

## Other International Issues

# TAX AVOIDANCE BY CITIZENS OF THE RUSSIAN FEDERATION: WILL THE DRAFT TAX CODE PROVIDE A SOLUTION?\*

### I. INTRODUCTION

Taxes imposed in the Russian Federation run the gamut from the sublime to the ridiculous, with the use of the word "Russia" or "Russia Federation" in business names,<sup>1</sup> pet dog ownership,<sup>2</sup> and the resale of automobiles and personal computers<sup>3</sup> subject to taxation. With such taxes being levied, it is not surprising that during the first eleven months of 1996, only 70% of the projected tax revenue was actually collected,<sup>4</sup> and that this tax shortfall deprived the Russian government of as much as \$100 billion.<sup>5</sup> During the first nine months of 1997, tax collection statistics did not improve; tax receipts

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1. See Fundamentals of the RF Tax System Act, RF Act No. 2118-1, RF Supreme Soviet Decree No. 2119-1 (Dec. 27, 1991), art. 19, para. 1(p), *translated and available in* LEXIS, Intlaw Library, Rflaw File (with additions and amendments through July 21, 1997) [hereinafter Fundamentals of the RF Tax System]; see also Charge for Use of the Names "Russia, Russia Federation" and Words and Phrases Formed on Their Basis, RF Act No. 4737-1 (Apr. 2, 1993), *translated and available in* LEXIS, Intlaw Library, Rusleg File.

2. See Fundamentals of the RF Tax System, *supra* note 1, art. 21, para. 1(j).

3. See *id.* art. 21, para. 1(i).

4. See Peter Henderson, *Divided Russian Parliament Delays Budget Decision*, Reuters Fin. Serv., Dec. 6, 1996, *available in* LEXIS, News Library, Reufin File.

5. See Matthew Brzezinski, *Fiscal Fight: Russia's Campaign to Stop Tax Evasion Faces Many Hurdles*, WALL ST. J. EUR., Apr. 14, 1997, at 1. During 1996, tax avoidance and evasion ran rampant; according to a study of Russia's Chief Oversight Administration, of the 2.6 million juristic persons registered with the tax authorities in 1996, 16% committed no serious violations of the tax laws, while 50% owed some amount of tax in arrears and 34% were not paying at all. See Elmar Murtazayev, *Presidential Staff Brings to Light Ineffectiveness of Tax System*, SEVODNYA, Feb. 5, 1997, *translated and available in* LEXIS, News Library, Spd File.

measured only 52% of targeted amounts.<sup>6</sup> The Russian government proposed a 20% cut to its 1997 budget,<sup>7</sup> and ironically has not been able to pay the salaries of its own tax inspectors.<sup>8</sup>

Further manifestations of Russia's problems with tax collection highlight the need for reform. For example, repeated violence against members of the State Tax Service has contributed to difficulties with tax collection, and proves that the current regime is unmanageable: In 1996, twenty-six tax collectors were murdered, seventy-four were injured, and six were kidnapped while eighteen Russian tax offices were "shot up."<sup>9</sup> Although President Boris Yeltsin included tax reform as a component of his 1996 election platform<sup>10</sup> and characterized tax reform as the "key economic task" of 1997 during a March speech to the Russian Parliament,<sup>11</sup> in the past he has only compounded the problem by granting tax exemptions to both business entities and entire regions during his

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6. See Stephanie Baker-Said, *IMF Loan Safe From Poor Tax Collection*, MOSCOW TIMES, Oct. 18, 1997, available in LEXIS, News Library, Mostms File. However, tax collection figures for 1997 have been erratic; tax revenues during the second quarter of 1997 only fell short of budgeted targets by 13%. See Donald H. Gold, *Investors Like Russia's Move to a Free Market*, INVESTOR'S BUS. DAILY, July 8, 1997, at A17; see also *Russia Tax Collection 46 Percent Up*, ITAR-TASS, June 5, 1997, translated and available in LEXIS, News Library, Tass File (reporting that Russia's tax revenues experienced a 46% increase in the first five months of 1997 compared to the same period in 1996). See Michael Lelyveld, *Financier: "Intolerable" Russian Tax Situation Must Be Dealt With In '98*, J. COMMERCE, Jan. 12, 1998, at 3A.

7. See Timothy Heritage, *Yeltsin Backs Tough Economic Reforms*, Reuters N. Am. Wire, May 19, 1997, available in LEXIS, News Library, Reuna File; see also *Revenue Shortfall Prompts Proposal for 20% Budget Cut*, CHI. TRIB., May 6, 1997, at 10.

8. See Richard C. Paddock, *Tax Hell in Russia is Really Hell; Americans Still Reeling From April 15 Can Take Comfort in the Plight of the Kremlin's Subjects*, L.A. TIMES, Apr. 22, 1997, at A1. Wages for some tax inspectors have not been paid since September of 1996. *State Tax Service Chief on Plans to Reform* (BBC Summary of World Broadcasts, May 3, 1997), available in LEXIS, News Library, Bbcswb File.

9. *Al Caponeskis*, FIN. TIMES, Jan. 30, 1997, at 15. During the first six months of 1997, ten members of the tax police were killed, forty were injured and two were reported missing. See Yelena Ivanova, *10 Tax Police Officers Killed, 40 Injured Over Jan-Jun 1997*, ITAR-TASS, Aug. 23, 1997, translated and available in LEXIS, News Library, Tass File. In addition, many tax offices are lacking in functional necessities such as electricity or telephone service. Paddock, *supra* note 8, at A1. One tax inspector was even bitten by a man owing taxes in arrears. See Sujata Rao, *Tax Police Sing Their Own Praises*, MOSCOW TIMES, Dec. 11, 1997, available in LEXIS, News Library, Mostms File.

10. See *Text of Yeltsin's Election Programme* (BBC Summary of World Broadcasts, June 13, 1996), translated and available in LEXIS, News Library, Bbcswb File.

11. See David Hoffman, *Yeltsin Vows to Restore Order; Pledges Government Shakeup: Thinner After Illness, Leader Speaks Firmly*, WASH. POST, Mar. 7, 1997, at A1.

1996 election campaign.<sup>12</sup>

Russia's problems with tax collection are also affecting its ability to obtain much-needed foreign aid. In 1996, the International Monetary Fund (IMF) twice delayed payments on a three-year, \$10 billion loan to Russia because of its acute problems with tax collection.<sup>13</sup> The IMF again froze loan tranches to Russia in early 1997 and only released a \$700 million payment in May after an IMF Managing Director personally appraised Russia's financial situation and Russia agreed to, *inter alia*, tax reform and improved tax collection.<sup>14</sup> Citing a continuing decline in tax collection, the IMF once again delayed Russia's final \$700 million installment for 1997<sup>15</sup> until yet another agreement was reached on tax reform and improved tax collection.<sup>16</sup> In addition, several Group of Seven (G7) ministers have publicly expressed concern over Russia's inability to collect taxes.<sup>17</sup> The World Bank, when extending a \$884 million loan to

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12. See David Filipov, *As Crises Ebb, It's Time to Get Down to Business*, BOSTON GLOBE, Jan. 5, 1997, at D5.

13. See Janet Guttman, *Focus—Duma May Vote on Budget for Jan-March 1997*, Reuters Fin. Serv., Dec. 3, 1996, available in LEXIS, News Library, Reufin File.

14. See Stephanie Baker-Said, *IMF Says No Loan Without Tax Code*, MOSCOW TIMES, Apr. 4, 1997, available in LEXIS, News Library, Mostms File; *IMF Experts to Come to Moscow on July 22*, ITAR-TASS, July 15, 1997, translated and available in LEXIS, News Library, Tass File. The IMF also sent a delegation to monitor the Russian economy before deciding whether to release a \$700 million payment due in September 1997. See Pavel Kuzetsov, *Release of IMF Credit Tranche for Moscow to be Recommended*, ITAR-TASS, Aug. 1, 1997, translated and available in LEXIS, News Library, Tass File.

15. See Stephanie Baker-Said, *IMF Casts Doubt Over Loan Release*, MOSCOW TIMES, Dec. 3, 1997, available in LEXIS, News Library, Mostms File; David Hoffman, *IMF Suspends Loan to Russia*, WASH. POST, Nov. 1, 1997, at A18; Konstantin Levin, *The IMF Forgives Russia*, KOMMERS., Nov. 11, 1997, translated and available in LEXIS, News Library, Sbe File. Another IMF delegation will spend the first two weeks of December in Moscow assessing the state of promised economic reforms. See Andrei Shitov, *Another IMF Team to Work in Moscow for Fortnight*, ITAR-TASS, Nov. 27, 1997, translated and available in LEXIS, News Library, Tass File.

16. The agreement between the Russian government and the IMF was reached in December 1997 and the loan tranche was released in January 1998. See Michael R. Gordon, *Russia Reaches I.M.F. Accord to Free Loans*, N.Y. TIMES, Dec. 13, 1997, at A1; Ivan Lebedev, *IMF Unlocks Extended Facility Tranche for Russia*, ITAR-TASS, Jan. 9, 1998, translated and available in LEXIS, News Library, Tass File.

17. For example, after a regular meeting held in April 1997, G7 ministers publicly stated that Russia must address its inability to collect taxes, see Janet Guttman, *G7 Welcomes Russian Reforms, Seeks Tough Tax Rules*, REUTER EUR. BUS. REP., Apr. 27, 1997, available in LEXIS, News Library, Reueub File, and then reiterated this message after the Denver Summit held in June 1997. See *Denver Summit Economic Statement Supports Russia's Course*, ITAR-TASS, June 22, 1997, translated and available in LEXIS, News Library, Tass File. Likewise, after a September 1997 meeting, G7 ministers, in assessing Russia's recent economic

Russia in June 1997, placed tax administration and collection at the top of the list of necessary reforms facing the Russian government.<sup>18</sup>

However, signs of improvement have recently appeared. Alexander Pochinok, the head of the Russian State Tax Service, has made increased tax collection a priority<sup>19</sup> and is currently overseeing a crackdown on the most flagrant tax-evading enterprises.<sup>20</sup> Newly-appointed Finance Minister Mikhail Zadornov has informed Finance Ministry staff that implementation of a new tax regime will be a primary task for 1998.<sup>21</sup>

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performance, again highlighted the need for improvement in tax collection. See *G7 Ministers Generally Satisfied with Russian Performance*, Agence France Presse, Sep. 20, 1997, translated and available in LEXIS, News Library, Afp File.

18. See *World Bank Announces 884 Million Dollars in Loans to Russia*, Agence France Presse, June 6, 1997, translated and available in LEXIS, News Library, Afp File.; see also Alexander Mineyev, *World Bank May Extend Three Loans to Russia*, ITAR-TASS, Nov. 18, 1997, translated and available in LEXIS, News Library, Tass File (linking approval of three new loans to improvement in tax collection).

19. See Natalya Varnavskaya and Sergei Kochetov, *New Head of the Tax Service: I Am No Longer That Lop-eared Fellow*, KOMMERS., Apr. 17, 1997, at 1. For example, Pochinok promised that he would fire the head of the tax inspectorate that collected the least amount of revenue in June. See *Russia's Tax Chief Promises to Fire Worst Collector*, ITAR-TASS, June 20, 1997, translated and available in LEXIS, News Library, Tass File. Pochinok has also gone so far as to publish his e-mail address and solicit public comments on the current tax system, tax reform and the draft code. See *Russian Tax Service Head Gives Out E-Mail Address*, RUS. & COMMONWEALTH BUS. L. REP., June 4, 1997, available in LEXIS, News Library, Rcbfr File.

20. See *Press Conference with State Tax Service Head Alexander Pochinok* (Official Kremlin International News Broadcast, July 25, 1997), translated and available in LEXIS, News Library, Curnws File; see also Chrystia Freeland, *Kremlin Victory on Company Tax Arrears*, FIN. TIMES, Apr. 19, 1997, at 24 (reporting that the campaign to collect unpaid taxes involves companies whose tax debt in total represents 60% of all taxes in arrears). This campaign has met with some success; RAO Norilsk Nickel recently transferred a 50% equity stake to the Russian government to hold in trust against its \$88.7 million tax debt, and Gazprom paid its entire tax debt of approximately 14.5 trillion rubles (\$2.52 billion) by the end of June. See Matthew Brzezinski, *Russia Concedes its Finances Are a Mess*, WALL ST. J., Apr. 18, 1997, at A14; Richard L. Holman, *World Wire—Postscripts . . .*, WALL ST. J., June 26, 1997, at A14. The Russian government recently has announced a renewed campaign against other tax-evading enterprises, a sign that the government is seriously striving to improve tax collection. See Stephanie Baker-Said, *State to Crack Down on Big Tax Debtors*, MOSCOW TIMES, Nov. 12, 1997, available in LEXIS, News Library, Mostms File; *New List of Bad Debtors to Government Coming on January 22*, ITAR-TASS, Jan. 9, 1998, translated and available in LEXIS, News Library, Tass File. For example, the government plans to seize key oil refineries of two Russian oil companies, Sibneft and Sidanko, who owe 526 billion and 766 billion rubles, respectively, in back taxes. See Jeanne Whalen, *Sibneft to Fight Oil Refinery Seizure*, MOSCOW TIMES, Dec. 10, 1997, available in LEXIS, News Library, Mostms File.

