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Tax Accounting in the Russian Federation

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Abstract

The paper describes tax accounting in the Russian Federation, its system, rules and connection with financial accounting. Then, using of IFRS related to costs is shown. The article contains information on interaction with tax authorities in Russia and real juridical proceedings. Next, international tax optimization with using of offshores is analyzed as a part of tax accounting.

1. Introduction

The aim of this article is to describe the system of tax accounting and international tax optimization in the Russian Federation. The mentioned theme is of great current interest. The reason is that nobody doubts in usefulness and necessity of financial and managerial accounting, whereas the rules of tax accounting and its importance varies in different states because of their laws.

Basically, financial accounting shares financial information with the external users especially (creditors, employees, business partners and other entities that do not belong to the company but are interested in possible future benefits and future risks). This type of accounting is regulated by state and international rules. Managerial accounting is normally used by the managers of the company for internal control and is not regulated from outside. The purpose of tax accounting is to describe business process in such way that income tax base (or, respectively, other taxes and assimilated debts and liabilities of the firm) can be properly evaluated (Král et al., 2012, p. 20). The main user of tax accounting reports is the state itself. Tax standards, laws and meaning of tax accounting distinguish

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significantly in different countries. For example, income tax base is evaluated in a tax declaration in the Czech Republic and may use data that are not registered in financial accounting (Sedlác̆ek et al., 2005, p. 252). Alternatively, in Russia, this problem is not so easy and requires using of tax accounting, which is described in this paper. The paper is organized as follows: Chapter 2 and Chapter 3 get the reader acquainted with the Russian financial and tax accounting system and its differences from IFRS. Chapters 4 to 6 describe the legal basis of tax regulation in Russia and illustrate it with real cases. In Chapter 7, the author offers to the taxpayers a possible strategy of interaction with the tax authorities. Chapter 8 is devoted to schemes of tax optimization in Russia including offshore strategies. Finally, Chapter 9 is a conclusion that sums up all the points mentioned in the paper.

2. Disclosure of tax accounting in Russia

Income tax (so-called tax on corporate profits) is much more complicated in the Russian Federation than in the Czech Republic. Firstly, a special kind of accounting – tax accounting exists for calculation of this tax. Russian companies have to keep tax records permanently.

Income tax is calculated at the end of the tax period to prepare the tax returns under the Czech law. According to the Russian system, each operation is recorded in both financial and tax accounting during the period. Mostly, these records are similar, but there is a mismatching when the same event is evaluated differently by tax and financial accounting rules. In this case, financial accounting will keep a real amount of the transaction, because this type of accounting must provide to its users complete and truthful information about the assets and liabilities state. In tax accounting, a maximum allowed amount will be recorded, or zero (for example, if an expense is not tax deductible), or an amount determined in accordance with the tax rules. The difference between these two types of accounting has to be recorded in the financial accounting so that tax revenue calculation would be possible in financial accounting as well. So, the amount of the record can be found by multiplying this difference and income tax rate.

There are permanent differences that appear due to non-deduction or limitation of certain costs and revenues under the tax rules, and temporary differences arising from different depreciation methods, different useful life of assets, different methods of inventory valuation, etc.

All these situations are strictly regulated by Russian accounting standard No. 18/02 (hereinafter RAS 18/02), "Income Tax Accounting", and the Chart of accounts. Thus, accounts 68 "Income tax", 99 "Profits and losses", 09 "Deferred tax assets", 77 "Deferred tax liabilities" are used for the above-mentioned operations. Permanent differences lead to permanent tax assets (Debit 68 Credit 99 - tax reducing, profit increasing) or permanent tax liabilities (Debit 99 Credit 68 - tax increasing, profit reducing). Deferred tax assets (Debit 09 Credit 68 - tax increasing in current period, but decreasing in later periods) and deferred tax liabilities (Debit 68 Credit 77 - on the contrary, tax reduction in current period, but increasing in later periods) arise due to temporary differences (RAS 18/02, 2002). In Russia, accounting and tax period on profit tax are the same, one calendar year (Russian Tax Code, 2013).

To illustrate this situation, I will give my own example.

The advertising expenses in Russian financial accounting are recorded in the full amount, but tax deductible is maximum 1 % of the revenues of the period. If these costs do not exceed the limit, entries in financial and tax accounting are the same. Now imagine that the limit was exceeded. Suppose that ABC Company, Ltd, has net revenues 100,000 rubles at the end of the tax period. Advertising costs are 5,000 rubles. In tax accounting we show maximum allowed amount = 100,000 * 1 % = 1,000 rubles. In financial accounting, we record the real amount of the transaction 5,000 rubles, and then permanent tax liability = (5,000 – 1,000) * 20 % = 800 rubles. This means that ABC Ltd. must pay extra 800 rubles of income tax.

