the abolition of the reduced rate could be offset by means of targeted government-funded allowances or by offering subsidies to producers of socially essential goods to keep prices down. To support the development of domestic air travel, the industry might be put on the list of zero-rated services for a limited period of two to four years in the same way as zero-rating applies to flights abroad. Calculations show that if the uniform positive VAT is set at 18%, additional VAT revenue from goods previously taxed at the reduced rate of 10% could amount to 1,750bn rubles (around 29bn dollars) annually. The proposed changes should therefore increase public revenue and raise the fiscal impact of VAT.

Conclusion

Value added tax is one of the most important sources of public income in the Russian Federation. The analysis has shown that the system of differential VAT rates including a standard, a reduced and a special rate is not optimal. It is expedient to switch to a uniform positive VAT rate of 18%, thus streamlining the mechanism of tax calculation and regulation, curtailing tax evasion, significantly increasing VAT revenue for the national treasury and eventually improving the efficiency and effectiveness of the tax.

Acknowledgment

The work was supported by the Russian Foundation for Basic Research, contract № 17-22-21001.

References

- Agha, A., & Haughton, J. (1996). Designing VAT systems: Some efficiency considerations. *Review of economics and statistics*, 78(2), 303-308.
- Bersenev, A. (2005, August 24) Does it make sense to have uniform VAT rate? *Buhgalteria*. Retrieved from <http://www.buhgalteria.ru/article/2039>.
- Ebrill, L., Keen, M., Bodin, J.P., & Summers, V. (2001). *The Modern VAT*. International Monetary Fund, Washington D.C.

- European Commission. Taxation and customs union. (2016). *Reading allowed: Tax information Communication database*. Retrieved from https://ec.europa.eu/taxation_customs/business/vat_en.
- Kaplow, L. (2011). An optimal tax system. *Fiscal studies*, 32(3), 415-435.
- Keen, M. (2008). VAT, tariffs, and withholding: Border taxes and informality in developing countries. *Journal of Public Economics*, 92 (2), 1892–1906.
- Keen, M., & Lockwood, B. (2010). The value added tax: Its causes and consequences. *Journal of Development Economics*, 92, 138-151.
- Kosonen, T. (2015). More and cheaper haircuts after VAT cut? On the efficiency and incidence of service sector consumption taxes. *Journal of Public Economics*, 131, 87–100.
- Mayburov, I., Ivanov, Iu. (Ed.) (2016). *Encyclopedia of the basic theory of taxation*. Moscow: Iuniti-Dana.
- Statistics Russia (2017). *Reading allowed: Russian Statistics Annual Report*. Retrieved from http://www.gks.ru/bgd/regl/b15_13/Main.htm.
- Taxation trends in the European Union. (2016). *Reading allowed: Data for the EU Member States, Iceland and Norway : 2016 edition*. Retrieved from <https://bookshop.europa.eu/en/taxation-trends-in-the-european-union-pbKPDU16001/>
- Zhou, B. & Zhou, Z. (2013). Studies on the top design of China's VAT reform. *International Conference on Social Sciences Research (SSR 2013)*, 1, 240-245.

Contact

Elena Iadrennikova

Ural Federal University named after the first President of Russia B.N. Yeltsin, Russia

620002, 19 Mira street, Ekaterinburg, Russia

elena.yadrennikova@mail.ru