21. See *Itar-Tass Economic News Digest of November 21*, ITAR-TASS, Nov. 21, 1997, translated and available in LEXIS, News Library, Tass File; see also *Press Conference with State Tax Service Head Alexander Pochinok* (Official Kremlin International News Broadcast, Nov. 21, 1997), translated and available in LEXIS, News Library, Curnws File.

Most importantly, in recognition of the abysmal level of tax collection and the need for reform, the Russian government submitted a four-part draft tax code to the Duma, the lower house of the Russian parliament, on April 30, 1997.<sup>22</sup> By a vote of 244 to 84 with 2 abstentions, the Duma approved the draft code upon its first reading on June 19, 1997.<sup>23</sup> However, on November 19, 1997, following a series of political maneuvers<sup>24</sup> and an onslaught of amendments,<sup>25</sup> the Duma voted to abrogate its June approval of the draft tax code, in essence sending the draft code back to the beginning of the legislative process.<sup>26</sup> Although the original draft

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22. See *Russia PM Chernomyrdin Sends Tax Code to Duma*, Reuters Fin. Serv., Apr. 30, 1997, available in LEXIS, News Library, Reufin File. The first part of the draft tax code was submitted to the Duma in 1996; the remaining three parts of the draft code were submitted on April 30, 1997. See *id.*

23. See *Russia Duma Passes Tax Code in First Reading*, ITAR-TASS, June 19, 1997, translated and available in LEXIS, News Library, Tass File. Under the Russian legislative system, draft legislation goes through two readings in the Duma where amendments are proposed and revisions are made. A required third reading and vote represents formal approval by the Duma. See Christian Lowe, *Duma Bows to Kremlin Pressure on Tax Code*, MOSCOW TIMES, June 20, 1997, available in LEXIS, News Library, Mostms File. After the Duma formally approves the draft code, the upper house of the Russian Parliament considers the draft and then, if approved, passes it on to President Yeltsin for signature. See The Constitution of the Russian Federation (Dec. 12, 1993), art. 105-107, translated and reprinted in *RUSSIA & THE REPUBLICS—LEGAL MATERIALS* (John N. Hazard & Vratislav Pechota eds., 1997). This document is also available in LEXIS, Intlaw Library, Rflaw File.

24. On October 21, 1997, Yeltsin offered to withdraw the draft code to appease Communist members of the Duma who were threatening to oust Yeltsin's Cabinet through a no-confidence vote. See David Hoffman, *Moscow Compromise Complicates Tax Tangle; To Placate Communist Legislators, Yeltsin Retreats on Revenue Bill*, WASH. POST, Oct. 23, 1997, at A28; Dmitry Zaks, *Yeltsin Gave As Good As He Got*, MOSCOW TIMES, Oct. 23, 1997, available in LEXIS, News Library, Mostms File. However, a compromise solution was reached: a "trilateral" or "conciliatory" commission composed of representatives from both houses of the Russian Parliament was given the task of amending the original draft code and submitting the revised version for a second reading. See Stephanie Baker-Said, *Analysts Back Kremlin on Tax Bill*, MOSCOW TIMES, Oct. 23, 1997, available in LEXIS, News Library, Mostms File; John Thornhill, *Russian Reformers Optimistic About Tax*, FIN. TIMES, Oct. 24, 1997, at 2.

25. As of November 1, 1997, over 5000 amendments to the draft tax code have been submitted. See Igor Zhukov, *5000 Amendments to Tax Code Submitted As of Now—Seleznyov*, ITAR-TASS, Nov. 1, 1997, translated and available in LEXIS, News Library, Tass File.

26. See Ivan Novikov, *Duma Rejects Government's Tax Code, Calls for Alternative Drafts*, ITAR-TASS, Nov. 19, 1997, translated and available in LEXIS, News Library, Tass File. A "compromise version" of the draft code will be generated by a special commission of representatives from both houses of Parliament and from the government and resubmitted to the Duma for a first reading in early February 1998. See Robert Serebrennikov, *Tax Code Draft Not to Be Submitted to Duma Until February 1*, ITAR-TASS, Nov. 21, 1997, translated and available in LEXIS, News Library, Tass File. The original draft code has not been rejected outright but is being considered as one of the alternatives for future reform. See *id.* (quoting

code submitted to the Duma in June will not be the exact version ultimately adopted,<sup>27</sup> this draft will provide a foundation for meaningful tax reform in Russia's near future.

This Note discusses personal income tax avoidance by citizens of the Russian Federation and analyzes whether the draft tax code will alleviate this situation. Section II outlines personal income taxation both during the Tsarist regimes of the late nineteenth and early twentieth centuries and during the Soviet Era. Section III provides a background on personal income taxation under the current tax regime of the Russian Federation. Section IV examines various methods of income tax avoidance currently used by citizens of the Russian Federation and suggests several explanations for the use of these practices. Section V analyzes whether the draft tax code will correct the flaws in the current tax regime and perhaps halt the widespread avoidance of personal income tax obligations. Section VI offers several conclusions about the future of the draft tax code and the Russian tax regime.

## II. HISTORY OF THE PERSONAL INCOME TAX IN TSARIST RUSSIA AND THE SOVIET UNION

### A. Taxation During the Tsarist Regimes of the Late Nineteenth and Early Twentieth Centuries

Under the tsarist regimes of the late nineteenth and early twentieth centuries, the peasantry, which constituted about three quarters of Russia's total population at the turn of the century,<sup>28</sup> bore much of the burden of, but had no experience with, a personal

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Vladimir Ryzhkov, Duma First Deputy Speaker).

27. According to the Head of the State Tax Service, Alexander Pochinok, the most feasible alternative draft being considered is quite similar to the original draft which was presented to the Duma in June 1997:

The [] draft, also known as the "Pokhmelkin draft" is an adapted version of the first part of the government's draft. So, . . . the most logical course of action for the government is to resubmit the text it already submitted to the Duma with the changes agreed during the work of the four working groups of the Duma and the government last summer and autumn. So, in effect, it is the same draft law.

*Press Conference with Stanislav Gomulko, Russian-European Center for Economic Policy Expert, and Vladimir Mau, RF Government's Working Center for Economic Reform Head* (Official Kremlin International News Broadcast, Dec. 15, 1997), translated and available in LEXIS, News Library, Curnws File.

28. See NICHOLAS V. RIASANOVSKY, *A HISTORY OF RUSSIA* 430 (5th ed. 1993) (population figure taken from the census of 1897).

income tax.<sup>29</sup> The peasantry was subject to two direct taxes, neither of which was tied to income. The first, a flat tax known as the "head tax," was technically repealed by Tsar Alexander II in 1886, but continued to be paid by some of the peasantry until 1907. The second, a special tax of "redemption payments," largely was abolished in 1905.<sup>30</sup> Over time, the tax burden on the peasantry shifted from direct to indirect taxation, with excise taxes, typically imposed on essential items rather than luxury goods,<sup>31</sup> representing over 75% of all government revenues by 1913.<sup>32</sup> Although several proposals to introduce a personal income tax were made beginning in 1892, a final bill imposing a general income tax was not approved by Tsar Nicholas II until April 1916, and was not rendered effective until early 1917.<sup>33</sup> Thus, on the eve of the Russian Revolution in 1917, a personal income tax did exist, but Russian citizens had virtually no experience complying with its provisions.

#### B. Taxation During the Soviet Era<sup>34</sup>

The Soviet framework of a personal income tax was established in the early 1940s and existed in slightly-revised forms until the demise of the Soviet Union. In 1943, the personal income tax was modified by a decree entitled "On the Income Tax on the Population."<sup>35</sup> Minor changes to the 1943 decree were made periodically from the 1940s through the early 1980s,<sup>36</sup> and in 1983, these changes were incorporated into legislation which amended the

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29. See MICHAEL A. NEWCITY, *TAXATION IN THE SOVIET UNION* 2-5 (1986); RIASANOVSKY, *supra* note 28, at 431-32.

30. See NEWCITY, *supra* note 29, at 2-3; RIASANOVSKY, *supra* note 28, at 432. Redemption payments were collected by the Russian government as repayment for the compensation paid to serf owners following the emancipation of the serfs in 1861. See NEWCITY, *supra* note 29, at 2.

31. These excise taxes affected everyday items such as sugar, tea, cotton and vodka. See RIASANOVSKY, *supra* note 28, at 432.

32. See NEWCITY, *supra* note 29, at 3; RIASANOVSKY, *supra* note 28, at 432.

33. See NEWCITY, *supra* note 29, at 4.

34. For the sake of simplicity, the history of the taxation of individuals during the Soviet Era will be limited to the basic system which was in place from the mid-1940s until the fall of the Soviet Union and will omit the various tax regimes associated with War Communism, the New Economic Policy, and Stalin's pre-World War II Five-Year Plans. For a general overview of taxation in the Soviet Union, see *id.*

35. See *id.* at 73-75.

36. See *id.* at 26-27.

original 1943 decree.<sup>37</sup> Because only slight modifications were made to the Russian tax system between the 1940s and the early 1980s, the system created by the 1943 decree is largely reflected in the 1983 legislation. Thus, the 1983 provisions<sup>38</sup> will be cited to as the relevant tax law during the Soviet Era.

Similar to the citizens of the Tsarist regimes, the citizens of the Soviet Era also gained little experience complying with a personal income tax. Under the Soviet tax regime, the personal income tax was not a principal source of revenue for the government. For example, in 1983, "state taxes on the population"<sup>39</sup> comprised only 7.7% of all Soviet state revenues, while the tax burden imposed on enterprises<sup>40</sup> comprised approximately 65.6% of those revenues.<sup>41</sup> Correspondingly, Soviet citizens faced a relatively minimal tax burden: "By 1983, 8.7% of personal income was being spent on taxes, duties and other government payments."<sup>42</sup> Nevertheless, Soviet citizens were subject to three significant direct taxes at the state level: (1) the income tax on the population; (2) the tax on bachelors, single citizens, and citizens with small families; and (3) the agricultural tax.<sup>43</sup>

1. *The Income Tax on the Population.* The income tax on the population represented the most comprehensive of the direct taxes imposed on Soviet citizens. This tax was levied on four different sources of income: (1) income received by factory and office workers at their primary place of work;<sup>44</sup> (2) income earned by individuals at workplaces other than their primary place of work;<sup>45</sup> (3) royalties

37. *See id.* at 74-75.

38. *See id.*

39. States taxes on the population reflect the income tax on the population, the bachelor's tax, and the agricultural tax. *See id.* at 74-75.

40. The taxation of enterprises was accomplished through numerous direct taxes, including the turnover tax, several profit taxes, the income tax on collective farms, the income tax on cooperatives, and state social insurance contributions. *See id.* at 48-72 (describing the taxation of enterprises in the Soviet Union).

41. *See id.* at 38.

42. *Id.* at 74 (citation omitted).

43. *See id.* at 73. The Soviet state also imposed two other direct taxes on individuals: local taxes and state duties. *See id.* Local taxes specifically levied by the Soviet state included the tax on the owners of buildings, a land tax, and a tax on the owners of means of transportation. *See id.* at 131-56. State duties were imposed on nine different types of services that the Soviet government provided to its citizens, including court proceedings, arbitration proceedings and foreign travel. *See id.* at 156-68.

44. *See id.* at 86-89; *see also infra* notes 48-49 and accompanying text.

45. *See* NEWCITY, *supra* note 29, at 89-92; *see also infra* notes 50-52 and accompanying



obtained from works of art, literature and scientific scholarship;<sup>46</sup> and (4) income generated from private activities, such as private trade in handicraft or artisan objects and private professional practice.<sup>47</sup> The income of factory and office workers earned at their primary workplace was subject to the lowest rate of taxation,<sup>48</sup> and the payment of tax owed on this income was not the responsibility of individual taxpayers: "the amount of tax due [was] calculated by the enterprise in which the taxpayer work[ed] and that amount [was] withheld from the taxpayer's wages."<sup>49</sup> Smaller amounts of income<sup>50</sup> earned by individuals at their secondary places of employment were subject to a higher marginal rate<sup>51</sup> and again the resulting tax obligation of individual taxpayers was settled by the employer-enterprise.<sup>52</sup> Only those individuals who received income from private activities, such as private professional practice or sales of handicraft work, were responsible for preparing and filing an income tax return with the tax authorities.<sup>53</sup> On a return submitted by January 15, these individuals estimated their income for the current year based on the previous year's earnings.<sup>54</sup> The taxpayers were then responsible for remitting the tax due in four equal installments on March 15, May 15, August 15, and November 15.<sup>55</sup>

The Soviet system did provide individuals with several tax exemptions. For example, factory and office workers did not pay income tax on a set minimum amount earned at their primary workplace.<sup>56</sup> In addition, tax exemptions were available for certain

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text.

46. See *NEWCITY*, *supra* note 29, at 92-99. Those individuals receiving income from works of art, literature or scientific scholarship were subject to three different tax schedules: one for royalties received domestically, one for royalties received abroad, and one for royalties received by the heirs of those producing the works. See *id.*

47. See *id.* at 99-104; see also *infra* notes 52-54 and accompanying text.

48. In 1983, marginal rates on income in this category ranged from .35% to 13%. See *NEWCITY*, *supra* note 29, at 86.

49. *Id.* at 89.

50. Ninety or fewer rubles per month. See *id.* at 91.

51. See *id.*

52. See *id.* at 92.

53. See *id.* at 102.

54. See *id.* at 103-04.

55. See *id.* at 104.

56. See *id.* at 77-78. In 1983, the tax-free minimum amount was 70 rubles per month and the average monthly wage was 182 rubles per month, resulting in 112 rubles of taxable income. See *id.* A tax exemption for minimum amounts of income also applied to income earned from the private sale of handicraft or artisan objects and from private professional practice. See *id.*

military personnel, invalids, and pensioners.<sup>57</sup> The Soviet tax regime also excluded from taxation several categories of income, including alimony, state-paid benefits such as social insurance and social security, amounts received through inheritance or gift except certain royalties, and interest received from state savings banks.<sup>58</sup>

2. *Bachelors' Tax.* Soviet citizens also obtained some experience with direct taxation of personal income through payment of the "bachelors' tax." Established in 1941, the bachelors' tax was imposed on the earnings of all childless men between the ages of twenty and fifty, whether or not they were married, and on the earnings of all childless and married women between the ages of twenty and forty-five.<sup>59</sup> Beginning in 1972, factory and office workers subject to the bachelor's tax were taxed at rates falling between .28% and 6.0% depending on their level of income,<sup>60</sup> while writers, artists, and workers holding second jobs, also subject to the bachelors' tax, faced a flat tax rate of 6%.<sup>61</sup> Like the income tax, most Soviet citizens were not personally responsible for calculating and remitting tax owed to the finance authorities.<sup>62</sup> Instead, their employer-enterprises would ensure that the appropriate amount of tax was deducted from monthly wages.<sup>63</sup>

3. *Agricultural Tax.* The agricultural tax imposed during the Soviet Era took the form, at different points in time, of both in-kind taxes and direct monetary payments.<sup>64</sup> Imposed at the household and not the individual level, this tax affected two major groups of Soviet citizens: those who were members of collective farms and those who

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at 78.

57. *See id.* at 80-81.

58. *See id.* at 82-85.

59. *See id.* at 107-09. Between 1944 and 1958, the bachelors' tax was expanded to encompass a broader group of Soviet citizens: childless but unmarried men *and* women, *plus* families with less than three children. *See id.* at 107-08.

60. *See id.* at 110-11. Individuals earning less than a tax-free minimum amount (which was set at the same level as for payment of the income tax on individuals) were not subject to the bachelors' tax. In addition, several individuals and forms of income enjoyed exemption from the tax. *See id.* at 110.

61. *See id.* at 112.

62. *See id.*

63. *See id.*

64. *See id.* at 112.

cultivated private parcels of land in rural areas.<sup>65</sup> The agricultural tax was imposed on the land itself and not the income produced from the land. Therefore, the rate of taxation was based on both the size and geographic location of the parcel, with different tax rates imposed by each union republic.<sup>66</sup> The Soviet households subject to the agricultural tax did not personally calculate the amount of tax due, but instead remitted, in two equal installments, an amount prescribed by the finance authorities.<sup>67</sup>

Thus, during the Soviet Era, citizens were subject to three comprehensive direct taxes on income or income-producing activities. However, most urban area employees were not required to affirmatively comply with the Soviet tax regime and instead relied on the enterprise for which they worked to calculate and remit any tax owed. Likewise, those engaged in agricultural production in rural areas of the Soviet Union were entitled to rely on the tax calculations of the local finance authority and merely were required to make the appropriate payments as they came due.

### III. PERSONAL INCOME TAXATION UNDER THE CURRENT TAX REGIME OF THE RUSSIAN FEDERATION

#### A. Substance and Administration of the Current Regime<sup>68</sup>

In March 1991, the Supreme Soviet created a state agency, the RSFSR State Tax Service, to replace the State Revenue Service of the USSR and to administer a new tax regime.<sup>69</sup> The powers of the State Tax Service were further defined by Russian President Boris Yeltsin in a decree issued in the fall of 1991.<sup>70</sup> This decree charged

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65. *See id.* at 113. Individuals living in urban areas who cultivated private parcels of land were not subject to the agricultural tax. *See id.*

66. *See id.* at 116. In addition, until 1983 farmers engaged solely in private farming were subject to tax rates which were 75 to 100% higher than those imposed on their collective farm counterparts. *See id.* at 117.

67. *See id.* at 117.

68. This section provides an overview of the taxation of income earned by individuals at places of employment and does not furnish information about the taxation of other sources of personal income such as that received from property or business investments.

69. *See* RSFSR State Tax Service Act (Mar. 21, 1991), *translated and reprinted in* 2 BUSINESS AND COMMERCIAL LAWS OF RUSSIA § 4.10 (John P. Hupp ed., 1995); *see also* Christopher Osakwe, *Navigating the Minefields of Russian Joint Venture Law and Tax Regulations: A Procedural Compass*, 25 VAND. J. TRANSNAT'L L. 799, 855-856 n.148 (1993).

70. RF State Tax Service, RF President's Edict No. 340 (Oct. 31, 1991), *translated and reprinted in* 2 BUSINESS AND COMMERCIAL LAWS OF RUSSIA § 4.11 (John P. Hupp ed., 1995).

the State Tax Service with the task of ensuring "compliance with tax legislation, correct assessment of taxes, complete and timely entry into the respective budgets, of state taxes and other payments prescribed by the legislation of the Russia Federation and the republics within it . . . ."<sup>71</sup> The general framework of the current tax regime in Russia was passed into law by the Supreme Soviet in December 1991.<sup>72</sup> This legislation divided the taxes to be levied in the Russian Federation into three levels (e.g., federal, republic/regional, and local)<sup>73</sup> and described the type of taxes that could be imposed and collected at each level by the appropriate government body.<sup>74</sup> Another legislative act of the Supreme Soviet passed at this time, entitled "On Income Tax of Natural Persons," has provided more specific guidance on the taxation of individuals.<sup>75</sup>

The Income Tax on Natural Persons Act places a duty both on all "taxable natural persons" to register all earned income and pay the appropriate tax due and on all enterprises and organizations to deduct from, and pay the appropriate tax due for, the incomes of their employees.<sup>76</sup> In doing so, the Income Tax on Natural Persons Act differentiates, *inter alia*, between income earned at the primary workplace and income earned at additional places of employment.<sup>77</sup> At individuals' primary workplaces, employer-enterprises should automatically calculate and then deduct tax due from earned income.<sup>78</sup> However, individuals earning income from more than one

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This document is also available in LEXIS, Intlaw Library, Rusleg File.

71. *Id.* art. 6.

72. *See generally* Fundamentals of the RF Tax System, *supra* note 1.

73. *See id.* art. 18, para. 1.

74. *Id.* art. 19 (federal taxes); *id.* art. 20 (taxes of republics and regions); *id.* art. 21 (local taxes).

75. RF Income Tax on Natural Persons Act, RF Act No. 1998-1, RF Supreme Soviet Enacting Decree No. 1999-1 (Dec. 7, 1991), *translated and available in* LEXIS, Intlaw Library, Rusleg File (with amendments and addenda as of June 21, 1996) [hereinafter Income Tax on Natural Persons Act].

76. *Id.* art. 20.

77. *See* Income Tax on Natural Persons Act, *supra* note 75. The Income Tax on Natural Persons Act also contains provisions addressing the taxation of income from business and other income, the taxation of foreign citizens and persons without citizenship having permanent residence in the Russian Federation, and the taxation of persons without permanent place of residence in the Russian Federation. *Id.*

78. *See id.* art. 7-9. Article 9 provides that "[e]nterprises, institutions and organizations shall be obliged to transfer to the budget amounts of tax calculated and deducted from natural persons on day of actual receipt of cash from their bank for remuneration of labor," thereby placing the burden on employers to remit any tax owed to the appropriate tax agency.

place of employment must submit an income declaration delineating "all income gained during the year, sources of their receipt and the sum of taxes calculated and paid"<sup>79</sup> to the local tax agency serving their primary residence.<sup>80</sup> Current government estimates suggest that employer-enterprises are obligated to remit the appropriate tax owed by their employees for seventy-five of the eighty million Russian citizens who are required to pay tax on earned income.<sup>81</sup> Tax officials have also estimated that approximately 3.3 million Russian citizens filed income tax declarations this year.<sup>82</sup>

The Income Tax on Natural Persons Act also allows the amount of tax due to be reduced by numerous exemptions. While several of these exemptions are available to all taxpayers,<sup>83</sup> many are based on either the nature of the income earned<sup>84</sup> or the status of the taxpayer.<sup>85</sup> Once taxable income has been calculated, Russian citizens face a top marginal rate of 35%,<sup>86</sup> but most Russians fall within the lowest of five tax brackets and pay only a marginal rate of 12%.<sup>87</sup>

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Pursuant to an amendment to the Income Tax on Natural Persons Act effective January 1, 1998, employers must submit an annual report to the tax authorities of the income paid to each employee at its primary place of business no later than March 1 of the following year. See Amendments and Addenda to the RF Income Tax on Natural Persons Act, RF Federal Act No. 94-FZ (June 28, 1997), translated and available in LEXIS, Intlaw Library, Rusleg File [hereinafter RF Federal Act No. 94-FZ].

79. Income Tax on Natural Persons Act, *supra* note 75, art. 18, para. 2; see also Andrei Zolotov, *April 1 No Joke for Some Taxpayers*, MOSCOW TIMES, Apr. 1, 1997, available in LEXIS, News Library, Mostms File.

80. See Income Tax on Natural Persons Act, *supra* note 75, art. 18, para. 1. The income declaration must be submitted by April 1 of the year subsequent to the one for which income is being reported. *Id.* As of January 1, 1998, employers do have an obligation, every three months, to submit a report of the address of and income paid to each individual outside its primary place of business. See RF Federal Act No. 94-FZ, *supra* note 77.

81. See KOMMERS., Mar. 7, 1997, at 6.

82. See Gennady Yezhov, *Russia to Simplify Tax Payment Procedure*, ITAR-TASS, July 8, 1997, translated and available in LEXIS, News Library, Tass File.

83. These exemptions include a deduction for charitable contributions and a deduction for "maintenance of children and dependents." Income Tax on Natural Persons Act, *supra* note 75, art. 3, para. 6.

84. See generally Income Tax on Natural Persons Act, *supra* note 75, art. 3, para. 1.

85. See *id.* paras. 2-3.

86. See *id.* art. 6 (setting forth marginal tax rates imposed on differing levels of taxable income). This tax rate applies to incomes greater than \$8,400 per year. See Paddock, *supra* note 8, at A1.

87. See Income Tax on Natural Persons Act, *supra* note 75, art. 6. This tax rate applies to incomes up to \$2,100 per year. See Paddock, *supra* note 8, at A1.

## B. Enforcement Under the Current Tax Regime

In early 1992, the Tax Inspectorate of the Russian Federation, commonly known as the tax police, was created to manage the enforcement of the new tax regime.<sup>88</sup> With the passage of the Federal Fiscal Police Act in June 1993, the Tax Inspectorate was removed from the supervision of the State Tax Service and became an independent enforcement agency.<sup>89</sup> In December 1995, in an effort to improve poor tax collection, new legislation transformed the Tax Inspectorate into a national agency and conferred upon it the authority to launch preliminary criminal investigations of suspected tax evaders, and to perform comprehensive audits and impose penalties based on audit findings.<sup>90</sup>

Under current tax legislation, penalties for the violation of the tax laws include various fines and surcharges.<sup>91</sup> In addition, the Russian Federation Criminal Code, which became effective on January 1, 1997, strengthens legal enforcement of tax legislation by providing that the *intentional* violation of such legislation is a criminal offense, carrying the penalty of imprisonment up to three years.<sup>92</sup> President Boris Yeltsin has recently enhanced the enforcement of tax laws by signing a decree outlawing tax concessions not supported by some provision of existing tax legislation.<sup>93</sup>

The Russian government has recently undertaken several

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88. See KOMMERS., Feb. 10-17, 1992, at 25.

89. See Federal Fiscal Police Act, RF Act No. 5238-1; RF Supreme Soviet Decree No. 4990-1 and Decree No. 5239-1 (June 24, 1993), *translated and reprinted in 2 BUSINESS AND COMMERCIAL LAWS OF RUSSIA* § 4.12.5 (John P. Hupp ed., 1995). This document is also available in LEXIS, News Library, Rusleg File.

90. See Amendments and Addenda to the RF Federal Fiscal Police Act and the RSFSR Code of Criminal Procedure, RF Federal Act No. 200-FZ (Nov. 15, 1995), *translated and available in LEXIS*, Intlaw Library, Rusleg File; *see also Russian Tax Police Gain New Powers Under Revised Law*, RUSS. & COMMONWEALTH BUS. L. REP., Feb. 12, 1996, *available in LEXIS*, News Library, Rcbllr File.

91. See Income Tax on Natural Persons Act, *supra* note 75, art. 22; *see also* Fundamentals of the RF Tax System, *supra* note 1, art. 13, para. 1. These include a 100% surcharge for understating income. See *Ride a High Tax Horse*, WALL ST. J., Nov. 29, 1996, at A6.

92. See Criminal Code of the Russian Federation, RF Act No. 63-FZ (June 13, 1996), art. 198 (Tax Evasion by an Individual), *translated and available in LEXIS*, Intlaw Library, Rflaw File; *see also* Brenda Horrigan et al., *What Foreign Investors Should Know About the New Russian Criminal Code*, RUSS. & COMMONWEALTH BUS. L. REP., Jan. 27, 1996, *available in LEXIS*, News Library, Rcbllr File.

93. See Yeltsin Signs Decree Abolishing Tax Concession, (BBC Summary of World Broadcasts, Apr. 4, 1997), *available in LEXIS*, News File, Bbcswb File.

practical measures to improve its dismal rate of tax collection. For example, tax authorities launched a media campaign by focusing on the benefits of tax revenue, such as new roads, schools, and housing in order encourage citizens to pay their taxes.<sup>94</sup> The tax police also have increased their enforcement efforts during the first six months of this year, and subsequently have uncovered approximately 10,000 violations and offenses, identified 22,700 individuals who did not register with the tax inspectorates, and commenced criminal prosecutions against 2,900 tax evaders.<sup>95</sup>

Most importantly, the Yeltsin government has taken a harder approach to non-payment and created the "Provisional (or Temporary) Extraordinary Commission for Strengthening Tax and Budgetary Discipline," known as the "VChK," which is responsible for collecting taxes in arrears.<sup>96</sup> The VChK, whose name evokes memories of Lenin's "Cheka," the secret police force that evolved into the KGB,<sup>97</sup> includes armed tax police who have so far enjoyed some success in their endeavors.<sup>98</sup> In a scare-tactic media campaign to promote the efforts of the VChK, the government has run television advertisements showing tax police carrying "AK-47 assault rifles, sniper rifles, tear gas, grenades, shotguns, [and] bullet-proof body armour," while warning that "[t]he tax police have guns, and they know how to use them."<sup>99</sup> Thus, the current tax regime, with its

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94. See Andrew Meier, *Russia's New War on Taxes; An Ominously Named Commission Targets Tax Cheats, Raising Fear But Little Prospect of Success*, TIME (Int'l ed.), Dec. 16, 1996, at 24. Some of these ads, however, are far from innocuous; a recent television spot depicted a tax evader being assaulted by a pair of clowns. See Marina Lapenkova, *Russian Tax Inspectors Find Old Habits Die Hard*, Agence France-Presse, Mar. 30, 1997, translated and available in 1997 WL2087012.

95. See *Itar-TASS Domestic News Digest of August 11*, ITAR-TASS, Aug. 11, 1997, translated and available in LEXIS, News Library, Tass File.

96. See Decree on the Provisional Extraordinary Commission under the President of the Russian Federation for Strengthening Tax and Budgetary Discipline, RF Presidential Decree No. 1428 (Oct. 11, 1996), translated and available in LEXIS, Intlaw Library, Rflaw File (with amendments and addenda as of November 1, 1996); see also *Itar-Tass Domestic Economic News Digest of April 12, 1997*, ITAR-TASS, Apr. 12, 1997, translated and available in LEXIS, News Library, Tass File; Michael R. Gordon, *On the Road to Capitalism, Tax Breakdown for Russia*, N.Y. TIMES, Feb. 19, 1997, at A1.

97. See *Ways of Making Russians Pay*, ECONOMIST, Nov. 2, 1996, at 48.

98. For example, tax receipts increased by 900 million rubles in the first month following the VChK's creation. See Meier, *supra* note 94, at 24. It is also interesting to note that the VChK work on a "bounty system" whereby they retain half of tax monies collected. *Id.*

99. Miranda Anichkina, *Russian Tax Police Go To Work With AK-47 Rifles*, EUROPEAN, Apr. 3, 1997, at 5.

legal provisions and enforcement mechanisms, has generally attempted to incorporate Russian citizens into a modern, Western system of taxation.

#### IV. INCOME TAX AVOIDANCE BY CITIZENS OF THE RUSSIAN FEDERATION

Although personal income taxes comprise only a small percentage of government revenues in Russia,<sup>100</sup> the collection of these personal income taxes remains problematic as many citizens seek to circumvent payment of tax through the use of various avoidance practices. Five of these tax avoidance practices will be discussed below.

##### A. Methods of Tax Avoidance

The first and most obvious method of tax avoidance used by Russian citizens is the simple non-reporting of income, which results in non-payment of tax. Although relatively low personal income tax rates exist in the Russian Federation, it is estimated that Russian families underreport their wages by approximately 40%.<sup>101</sup> For example, one Russian citizen reported that he had not paid taxes since he left a government job three years earlier.<sup>102</sup> This non-reporting of income is facilitated by the Russian tax police's tendency only to scrutinize those taxpayers with the "clearest financial records and transparent investments."<sup>103</sup> Therefore, generating no paper trail with the State Tax Service almost guarantees that the tax police will not come knocking.

Non-reporting of income also encompasses the receipt of salaries-in-kind. In recent months, many Russian business entities have experienced severe difficulties paying monetary compensation to their employees and have resorted to the payment of salaries-in-kind.<sup>104</sup> For example, each employee of a women's underwear factory

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100. Personal income taxes comprise 7.5% of government revenues in Russia whereas they comprise approximately 30% of government revenues in Western Europe. See Gordon, *supra* note 96, at A1.

101. See Avraham Sharma, *Inside Russia's True Economy*, 103 FOREIGN POLICY 110, 112 (June 1996).

102. See Wendy Sloane *et al.*, *Dodging Taxes and Fudging Forms is de Rigueur Around the World*, CHRISTIAN SCI. MONITOR, Apr. 12, 1995, at 1.

103. See Gordon, *supra* note 96, at A8.

104. See Daniel Rosenblum, *Russia's Mounting Wage Debt*, J. COMMERCE, Feb. 20, 1997, at



located in Volgograd recently received seven to nine bras in lieu of salary; each employee in a tire factory located in Kazakhstan received two tires instead of backpack.<sup>105</sup> Under the Income Tax on Natural Persons Act, salaries-in-kind are technically a component of total annual income.<sup>106</sup> However, because it is unreasonable for the financially-strapped payor of these salaries-in-kind to deduct any tax due, Russian citizens continue to engage in the practice of non-reporting of income as they would with wages paid in currency.

The second tax avoidance practice involves the use of interest-free loans as substitute wage payments.<sup>107</sup> In this scheme, an employer makes a small interest-free loan to his employee in lieu of salary. After the employee deposits this "loan" into a bank savings account, the employer pays the involved bank the rest of the employee's salary plus a small service charge. The bank turns around and pays interest on the employee's savings account at an elevated rate, often 1000% or more.<sup>108</sup> Thus, the employee's salary is paid as a combination loan/interest payment. Because the employee promises to pay back the loan over a lengthy time period (typically ten years), the effect of inflation on the Russian ruble assures risk-free repayment. Until January 1997, the current regime taxed neither the loan made to, nor the interest received by, the employee.

The adoption of Federal Act No. 11-FZ by the Duma in December 1996 now makes this scheme fully taxable.<sup>109</sup> First, the employee must include in taxable income the difference between the

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7A (citing November 1996 survey which found that two-thirds of Russian citizens are not receiving wages on time).

105. *See id.*

106. *See* Income Tax on Natural Persons Act, *supra* note 75, art. 2 (providing that "[i]ncome derived in kind, shall be calculated as part of total annual income at the state controlled prices or, if such prices are not available, at free (market) prices at the date of income receipt.").

107. *See The Strange Saga of Decree No. 1215 Reveals Serious Problems in Russia*, RUSS. & COMMONWEALTH BUS. L. REP., Oct. 5, 1996, available in LEXIS, News Library, Rcb1r File; *see also* Daniel Williams, *Russia's Ever-Mounting Back Taxes; Debt-Ridden Government Encumbered By Arrears of \$100 Billion*, WASH. POST, Dec. 26, 1997, at A31.

108. *See id.* Interest rates have been reported as high as 530,000%. *See Press Briefing by Deputy Finance Minister Sergei Shatalov* (Official Kremlin International News Broadcast, Apr. 25, 1997), translated and available in LEXIS, News Library, Curnws File.

109. *See* Amendments to RF Income Tax on Natural Persons Act, RF Federal Act No. 11-FZ (Dec. 25, 1996), translated and available in LEXIS, Intlaw Library, Rusleg File [hereinafter Amendments to Income Tax on Natural Persons Act]; *see also* *Russia Increases Profit and Personal Income Taxes*, RUSS. & COMMONWEALTH BUS. L. REP., Feb. 12, 1997, available in LEXIS, News Library, Rcb1r File.

interest that the employee pays to the employer under the terms of the loan (e.g., zero) and the interest that the employee would have to pay if the loan's interest rate equaled two-thirds of the Russian Federation Central Bank's refinance rate, but only if the loan's interest rate is less than two-thirds of the refinance rate.<sup>110</sup> Second, for employee savings accounts with interest rates exceeding the refinance rate, the amount of interest earned exceeding the amount which would have been earned at the refinance rate should be "subject to taxation at the source of payment."<sup>111</sup> However, implementation of this provision remains problematic. An earlier decree charging banks with the responsibility of withholding the appropriate taxes from their customer's accounts was met with considerable outrage,<sup>112</sup> and voluntary compliance on the part of Russian citizens appears doubtful.

A stock-for-salary scheme constitutes the third method of tax avoidance used by Russian citizens.<sup>113</sup> Under this scheme, the employee receives from his employer a stock option, allowing him to buy a designated number of company shares within a specific time period at a nominal price. After the employee exercises his option and purchases company stock, the company immediately buys back the shares for an inflated amount, representing a tax-free salary substitute to the employee.

Under a fourth method of tax avoidance known as "cash services payroll tax evasion,"<sup>114</sup> employees enjoy an indirect tax benefit from the actions of their employer-enterprises. The enterprise executes a fictitious contract with a "cash services firm" under which the firm agrees to perform a specified task. The enterprise uses its payroll money to pay the firm for the fictitious job, and the firm, after deducting a small fee, almost immediately gives the cash payment back to the enterprise. The enterprise then pays its workers using

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110. See Amendments to Income Tax on Natural Persons Act, *supra* note 109, art. 3, para. 1(ab); see also *Russia Increases Profit and Personal Income Taxes*, *supra* note 109.

111. See Amendments to Income Tax on Natural Persons Act, *supra* note 109, art. 3, para. 1(m); see also *Russia Increases Profit and Personal Income Taxes*, *supra* note 109.

112. A presidential decree issued in August 1996 appeared to place this responsibility on banks; however, strong business protests and rumors of mass closures of personal bank accounts prompted the rescission of this decree within a matter of weeks. See *The Strange Saga of Decree No. 1215*, *supra* note 107.

113. See *id.*

114. See Neela Banerjee, *In Russia, to the Victor Go the Headaches*, WALL ST. J., June 13, 1996, at A8.

this cash and reports a much smaller payroll amount to the State Tax Service. This scheme reduces the tax burden not only of the involved enterprise, but also of its employees, as the enterprise is responsible for paying the personal income tax of all of its employees who hold only one job.<sup>115</sup>

A variant on the cash service tax avoidance method involves the use of insurance to produce tax-free income.<sup>116</sup> An enterprise executes an insurance contract under which its employees are insured against some future event that is certain to occur (e.g., that snow will fall during the winter months). When the specified event does occur, the insurance company pays these employees the exact amount of money that they would have received as wages. Under the current tax regime these workers receive tax-free wage payments because the receipt of insurance proceeds is not subject to taxation.

A final method of tax avoidance involves sending money abroad. Methods used by Russian citizens to export capital include the payment of fictitious invoices sent by legitimate Western companies or the transport of suitcases loaded with cash onto international flights leaving Moscow, a practice facilitated by the payment of bribes to customs officials.<sup>117</sup> For example, Russians have used cash carried in suitcases to buy luxury villas in Cyprus.<sup>118</sup> Russian tax officials estimate that this flight of capital deprives the Russian government of approximately \$50 billion in tax revenue per year.<sup>119</sup>

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115. See text accompanying note 77. However, Russian officials have drafted a law which would make large cash transactions between firms illegal. See Maxim Ognev, *Russian Authorities Move to Restrict Cash Transactions*, Agence France Presse, Sept. 17, 1997, translated and available in LEXIS, News Library, Afp File.

116. This method was described by Alexander Pochinok, then chairman of the Duma's Subcommittee on Tax Legislation and now head of the State Tax Service, at a conference held at Duke University in January 1997. See Michael Newcity, *Russian Legislator Discusses Prospects for Tax Reform*, 14 TAX NOTES INT'L 1033, 1034 (1997); see also Williams, *supra* note 107.

117. See Vincent Boland, *Russian Mafia Has \$10bn in Swiss Bank*, FIN. TIMES, Feb. 14, 1997, at 3.

118. See James Hansam, *Sunshine Isle Lures Moscow Billions*, EVENING STANDARD, July 31, 1997, at 35.

119. See Brzezinski, *supra* note 5, at 1. The State Tax Service is considering a limited tax amnesty program whereby capital held abroad could be brought back to Russia without being taxed. See Natalia Varnavskaya, *Tax Amnesty of Illicit Capital in the Making; State Prepared to Launder Money for Ten Percent*, KOMMERS., Oct. 7, 1997, translated and available in LEXIS, News Library, Spd File (describing a draft bill which would allow Russian citizens to declare any concealed income or property and only be subject to a tax in the range of 10-15%); see also *Speech By President Boris Yeltsin at the Federation Council* (Official Kremlin International

## B. Explanations for Income Tax Avoidance

Possible explanations for income tax avoidance by Russian citizens can be grouped into two categories: (1) flaws within the current tax regime; and (2) factors external to the current tax regime.

1. *Flaws Within the Current Tax Regime.* Simply stated, the current tax regime is a morass of complexity and confusion that daunts even the most ambitious and conscientious taxpayer. One source estimates that this regime consists of 200 taxes found in approximately 4,000 documents, including, "1200 presidential decrees, government orders and ministerial instructions... [and] another 3,000 legislative and sub-legislative acts."<sup>120</sup> Frequent changes in tax legislation have served to further complicate this situation. With over 800 modifications made in the first five years alone, the tax regime has been analogized to "a magazine that comes out once a week, because it keeps changing."<sup>121</sup> Once federal tax legislation has been enacted, each level of government may determine only the type and size of taxes to be levied in their respective jurisdictions based upon affirmative language in the legislation.<sup>122</sup> However, in practice, governmental authorities have not followed this provision but instead have enacted their own tax laws, resulting in multiple layers of tax legislation.<sup>123</sup> The current tax regime also provides little guidance as to the meaning of important terms, such as "taxpayers" and "bases of taxation."<sup>124</sup> In addition,

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News Broadcast, Sept. 24, 1997), translated and available in LEXIS, News Library, Curnws File, *State Tax Service Chief Outlines Measures to Increase Tax Take* (BBC Summary of World Broadcasts, Apr. 29, 1997), translated and available in LEXIS, News Library, Bbcswb File.

120. Mikhail Berger, *Not Everyone Wants Simpler Tax Collection*, MOSCOW TIMES, Feb. 26, 1997, available in LEXIS, News Library, Mostms File; see also *Speech by Alexander Pochinok, State Tax Service Chief, at the Monthly Luncheon of the American Chamber of Commerce in Russia* (Official Kremlin International News Broadcast, June 18, 1997), translated and available in LEXIS, News Library, Curnws File (stating that there are approximately 230 types of taxes covered by 1500 to 2000 pieces of tax legislation).

121. George Melloan, *Global View: Why Russia Needs a Bolshoi Tax*, WALL ST. J., Sep. 25, 1995, at A19. Several legitimate explanations underlie these frequent changes, including the need to respond to a changing Russian economy and to evolving tax avoidance practices. See Kathleen Matthews, *Russian Tax Reform Includes New Tax Code*, 10 TAX NOTES INT'L 479, 479 (1995).

122. Fundamentals of the RF Tax System, *supra* note 1, art. 18, para. 2. For example, regional legislative bodies may introduce taxes collected for education, while local legislative bodies may establish a broad range of taxes. See *id.* art. 20, paras. 2, 4.

123. See Matthews, *supra* note 121, at 480.

124. See Fundamentals of the RF Tax System, *supra* note 1, art. 3 (taxpayer), art. 5 (bases

although the general provisions of the current tax regime (outlined in "Fundamentals of the RF Tax System Act") do set forth the rights and duties of both the taxpayer<sup>125</sup> and the tax authorities,<sup>126</sup> albeit in a cursory manner, the specific provisions governing personal taxation (found in "On Taxation of Natural Persons Act") contain merely a short description of the duties of the taxpayer and omit entirely any description of those of the tax authorities.<sup>127</sup> It is therefore not surprising that the actual income tax declaration required to be filed is incomprehensible to even the most sophisticated taxpayers.<sup>128</sup> According to one tax inspector, not one taxpayer in her jurisdiction was able to file an income tax declaration without assistance.<sup>129</sup>

Three other aspects of the tax payment procedure also complicate the existing regime. First, because the tax authorities do not currently have a comprehensive database of taxpayer information,<sup>130</sup> they may apply enforcement mechanisms in an

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of taxation); see also Matthews, *supra* note 118, at 481 ("Because certain definitions have not been formulated and each taxpayer often understands these terms in his or her own way, the argument between the tax authorities and the taxpayer becomes about the terms, not about the essence of the matter . . .").

125. See Fundamentals of the RF Tax System, *supra* note 1, art. 11 (taxpayer duties), art. 12 (taxpayer rights).

126. See Fundamentals of the RF Tax System, *supra* note 1, art. 14 (rights of the tax authorities), art. 16 (duties and responsibilities of the tax authorities).

127. See Income Tax on Natural Persons Act, *supra* note 75, art. 20. Article 20 also fails to include any enumeration of the rights of the taxpayer. See *id.*

128. See Irina Yasina, *Taxpayers Buy Right to Gripe*, MOSCOW TIMES, Apr. 15, 1997, available in LEXIS, News Library, Mostms File (describing how a woman with a PhD in economics was unable to complete the Russian tax form).

129. See *id.* The State Tax Service has created, subject to final approval, a new, less complicated tax declaration form and is planning an educational campaign to assist taxpayers in using the new form. See *Itar-Tass Economic News Digest of November 21*, *supra* note 21; see also *Press Conference with State Tax Service Head Alexander Pochinok*, *supra* note 21.

130. See Gordon, *supra* note 96, at A1. However, the IMF is financing a project to issue personal identification numbers to all Russian citizens. See Yelena Loria, *All Russians to be Numbered*, RUSS. PRESS DIG., Apr. 25, 1997, available in LEXIS, News Library, Spd File. In addition, a system of social security numbers has been introduced to track employer contributions to the Russian Federal Pension Fund but currently tax officials cannot access the information on wages contained therein. See Mark Whitehouse, *Russia Phases In Social Security Numbers*, MOSCOW TIMES, Jan. 30, 1997, available in LEXIS, News Library, Mostms File. Alexander Pochinok, head of the State Tax Service, recently announced that the State Tax Service is starting to compile "files" of "tax histories" on taxpayers. See *Press Conference with State Tax Service Head Alexander Pochinok*, *supra* note 21. In addition, the Tax Police now maintain a computer database, called "Isinpol," to track those citizens who have committed tax violations. See *TV Reports Computerized Tax Clampdown, Interviews Interior Minister* (BBC Summary of World Broadcasts, Nov. 4, 1997), available in LEXIS, News Library, Bbcswb File.

arbitrary fashion based on potentially inaccurate information. Second, penalties under the current system, which often amount to two to three times the taxes owed, may apply even to innocent mistakes.<sup>131</sup> Third, Russia has no judicial forum devoted specifically to the litigation of tax issues.<sup>132</sup> Instead, Russian citizens must petition a people's court to obtain a judicial hearing. However, because few courts consider themselves skilled enough in the area of tax law to accept the challenge, judicial hearings are difficult to obtain.<sup>133</sup>

Given the confusing nature of the system, and the fact that tax laws, regulations, and rulings do not appear in a single official publication,<sup>134</sup> many Russians engage in tax avoidance simply because they often cannot calculate out how much they owe and where and when to pay. In addition, even those citizens who may want to voluntarily comply with the existing regime may be deterred from doing so because if they make a mistake on their income declaration, they will be penalized under a somewhat arbitrary system and left with scant judicial recourse.<sup>135</sup>

2. *Factors External to the Current Tax Regime.* Several explanations for income tax avoidance by Russian citizens exist independently of the flaws contained in current tax laws. First, Russian citizens possess little to no experience with a tax system that requires affirmative compliance, i.e., the voluntary filing of an income tax declaration and voluntary payment of income tax. Basically, no personal income tax existed under the tsarist regimes of the late nineteenth and early twentieth centuries,<sup>136</sup> and taxation of personal income during the Soviet Era placed the burden of compliance on employers. In general, taxpayers were required to take affirmative action with respect to the tax laws only in very

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131. See Fundamentals of the RF Tax System, *supra* note 1, art. 13, para. 1(a). However, a 1996 presidential decree forgives those tax violations which are inadvertent and voluntarily disclosed by the taxpayer to the tax authorities. See Main Lines of Tax Reform in the RF and Measures to Tighten Up Tax and Payments Discipline, RF President's Edict No. 685 (May 8, 1996), para. 13, translated and available in LEXIS, Intlaw Library, Rusleg File.

132. See Matthews, *supra* note 121, at 481-82.

133. See *id.*

134. See David F. Black, *So You Want to Invest in Russia? A Legislative Analysis of the Foreign Investment Climate in Russia*, 5 MINN. J. GLOBAL TRADE 123, 147 (1996).

135. See *Ride a High Tax Horse*, *supra* note 91, at A6.

136. See *supra* Section II(A).

limited situations.<sup>137</sup> Therefore, Russians are simply unaccustomed to calculating taxable income, filing income tax forms, and voluntarily remitting tax due.<sup>138</sup>

Because of their lack of experience with a modern, Western system of taxation, Russians fail to appreciate the criminality of income tax avoidance. In a recent survey conducted by the Russian Market Research Co., 61% of those responding stated that they do not consider tax evasion to be a crime, while only 14% believed that it is.<sup>139</sup> This perception is furthered by the fact that tax evasion in Russia is categorized under the Criminal Code as only an economic crime and not placed in the more serious category of crimes against the state.<sup>140</sup> Thus, beyond being unaccustomed with a tax system requiring voluntary compliance, Russian citizens also lack an understanding of its mandatory legal nature.

Second, because Russians are keenly aware that many well-connected business enterprises and individuals escape with non-payment of tax, they are provided with little incentive for voluntary compliance with the tax laws. Substantial press coverage has been devoted to tax avoidance engaged in by Russian enterprises and the State Tax Service's resulting permissive attitude. For example, media reports have noted that a high percentage of Russia's tax debt is

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137. See *supra* Section II(B). Only those taxpayers engaged in private activities had an obligation to prepare and file an income tax return with the tax authorities. See *id.*

138. See Viktor K. Grebenshkov, *Inspectors Press Russians to Pay Taxes; Revenue: Moscow is Converting to the Western European System. Citizens are Unused to Filling Out the Forms*, L.A. TIMES, Feb. 27, 1992, at A10 ("Russians have not filled out forms and fulfilled the other taxation rites long familiar to Westerners; for generations, wage earners in the former Soviet Union needed no knowledge of taxation since taxes were automatically deducted from salaries by factory accountants"); Lapenkova, *supra* note 94 ("Russians have been slow to acquire the habit of filling in tax forms"). Minister Yevgeny Yasin has aptly described this culture of non-payment: "Over the last 80 years, no-one in Russia has paid any taxes at all. The state took our money away from us and gave each person exactly the amount which it considered necessary. We, the population and the enterprises are not accustomed to paying out of our own pocket." *Trading Punches on Tax Reform*, MOSCOW NEWS, Sept. 4, 1997, translated and available in LEXIS, News Library, Moscows File.

139. Steve Liesman, *Russia's Chubais Faces High Stakes Test*, WALL ST. J., Mar. 10, 1997, at A15. In fact, Alexei Anisimov, allegedly the first Moscow businessman to receive a jail sentence for income tax evasion, expected only to receive a verbal reprimand in court for his tax-evading practices and was stunned when he was sentenced to one year in prison. See Williams, *supra* note 107, at A31.

140. See Criminal Code of the Russian Federation, RF Act No. 63-FZ (June 13, 1996), art. 198, translated and available in LEXIS, Intlaw Library, Rflaw File; see also Natalya Varnavskaya, *Vitaly Artyukhov: Russia Needs a System in Which Failing to Pay Taxes Would be Frightening, Ruinous and Shameful*, KOMMERS., Apr. 8, 1997, at 1.

owed by a relatively small group of enterprises. Some sources state that half of Russia's tax debt is the responsibility of 180 companies<sup>141</sup> while others suggest that over 40% of the debt is owed by just seventy-two companies.<sup>142</sup> Alexander Pochinok, head of the State Tax Service, has calculated that the tax debt owed by the eighteen largest tax debtors reaches over 100 trillion rubles.<sup>143</sup> In particular, AvtoVAZ, Russia's largest car manufacturer and the country's largest tax debtor,<sup>144</sup> did not face pressure from the VChK to pay its debt until the summer of 1997.<sup>145</sup> In addition, the Russian government has publicly acknowledged that approximately 200 government officials failed to submit their tax declarations this year in a timely manner. However, the Tax Inspectorates may not verify the declarations of civil servants, nor impose punishments or fines for either late or improper submissions under current tax law.<sup>146</sup> Furthermore, many wealthy individuals appear to be less than forthcoming in declaring income on their tax declarations. A recent media report revealed that oil and media magnate Boris Berezovsky, whose net worth is estimated at \$3 billion, declared under \$500,000 in income and valued his entire net worth at \$38,000 on his 1996 tax form.<sup>147</sup> Therefore, many Russians notice that the more privileged

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141. See Susan Sachs, *Russia's Vicious Winter*, NEWSDAY, Oct. 20, 1996, at A8.

142. See Gordon, *supra* note 96, at A1.

143. See *Press Conference with State Tax Service Head Alexander Pochinok*, *supra* note 21.

144. AvtoVAZ was reported to owe approximately 2.8 trillion rubles, or \$500 million, as of April 1, 1997. See *Russia Companies Seen Restructuring Tax Arrears*, Reuters Eur. Bus. Rep., May 23, 1997, available in LEXIS, News Library, Reueub File.

145. As of late July 1997, a decision was "nearing completion" on the tax debt owed by AvtoVAZ. See *Press Conference with State Tax Service Head Alexander Pochinok*, *supra* note 20. In August 1997, AvtoVAZ announced that it would issue stock shares to the Russian government as collateral for its tax obligation. See *Russia's Biggest Car Maker to Issue New Shares to Clear Tax Debt* (BBC Summary of World Broadcasts, Aug. 8, 1997), available in LEXIS, News Library, Bbcswb File. In October 1997, Prime Minister Viktor Chernomyrdin approved the rescheduling of AvtoVAZ's 2.85 trillion ruble (\$490 million) tax debt over a period of ten years in exchange for the government's receipt of 50% plus one share of AvtoVAZ's outstanding stock as collateral. If AvtoVAZ once again falls behind in tax payments, the government may sell the shares to recoup the tax arrearages. See Boris Aliabyev, *AvtoVAZ Spared From Bankruptcy*, MOSCOW TIMES, Oct. 17, 1997, available in LEXIS, News Library, Mostms File; *Lada Automaker Staves Off Bankruptcy With Debt Deal*, Agence France Presse, Oct. 17, 1997, translated and available in LEXIS, News Library, Afp File.

146. See *Press Conference with State Tax Service Head Alexander Pochinok*, *supra* note 20.

147. See *Bigger Fish Will Evade New Taxes*, MOSCOW TIMES, Oct. 23, 1997, available in LEXIS, News Library, Mostms File. The tax authorities have begun to crack down on wealthy individuals. In September, several Russian pop celebrities were chastised on national



taxpayers openly disregard the tax laws,<sup>148</sup> and question why they should part with their hard-earned rubles to comply with the system.

Third, corruption and political favors permeate the current Russian tax regime, leaving Russian citizens with little motivation to voluntarily comply with such a distasteful system. For example, one Moscow taxpayer revealed that his tax burden depends upon the specific deal he forges with a tax inspector.<sup>149</sup> Evidence also exists that "cronyism" has invaded the Russian tax system: the Russian Finance Ministry estimates that tax breaks for the wealthy and politically-connected approach \$28.6 billion per year.<sup>150</sup> The VChK delayed investigating Gazprom, a gas conglomerate owing over 14 trillion rubles (\$2.6 billion) in delinquent taxes, allegedly because Prime Minister Viktor Chernomyrdin, who heads the tax commission, once served as chairman of the company.<sup>151</sup> An inquiry

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television for under-reporting income on their tax declarations. See Daniel Williams, *Russia's New Pop Music Stars Find Their Celebrity Taxing; Delinquent Performers Get a Televised Tongue-Lashing as Part of the Yeltsin Government's Revenue Collection Drive*, WASH. POST, Oct. 1, 1997, at A19. More importantly, a new draft law would require retailers to provide the government with the name and address of any individual purchasing certain items, such as automobiles, boats, airplanes, real estate, stock, gold, and jewelry, worth one thousand times the minimum wage, or approximately \$14,000. The tax police would then be allowed to contact the purchaser and receive a written declaration of the source of funds used for the purchase. Purchasers who fail to comply would be subject to fines ranging from \$1500 to \$15,000. See Christian Lowe, *Tax Law Aimed at Big-Ticket Purchases*, MOSCOW TIMES, Nov. 25, 1997, available in LEXIS, News Library, Mostms File. As of early December 1997, the draft law, after being approved by the Duma but rejected by the Federation Council (upper house of Parliament), is being revised by a conciliation committee before being resubmitted for full parliamentary approval. See Christian Lowe, *Sales Tax Reporting Bill Blocked*, MOSCOW TIMES, Dec. 5, 1997, available in LEXIS, News Library, Mostms File.

148. See Anichkina, *supra* note 99, at 5. However, the VChK has been summoning Russia's largest tax debtors and deciding whether each debtor-enterprise will pay the debt immediately in full, be allowed to reschedule its tax debt using shares or asset-backed bonds as collateral (pursuant to Government Decree Number 254) or be forced to declare bankruptcy. See *Press Conference with State Tax Service Head Alexander Pochinok*, *supra* note 20; see also *Speech by Alexander Pochinok, State Tax Service Chief, at the Monthly Luncheon of the American Chamber of Commerce in Russia*, *supra* note 120. In restructuring these tax debts, the VChK must follow the procedures outlined in Government Decree Number 254. See *Conditions and Rules of Restructuring Debt Arrears of Organizations on Payments into the Federal Budget*, RF Government Decree No. 254 (Mar. 5, 1997), translated and available in LEXIS, Intlaw Library, Rusleg File.

149. See Zolotov, *supra* note 79 (quoting Georgy Konotop, a self-employed retailer of clothing and luggage at a Moscow market: "If I say that I made, let's say, 500,000 a month, the inspector would say, 'Shame on you! Write down some more. Otherwise you are even below the minimal standard of living.' So I write down 600,000.")

150. Paddock, *supra* note 8, at A1.

151. See Meier, *supra* note 94, at 24. Gazprom, in response to a government recent

by the Russian Parliament has uncovered that several top members of the State Tax Service spent 6.6 billion rubles (\$1.1 million) of taxpayer money to buy and renovate apartments for their own personal use,<sup>152</sup> while a tax inspector and a tax policeman recently were arrested for extorting bribes from business men in St. Petersburg.<sup>153</sup> Paradoxically, ordinary Russians are expected to pay their taxes in full and on time, yet the salaries received by the tax police are exempt from taxation.<sup>154</sup> These shady dealings and political favoritism have turned Russian citizens toward non-payment, prompting one Moscow taxpayer to comment, "I have no idea where my tax money is going . . . . It's probably going into the pockets of the inspectors."<sup>155</sup>

Fourth, Russian taxpayers possess a generally negative view of their government and are unwilling to finance its activities. Many Russian citizens learned to distrust and dislike their often corrupt government during the Soviet era,<sup>156</sup> and this skepticism and distaste has carried over to the post-Communist Yeltsin regime. One taxpayer commented that "there is a general view that people here have been robbed by the government so much in the past that now they don't owe anything to this government."<sup>157</sup> This perception stems, in part, from the large amount of unchecked criminal activity in Russian society<sup>158</sup> and more recently from the huge outlays for military operations in Chechnya.<sup>159</sup> Thus, many Russian citizens have little faith in the workings of their new government and simply feel that "only an idiot pays all his taxes to our corrupt government."<sup>160</sup>

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crackdown on tax evasion by enterprises, paid its entire tax debt at the end of June. See Holman, *supra* note 20, at A14.

152. See Anichkina, *supra* note 99, at 5.

153. See *Russian Tax Police Heighten Enforcement of Big Names' Tax Bills*, 15 TAX NOTES INT'L 448, 448 (1997). In addition, the Russian government has recently purchased two luxury yachts, valued at approximately \$500,000, for the use of high-ranking government officials. See Christian Lowe, *Kremlin Buys Yacht for Officials*, MOSCOW TIMES, Dec. 17, 1997, available in LEXIS, News Library, Mostms File.

154. See Berger, *supra* note 120.

155. Sachs, *supra* note 141, at A8.

156. See Paddock, *supra* note 8, at A1 ("Communism lasted longer here [in Russia], and it was harsher and more corrupt than that in the socialist systems of Central Europe.").

157. Wendy Sloane *et al.*, *supra* note 102, at 1.

158. See *infra* notes 163-66 and accompanying text.

159. See Paddock, *supra* note 8, at A1 (quoting a Russian citizen: "I think a major part of taxes was blown up in smoke in the war in Chechnya.").

160. *Id.*

Taxpayers cannot point to any concrete improvements in their standard of living since the current tax regime was instituted, and thus see no reason to continue paying absent any visible changes.<sup>161</sup> This viewpoint was aptly summarized by a Moscow tax inspector: "If people lived in normal apartments, rode in good public transport, if their children went to good schools and they always received a good salary on time, then the necessity to pay taxes would have infiltrated their minds better."<sup>162</sup>

Finally, the non-paying shadow or underground economy in Russia provides Russian citizens with yet another example of permitted tax avoidance. The shadow economy in Russia, supported by persons ranging from hard-core criminals to those merely engaged in questionable business dealings,<sup>163</sup> constitutes approximately 40% of Russia's current Gross Domestic Product.<sup>164</sup> This shadow economy represents an overwhelmingly large portion of the Russian economic system. "[I]n the industrial countries the shadow economy accounts for 5-7% of the GDP, whereas in Africa and Latin America this figure reaches 30%. Only in Ukraine is the percentage bigger—50."<sup>165</sup> The Russian shadow economy obviously decreases the tax revenue raised by the State Tax Service because its activities occur off-the-books and therefore its profits are not subject to taxation. The shadow economy also diverts potential tax revenue away from the state treasury through the collection of bribes, which monies would have perhaps been otherwise available for tax payments.<sup>166</sup> The fact that this shadow economy is allowed to flourish and escape taxation adds to the perception among Russian citizens that both the tax system and the Russian government are corrupt and that crime

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161. *See Id.*

162. Fred Coleman, *Meanwhile, in Russia . . .*, U.S. NEWS & WORLD REP., Apr. 14, 1997, at 10.

163. *See* Alexander Kakotkin, *Triumphant March of Crimes*, RUSS. PRESS DIG., July 24, 1996, available in 1996 WL 6538100.

164. This finding was made in a recent study conducted by Louise Shelley, a professor of law at American University in Washington, D.C. *See* Jonathan Lynn, *Focus—Mafia Runs Nearly Half Russian Economy*, Reuters Fin. Serv., Mar. 19, 1997, available in LEXIS, News Library, Reufin File. The Russian government has acknowledged that the shadow economy "influences" approximately 50% of Russia's GDP but believes that the shadow economy itself only accounts for between 20-23% of GDP. *See Press Conference Regarding the "Shadow Economy" in Russia* (Official Kremlin International News Broadcast, Oct. 6, 1997), translated and available in LEXIS, News Library, Curnws File.

165. Kakotkin, *supra* note 163.

166. *See* Lynn, *supra* note 164.

pays in the area of personal income taxation.

## V. EXAMINATION OF THE DRAFT TAX CODE

After four years of work<sup>167</sup> a new draft tax code consisting of a General Part and three Special Parts was submitted to the Russian Duma by Prime Minister Viktor Chernomyrdin on April 30, 1997.<sup>168</sup> The General Part of the draft code provides, *inter alia*, lists of taxes at all three levels (federal, regional, and local), basic principles of the tax system and of tax accounting, and new procedures for administrative and judicial appeals.<sup>169</sup> Section XI, contained in one of the Special Parts, articulates the principles of the federal personal income tax.

### A. Personal Income Taxation Under the Draft Tax Code<sup>170</sup>

In general, Section XI provides definitions of taxpayer<sup>171</sup> and income,<sup>172</sup> and more precise instructions for calculating income,<sup>173</sup> exemptions,<sup>174</sup> deductions,<sup>175</sup> and concessions.<sup>176</sup> Like the current regime, the draft code differentiates between income earned at the primary workplace and that earned at additional places of employment. If an individual holds only one job, his employer-enterprise is required to calculate tax due on earned wages, make advance tax payments<sup>177</sup> either monthly<sup>178</sup> or at the time that the

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167. See *Press Briefing by Deputy Finance Minister Sergei Shatalov*, *supra* note 108 (stating that initial work on the draft tax code began in the spring of 1993).

168. The draft code was initially approved by the Duma on its first reading on June 19, 1997, but then abrogated by a Duma resolution passed on November 19, 1997. See *supra* notes 23-26 and accompanying text.

169. See Andrei I. Belinski, *The New Tax Code as a Cure for the Russian Tax System*, EAST/WEST EXECUTIVE GUIDE, Mar. 1, 1997, available in LEXIS, News Library, Curwms File.

170. This section provides an overview of the taxation of income earned by individuals at places of employment and does not furnish information about the taxation of other sources of personal income such as that received from property sales or business investments.

171. See May 1997 Draft of Personal Income Tax Provisions, art. 606 (document not publicly available) [hereinafter Draft of Personal Income Tax Provisions].

172. See *id.* art. 607-08.

173. See *id.* art. 626-27.

174. See *id.* art. 610.

175. See *id.* art. 612-18.

176. See *id.* art. 619-24.

177. See *id.* art. 626, para. 1.

178. See *id.* art. 626, para. 2(1).

taxpayer receives the wages,<sup>179</sup> and file a tax return by February 1 of the following year.<sup>180</sup> If an individual holds more than one job, each employer-enterprise must determine the amount of tax due, make advance tax payments, and file a tax return by February 1.<sup>181</sup> An individual is responsible for making advance tax payments only if engaging in economic activity as an entrepreneur<sup>182</sup> or "receiving income outside of a labor relationship."<sup>183</sup> In these cases, the taxpayer must file a return by April 1 declaring the actual income received over the course of the tax period, any expenses directly related to earning this income, and any prepayments made. In all cases, the taxpayer has the duty to maintain records of income, expenses, and advance taxes paid,<sup>184</sup> while the employer-enterprise is under a similar duty to maintain records of income and advance taxes paid.<sup>185</sup>

The draft code also permits taxable income to be reduced by several deductions, exemptions, and concessions. Several general deductions, such as the standard deduction<sup>186</sup> and the deduction for children and dependents,<sup>187</sup> may be taken by most taxpayers. The tax exemptions, which are similar to those permitted during the Soviet Era, are based on the nature of income earned;<sup>188</sup> tax concessions are granted based on the status of the taxpayer.<sup>189</sup> Once taxable income

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179. *See id.* art. 626, para. 2(6).

180. *See id.* art. 628, para. 2(3).

181. *See id.* art. 626, para. 2(1), *id.* art. 628, para. 2(3).

182. *See id.* art. 626, para. 2(2), *id.* art. 626, para. 5.

183. *Id.* art. 626, para. 3. Although the draft code does not define the parameters of article 626, paragraph 3, most likely this provision applies to individuals who are working on a temporary basis for an enterprise.

184. *See id.* art. 611, para. 1, 4.

185. *See id.* art. 611, para. 2(1), *id.* art. 627, para. 1.

186. *See id.* art. 612, para. 2. The standard deduction, calculated monthly, equals the minimum monthly wage established by federal law and is deducted directly from monthly wages by the income source if advance tax payments are being made or by the taxpayer if tax is paid at the end of the tax period. *Id.* art. 614, para. 1.

187. *See id.* art. 612, para. 2(3). The taxpayer is entitled to a monthly deduction equal to the minimum monthly wage under federal law for each child or dependent. *Id.* Again, the deduction is taken directly at the income source if advance tax payments are being made or by the taxpayer if tax is paid at the end of the tax period. *Id.* art. 615, para. 8.

188. *See generally id.* art. 610.

189. *See generally id.* arts. 619-24. Taxpayers who qualify may deduct two, four, nine or fourteen times the minimum monthly wage from their earned income each month. *See id.* art. 619, paras. 1(1)-1(4). Again, tax concessions are taken after tax deductions directly at the income source if advance tax payments are being made or by the taxpayer if tax is paid at the end of the tax period. *See id.* art. 620, paras. 1-2.

has been calculated, the Russian taxpayer faces two tax rates: 12% on income less than 60 million rubles (\$10,540) per year and 30% on income over 60 million rubles per year.<sup>190</sup>

## B. Analysis of the Draft Tax Code

An examination of the newly-submitted draft code raises three issues: (1) whether the draft code addresses the previously-enumerated flaws in the current tax regime; (2) whether the draft code mitigates those factors external to the current tax regime which impede tax collection; and (3) whether the draft code addresses the specific methods of tax avoidance engaged in by Russian citizens.

1. *Does the Draft Tax Code Address the Flaws in the Current Tax Regime?* In many respects, the draft code does attempt to correct the perceived weaknesses of Russia's current tax system. First, the draft code simplifies several aspects of the tax system. For example, the draft code drastically reduces the types of taxes that can be imposed at the federal, regional, and local levels from approximately two hundred<sup>191</sup> to around thirty,<sup>192</sup> thereby streamlining the tax system. In addition, the code clarifies which types of taxes each level of government may impose.<sup>193</sup> More importantly, the draft code simplifies the personal income tax system by imposing only two marginal tax rates on individuals,<sup>194</sup> and by placing the compliance obligation somewhat more heavily on the employer-enterprise.<sup>195</sup>

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190. See *id.* art. 625, para. 1. In effect, the draft code decreases the number of individual income tax brackets from five to two. See, e.g., *Yeltsin Over First Tax Hurdle But Still Some Way to Go*, FIN. TIMES, June 26, 1997, at 2. The State Duma Committee for Budget, Taxes and Banks has proposed an alternative rate structure with progressive tax rates beginning at 20 million rubles and the maximum tax rate imposed on incomes of 100 rubles and above. See *Press Conference with State Duma Committee for Budget, Taxes and Banks* (Official Kremlin International News Broadcast, Oct. 29, 1997), translated and available in LEXIS, News Library, Curnws File.

191. The current system is composed of approximately 40 taxes at the federal level and between 70 and 140 taxes combined at the regional and local levels. See Newcity, *supra* note 116, at 1033.

192. See *id.*

193. The draft code provides for twelve taxes at the federal level, eight taxes at the regional level, and twelve taxes at the local level. See *Russia's Draft Tax Code: General Part (Chapters 1-12) (Unofficial Translation)*, 96 TAX NOTES INT'L 237-22 (Dec. 9, 1996), available in LEXIS, Taxana Library, Tni File [hereinafter *Draft Russian Tax Code Part I*].

194. See *supra* note 190 and accompanying text.

195. See *supra* notes 177-185 and accompanying text. In essence, only an individual who is an entrepreneur or working for an employer on a temporary basis must take sole responsibility

Furthermore, new and stricter procedures for the amendment of tax legislation presumably will prevent the frequent changes which have needlessly complicated the current tax regime. For example, Article 9, paragraph 1 of the draft code provides that the establishment, amendment, or elimination of federal taxes can be made only through the passage of federal legislation.<sup>196</sup> Regional and local tax authorities will not be able to layer additional taxes on top of those delineated in the draft code as they have done in the past because the draft code stipulates that “[s]tandards (provisions) of the legislative acts adopted on the basis and in implementation of this Code or in accordance with this Code cannot run contrary to the standards (provisions) of this Code or go beyond these provisions.”<sup>197</sup> Finally, the Russian government also is preparing very simple instructions for preparing a tax return in order to facilitate voluntary tax compliance.<sup>198</sup>

Second, the draft code contains several measures that allow the individual taxpayer to more easily comprehend the Russian tax regime, thereby possibly stimulating voluntary compliance. For example, the draft code provides detailed definitions for often-disputed terms such as “taxpayer,”<sup>199</sup> “economic activity,”<sup>200</sup> “objects of taxation,”<sup>201</sup> and “income from sources in the Russian Federation.”<sup>202</sup> The draft code also mandates that each provision levying a tax must describe the taxpayers affected, the object of taxation, the applicable tax rate, and the time and procedure for paying the tax.<sup>203</sup> In addition, the rights and obligations of both

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for the calculation and payment of income tax. *Id.*

196. *See Draft Russian Tax Code Part I, supra* note 193, art. 9, para. 1.

197. *Id.* art. 4, para. 2. In addition, the Russian Federation Constitutional Court has recently ruled that Russia's regional governments should not introduce any taxes and deductions which do not conform to the taxes and deductions stipulated under federal legislation. *See Application Fee for Right of Residence in Moscow Region Deemed Unlawful* (BBC Summary of World Broadcasts, July 4, 1997), available in LEXIS, News Library, Bbcswb File.

198. *See Press Conference with Alexander Pochinok* (Official Kremlin International News Broadcast, Apr. 23, 1997), translated and available in LEXIS, News Library, Curnws File.

199. *Draft Russian Tax Code Part I, supra* note 193, art. 61.

200. *Id.* art. 21.

201. *Id.* art. 91; *see also* Draft of Personal Income Tax Provisions, *supra* note 171, art. 607, para. 1.

202. *Id.* art. 103; *see generally* Matthews, *supra* note 121, at 481.

203. *See id.* art. 6, para. 4.

taxpayers<sup>204</sup> and the tax authorities<sup>205</sup> are clearly articulated in the draft code, which helps the taxpayer comprehend his duty to pay tax and guards him against unreasonable tax investigations. Moreover, the draft code outlines the procedures for satisfying a tax obligation<sup>206</sup> and allows the taxpayer to delay payment for certain periods of time.<sup>207</sup> Thus, the taxpayer is given greater flexibility to meet his tax obligation than under the current regime. The taxpayer may also make adjustments to a tax return within thirty days of filing and not be penalized for doing so.<sup>208</sup>

Finally, the draft code makes available to the taxpayer both administrative and judicial rights of appeal which are extremely useful in situations where the taxpayer believes his tax obligation has been assessed incorrectly. For example, Article 172 of the draft code stipulates that a taxpayer may submit an application to the relevant tax body, Tax Board, or other court asserting that the tax authorities withheld an excessive sum of tax and recover the excessive sum with interest.<sup>209</sup> In addition, Article 236 provides the taxpayer with the right to lodge an appeal against actions of the tax authorities.<sup>210</sup> Most importantly, a permanent tax court will be created in which Russian citizens will be able to contest tax liability before making payment of disputed tax.<sup>211</sup> The requirements that each taxpayer be registered with the local tax authorities at his place of residence,<sup>212</sup> and be assigned a taxpayer identification number,<sup>213</sup> should protect the taxpayer against unfounded accusations of tax violations. Finally, the

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204. See *Draft Russian Tax Code Part I*, *supra* note 193, arts. 62 (rights of taxpayers), 64 (obligations of taxpayers).

205. See *Russia's Draft Tax Code: General Part (Chapters 13-29) (Unofficial Translation)*, 96 TAX NOTES INT'L 237-23 (Dec. 9, 1996), art. 226 (rights of tax authorities), art. 227 (obligations of tax authorities), available in LEXIS, Taxana Library, Tni File [hereinafter *Draft Russian Tax Code Part II*].

206. See *Draft Russian Tax Code Part I*, *supra* note 193, art. 112, 116. Article 628 also provides detailed guidance as to filing procedures and deadlines for personal tax returns. See *Draft of Personal Income Tax Provisions*, *supra* note 171.

207. The taxpayer can delay payment for one to six months either through deferral or extension. See *Draft Russian Tax Code Part I*, *supra* note 193, art. 134. Another option is for the taxpayer to delay payment for one to five years through a tax loan. See *id.* art. 135.

208. See *Draft of Personal Income Tax Provisions*, *supra* note 171, art. 628, para. 7.

209. *Draft Russian Tax Code Part II*, *supra* note 205, art. 172.

210. See *id.* art. 236; see *id.* arts. 237-38, 243-47 (setting forth the logistics of the appeals process).

211. See *Matthews*, *supra* note 121, at 481-82.

212. See *Draft Russian Tax Code Part II*, *supra* note 205, art. 202, para. 1.

213. See *id.* art. 202, para. 11.



draft code articulates the rights of individuals charged with tax violations,<sup>214</sup> and sets forth an appeals process for tax judgments,<sup>215</sup> to protect the taxpayer against arbitrary enforcement of the tax laws.

2. *Does the Draft Tax Code Curb the External Factors Which Impede Tax Collection?* By eliminating the current plethora of exemptions and setting forth stringent penalties for tax evasion, the draft code may reduce the externalities which hinder tax collection.<sup>216</sup> First, the draft code addresses the most conspicuous cases of non-payment created by the widespread preferential tax treatments by curtailing some of the more visible tax exemptions which exist under the current tax regime. For example, the long-time blanket exemption enjoyed by military personnel has been eliminated.<sup>217</sup> The head of the State Tax Service has publicly announced that he favors eliminating the tax privileges enjoyed by employees of the Interior Ministry, including tax inspectors and the tax police.<sup>218</sup> The use of charitable organization status to avoid tax payment, a practice which is currently subject to exploitation,<sup>219</sup> also will be restricted by the implementation of stricter standards for determining what constitutes a charitable organization<sup>220</sup> and charitable activity.<sup>221</sup> Hopefully, the reduction of widespread and visible tax avoidance will motivate the average Russian taxpayer to comply with the tax laws.

Second, the increase in enumerated tax violations and stringent penalties in the draft code may reduce the tax-evading shadow economy,<sup>222</sup> thus partially removing yet another example of tax

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214. See *Draft Russian Tax Code Part II*, *supra* note 205, art. 327.

215. See *id.* art. 404.

216. See *supra* Section IV.B(2).

217. The former exemption was found in Income Tax on Natural Persons Act, *supra* note 75, art. 3, para. 1(z13) (providing an income exemption for "amounts of money allowances, monetary rewards and other payments received by military servicemen due to performance of military service duties"). However, such an exemption for military personnel is not contained in the relevant section of the draft of personal income tax provisions and therefore has presumably been eliminated. See *Draft of Personal Income Tax Provisions*, *supra* note 171, art. 610.

218. See *Press Conference with Alexander Pochinok*, *supra* note 198.

219. See, e.g., Newcity, *supra* note 116, at 1033 (citing one charitable organization which was recently able to import into Russia and sell tax-free approximately \$4 billion worth of tobacco, alcohol and automobiles).

220. See *Draft Russian Tax Code Part I*, *supra* note 193, art. 53.

221. See *id.* art. 25.

222. Russian government officials have acknowledged that the tax code may represent a step forward but will by no means eliminate the tax-evading shadow economy. See *Press*

avoidance permitted under the current tax regime. More specifically, the draft code lists twenty-four violations and their attendant penalties in layman's language.<sup>223</sup> Although these provisions may not sway the truly criminal element of the shadow economy, persons involved merely in questionable transactions may be deterred by the weighty penalties which may be incurred. Tax evasion, defined as those "actions . . . which are deliberately aimed at avoiding tax control," carries a sanction of up to three times the amount of tax due.<sup>224</sup> In addition, the authors of the draft code envisioned that its provisions would apply to all types of income, including income obtained through illegal activities.<sup>225</sup> With fewer examples of tax avoidance behavior, Russian taxpayers may be more inclined to file their tax declarations and pay their tax obligations.

Third, the draft code indirectly addresses the problem of corruption among the tax authorities, a factor which contributes to poor tax collection. For example, one code provision charges the tax police with the task of "preventing, detecting and suppressing corruption and other criminal offenses in tax bodies."<sup>226</sup> In addition, Article 293 makes it a crime, resulting in a fine of fifty times the monthly minimum wage, for a taxpayer to "unlawfully influence" a tax official.<sup>227</sup> The new transparent and comprehensive provisions of the draft code may discourage taxpayers from engaging in questionable transactions with tax inspectors regarding the amount of tax owed and convince taxpayers that the system is fair enough to warrant compliance.

Finally, although the culture of non-payment is strongly rooted among Russian citizens,<sup>228</sup> the fact that the draft code contains numerous provisions outlining tax violations may change the widespread perception that tax evasion is not a crime.<sup>229</sup> In addition to twenty-four express types of tax violations with corresponding

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*Conference Regarding the "Shadow Economy" in Russia*, *supra* note 164.

223. *Draft Russian Tax Code Part II*, *supra* note 205, arts. 269-293.

224. *Id.* art. 283.

225. See *First Deputy Premier Nemtsov Says Tax Evasion is a Grave Crime* (BBC Summary of World Broadcasts, June 18, 1997), available in LEXIS, News Library, Bbcswb File.

226. *Draft Russian Tax Code Part II*, *supra* note 205, art. 221, para. 5.

227. *Id.* art. 293. However, whether the tax police will enforce the above provisions remains uncertain given the pervasiveness of crime within Russia.

228. See *supra* text accompanying notes 136-138.

229. See *supra* note 139 and accompanying text.

penalties,<sup>230</sup> the general provisions regarding standards of liability for, and possible defenses to, tax violations<sup>231</sup> should give taxpayers the clear impression that tax evasion bears dire consequences.

On the other hand, the negative perception of the Russian government among taxpayers is not a phenomenon that can be easily changed with the passage of more comprehensive and comprehensible tax legislation. Nevertheless, the tax code, with its provisions against favoritism of the wealthy and politically-connected, may help restore the citizens' faith in their government, and lead to increased compliance with the tax laws.

3. *Does the Draft Tax Code Address the Specific Methods of Tax Avoidance Used by Russian Citizens?* The draft tax code appears to address the use of several of the methods of tax avoidance, such as interest-free loans, stock-for-salary schemes, and insurance-for-salary arrangements. For example, two provisions of the draft code attempt to curb the use of interest-free loans as substitute wage payments. First, the interest earned on these deposits will be fully-taxable. If the interest rate on the loan is less than or equal to the refinance rate of the Russian Federation Central Bank, then the earned interest is taxed at 12%; if the interest rate on the loan is more than the refinance rate, then the earned interest is taxed at 30%.<sup>232</sup> Second, in order to ensure that banks cooperate with the taxation of interest,<sup>233</sup> the draft code requires banks to report the opening or closing of a taxpayer's account to the tax authorities using the taxpayer's identification number,<sup>234</sup> as well as to supply the tax authorities with information about financial and other operations of a taxpayer who is the subject of a tax examination.<sup>235</sup> If a bank fails to report the opening or closing of a taxpayer's account, it may incur a penalty of 300 times the minimum monthly wage.<sup>236</sup> This provision makes large-

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230. See *Draft Russian Tax Code Part II*, *supra* note 205, arts. 269-93. See, e.g., *id.* art. 269 (stating that a violation of the registration requirement carries a monetary penalty of 100 times the minimum monthly wage); *id.* art. 275 (stating that evasion of the obligation to file a tax declaration carries a monetary penalty of 50% of the amount of tax due if overdue by 180 days or less and 100% of the amount of tax due if overdue up to one year).

231. See *id.* arts. 251-265.

232. See *Press Briefing by Deputy Finance Minister Sergei Shatalov*, *supra* note 108.

233. The taxation of interest has been a thorny issue in the past due to the strong protest of banks against the institution of such a practice. See *supra* note 112 and accompanying text.

234. See *Draft Russian Tax Code Part II*, *supra* note 205, art. 204.

235. See *id.* art. 204, para. 2.

236. See *id.* art. 284.

scale non-compliance extremely costly. Bank cooperation is essential to the taxation of interest on personal savings accounts since the tax authorities must rely on bank records to determine which taxpayers possess accounts accruing interest which may be subject to taxation.

The draft code also taxes the gains realized from the sale of stock, thereby rendering ineffective the use of stock options as substitute wage payments. An employee who exercises his stock options and immediately resells the stock at a significantly higher price to his employer will be taxed on the difference between the sale price and the purchase price of such stock.<sup>237</sup> Because the employee typically pays a minimal amount for the options and receives a much larger sum from the stock sale, typically the equivalent of his salary, the use of this tax-avoidance scheme probably will be curtailed. Likewise, the draft code clearly discourages the use of insurance payments in lieu of salary by taxing the employee on both the insurance premium paid by his employer and the actual insurance payment received if such payment exceeds the insurance premium by a specified amount.<sup>238</sup> In short, the draft code contains provisions which undermine the interest-free loan, stock-for-salary and insurance-for salary schemes as methods of tax avoidance.

Several aspects of the draft code also may prevent the use of other avoidance practices such as the non-reporting of income,<sup>239</sup> cash services payroll tax evasion, and capital flight. First, the more transparent, comprehensible tax system<sup>240</sup> will permit the average Russian taxpayer to determine when, where, and how to pay his taxes and thus cause him to be less inclined to engage in not reporting income or sending income abroad.

Second, the draft code sets forth strong, clearly-defined penalties for non-compliance, but simultaneously protects against the arbitrary use of such penalties. As previously discussed, the draft code delineates twenty-four different tax crimes with corresponding

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237. See *Draft Russian Tax Code Part I*, *supra* note 193, art. 101, para. 7; art. 103, para. 6(b).

238. See *Draft of Personal Income Tax Provisions*, *supra* note 171, art. 608, para. 6.

239. The draft tax code directly taxes both monetary wages and income received in-kind. See *id.* art. 607, para. 1 (stating that “[t]he object of taxation shall be income earned by a taxpayer in a tax period from sources in the Russian Federation and/or outside its borders”), *id.* art. 608, para. 1 (stating that “[i]n-kind income earned by a taxpayer in the form of goods (work, services) shall be counted toward the taxpayer’s income at the value of these goods (work, services) on the day such income is received . . .”).

240. See *supra* notes 191-208 and accompanying text.

penalties. Under these provisions, the non-reporting of income, the use of cash services payroll tax evasion, and the transport of capital abroad may all be characterized as the failure to file a tax declaration<sup>241</sup> and/or tax evasion.<sup>242</sup> Given that the failure to file a tax declaration carries penalties ranging from 5% to 100% of tax due,<sup>243</sup> and tax evasion results in a fine of up to three times the amount of tax due,<sup>244</sup> the new provisions serve as a strong deterrent against non-compliance for those Russian citizens whose financial situations are already precarious.

At the same time, the draft code deters the use of arbitrary enforcement mechanisms and sanctions. For example, the draft code provides the taxpayer with judicial recourse when he believes that his tax burden has been unfairly assessed,<sup>245</sup> or that he has been incorrectly accused of violating the tax laws.<sup>246</sup> The code also contains a comprehensive list of circumstances which absolve the taxpayer from liability<sup>247</sup> or "alleviate" his responsibility for the tax violation.<sup>248</sup> For example, an individual who negligently breaches a tax code provision can be relieved of liability by informing the tax authorities of the transgression,<sup>249</sup> while an individual who commits a tax violation due to grave personal or family circumstances most likely will face a lesser sanction.<sup>250</sup> Thus, because these safeguards provide Russian citizens with the assurance that they will not be prosecuted unfairly or for inadvertent errors when attempting to comply with the tax laws, these citizens may be more likely to comply voluntarily with the new tax system and less likely to use avoidance practices such as the non-reporting of income and the sending of capital abroad.

Finally, the draft code furnishes the tax authorities with wide latitude to investigate taxpayers while preventing the arbitrary use of

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241. See *Russian Draft Tax Code Part II*, *supra* note 205, arts. 274-75.

242. See *id.* art. 283.

243. See *id.* arts. 274-75.

244. See *id.* art. 283.

245. See *Draft Russian Tax Code Part II*, *supra* note 205, arts. 172, 236-38, 243-47; see also *supra* notes 209-211 and accompanying text.

246. See *id.* art. 327 (listing rights of the individual charged with a tax violation); *id.* arts. 404-10 (establishing the right of appeal against the decision of the tax authority in the tax violation case).

247. See *id.* art. 256.

248. See *id.* art. 257.

249. See *id.* art. 256, para. 3, art. 259, para. 2.

250. See *id.* art. 257, para. 1.

this prerogative.<sup>251</sup> For example, in connection with a tax inspection, the tax authorities can enjoy unfettered access to the taxpayer's business premises,<sup>252</sup> question any persons possessing relevant information about the taxpayer,<sup>253</sup> and obtain all records regarding bank accounts maintained in the taxpayer's name.<sup>254</sup> However, tax inspectors are not allowed free access into a taxpayer's residence,<sup>255</sup> and will be subject to criminal proceedings if information gained from a tax inspection which has been classified as a tax secret is publicly disclosed.<sup>256</sup> In addition, tax service personnel are responsible for any damage caused to a taxpayer or his property which results from improper action taken during a tax inspection,<sup>257</sup> or caused by other official conduct.<sup>258</sup> Again, the combination of "carrot and stick" policies in the enforcement area may motivate the taxpayer to comply voluntarily with an apparently more objective and fair system of taxation.

## VI. CONCLUSION

In general, the draft code may eliminate several of the tax avoidance methods that Russian citizens currently exploit. Although the draft code likely will improve tax collection in Russia, several aspects of implementing the code may be problematic. For example, the actual enactment of the draft code probably will be a lengthy process. Russia's Deputy Finance Minister has publicly stated that tax reform will not occur until the year 1999,<sup>259</sup> and even the head of Russia's State Tax Service, Alexander Pochinok, admits that a new

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251. In general, tax authorities have the right to verify information regarding income which has been included on a tax return. See *Draft of Personal Income Tax Provisions*, *supra* note 171, art. 633.

252. See *Draft Russian Tax Code Part II*, *supra* note 205, art. 205, para. 3; see generally *id.* art. 226 (rights of tax authorities).

253. See *id.* art. 205, para. 3; see generally *id.* art. 226 (rights of tax authorities).

254. See *id.* art. 204; see generally *id.* art. 226 (rights of tax authorities). Unrelated to the tax code but equally important to the exercise of tax inspections is the fact that the State Tax Service should be receiving the largest portion of the 1997 budget among the civilian ministries. See Peter Rutland, *State Tax Service Ranks as Best Funded Agency Among Civilian Ministries*, 14 TAX NOTES INT'L 1130, 1130 (1997).

255. See *Draft Russian Tax Code Part II*, *supra* note 205, art. 208, para. 3.

256. See *id.* art. 210.

257. See *id.* art. 211.

258. See *id.* art. 228.

259. See *Tax Reforms to be Carried Out in Russia Not Earlier Than 1999*, ITAR-TASS, Jan. 8, 1998, translated and available in LEXIS, News Library, Tass File.

tax system will be established in July 1998 at the earliest.<sup>260</sup>

The current draft will cost the Russian government approximately 73 trillion rubles (\$12.7 billion) per year in lost tax revenues due to an overall decrease in the tax burden across all levels.<sup>261</sup> However, tax officials hope that a 20% increase in tax collection<sup>262</sup> and the elimination of tax loopholes, which presently cost the Russian government 170 trillion rubles per year in revenue,<sup>263</sup> will offset this loss. Furthermore, the draft code lacks transitional rules to help guide taxpayers and tax inspectors through the potentially-turbulent changeover from the old regime to the new.<sup>264</sup>

Most importantly, although the draft tax code represents an important step in the right direction, the draft fails to solve, and perhaps should not be expected to solve, a fundamental characteristic of Russian society which hinders tax collection. Namely, Russian citizens are unaccustomed to voluntarily paying tax and are likely to continue to avoiding payment until they receive concrete benefits

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260. See *Press Conference with State Tax Service Head Alexander Pochinok* (Official Kremlin International News Broadcast, Nov. 11, 1997), translated and available in LEXIS, News Library, Curnws File. In the interim, the Ministry of Finance has submitted a package of eleven tax bills to the Duma as a temporary replacement for the draft tax code. See Christian Lowe, *State Duma Puts Off Draft Budget Debate*, MOSCOW TIMES, Nov. 14, 1997, available in LEXIS, News Library, Mostms File. The Duma has recently approved one of the eleven bills—this bill would reduce the income tax imposed on Russian citizens: the lowest tax bracket (12%) would cover annual income up to 20 million rubles (opposed to the current level of 12 million rubles) and the highest tax bracket (35%) would cover annual incomes over 100 million rubles (opposed to the current level of 48 million rubles). See Boris Aliabyev, *Duma Proposes Tax, Excise Increases*, MOSCOW TIMES, Dec. 20, 1997, available in LEXIS, News Library, Mostms File.

261. See *Interview with Deputy Finance Minister Sergei Shatalov* (Official Kremlin International News Broadcast, June 16, 1997), translated and available in LEXIS, News Library, Curnws File.

262. See *Press Briefing by Deputy Finance Minister Sergei Shatalov*, *supra* note 108.

263. See Stephanie Baker-Said, *Little Leeway in Tax Code, Author Says*, MOSCOW TIMES, May 23, 1997, available in LEXIS, News Library, Mostms File.

264. See Belinski, *supra* note 169. However, Alexander Pochinok, head of the State Tax Service, has made public assurances that the State Tax Service will prepare supplementary materials such as instructions and other aids to help familiarize the public with the draft code once it is formally adopted. See *Press Conference with State Tax Service Head Alexander Pochinok*, *supra* note 20.

from doing so. Thus, until Russians experience an increase in their standard of living which can be easily attributed to tax collection, the culture of non-payment will not dissipate and full compliance with any future tax regime cannot be expected.

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