At the end of the year, tax declaration is filled in with tax accounting data, and profit and loss statement with financial accounting data. Fill in a tax return is rather simple: it consists of all revenues and expenses recorded in tax accounting in this season. Their remainder is profit or loss. Profit tax in the tax return is calculated as follows: Tax profit * Income tax rate. It is also possible to calculate the tax payable according to financial accounting data, but it is much more complicated. We use account 68 "Income tax" for it. This account, as we have seen, includes all the differences between tax and financial accounting. Certainly, the amount of tax payable of the same period must be the same in both cases.
3. Russian accounting and IFRS

The Russian system of cost accounting has some differences from IFRS. Since 2011 (the Russian Federation Government Resolution of 25. 02. 2011 No. 107) IFRS are applied in Russia, but do not deny Russian accounting system. IFRS in Russia are primarily used by large multinational or consolidated companies.


Under IFRS, recognition of costs is based on a direct comparison between costs and related incomes. For example, different cost components that make costs of sale are deductible at the same time as sale revenues.

An important difference is that the IFRS operations may not be documented. For example, annual bonuses are usually approved in the next year. In Russia, costs are recognized after charging: bonuses for 2014 will be deductible in 2015.

According to IFRS, an accountant has to estimate an approximate amount of potential bonuses (e.g. based on experience) and record this amount in 2014 (estimated value). After calculation and payment (in 2015), the difference between the actual amount and estimated value has influence on profits and losses in 2015. However, the difference is usually very small.

Ministry of Finance of the Russian Federation decided that business could use a method of comparing values of assets and liabilities to their tax base in accordance with IAS 12 "Income Taxes" since 2012. According to paragraph 3 of RAS 18/02, calculation of income tax is made by comparing financial accounting and tax costs and revenues. Under IFRS, deferred taxes are calculated with balance method: a value of an asset or liability is compared to its tax base (paragraph 5 of IAS 12). This method allows ignoring concept of permanent differences completely, because they are connected with current period only. Permanent differences lead only to further tax expenses for the period. Therefore, IFRS income tax payable operates with deferred tax assets and liabilities only.

4. Problems of legal tax regulation in Russia

As we can see, the mechanism of calculating the income tax in Russia is not easy. It depends on tax expenses recognition. The relevant provisions of Chapter 25 "Corporate Income Tax" of Russian Tax Code are sufficiently blurred and are not specified often, so in addition to laws the Ministry of Finance (MF RF) and the Federal Tax Service (hereinafter FTS) issue many letters annually. MF letters in Russia are similar to MF guidelines in the Czech Republic. They are the official opinions on specific minor situations whose solutions are not listed in the law. These letters are often decisive arguments in the legal proceedings, but they are not obligatory. Therefore, controversial issues are often addressed to the courts, where the taxpayers won a significant number of cases several years ago, but now this share is declining. This is illustrated by Table 1 that I have filled in with FTS data from 2013 and 2014.

<table>
<thead>
<tr>
<th>Year</th>
<th>Taxpayers' victories, % of all cases</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008</td>
<td>57 %</td>
</tr>
<tr>
<td>2009</td>
<td>56 %</td>
</tr>
<tr>
<td>2010</td>
<td>59 %</td>
</tr>
<tr>
<td>2011</td>
<td>37 %</td>
</tr>
<tr>
<td>2012</td>
<td>34 %</td>
</tr>
<tr>
<td>2013</td>
<td>26 %</td>
</tr>
</tbody>
</table>


Significant decrease in 2011 can be explained by the fact that FTS issued an order No. MMB-7-7/147@ on 09.02.2011, according to which tax inspectors can sue a company only if FTS has already won several similar cases.
(FTS, 2011). This means that Russian reality requires from managers not only good knowledge of accounting and tax regulations, but also cooperation with lawyers.

Russian Tax Code contains two main requirements for recognition of expenses: documentary confirmation and economic feasibility. The second criterion usually causes the most disputes. For example, should tax expense be deducted if the company did not receive any revenues from it (for example, searching for new employees if nobody reacted to this advertisement)? Almost all such cases in Russia are solved at court. Courts take taxpayers’ side often if the services were actually provided and paid and taxpayers had business reasons (see decisions of the Federal Commercial Court of the Moscow District on 13.03.2009 No. KA-A40/1354-09 and on 09.11.2007 No. KA-A40/10001-07).

5. Illustrative examples of tax judicial contests in the Russian Federation

Tax authorities often refuse to recognize costs if they seem to be economically unreasonable. In addition, some tax authorities suppose that a company cannot recognize costs if it had no income (or incomes were less than costs) during a particular tax period because the authorities classify these costs as costs not aimed at generating income.

However, that point of view is not correct, because Russian Tax Code does not fix a dependence between costs recognition and income receiving (MF RF letters on 08.12.2006 No. 03-03-04/1/821 and on 21.05.2010 No. 03-03-06/1/341).

The law confirms that a taxpayer’s expenses should be related to the matter of their business and not just to a profit in a certain period. Getting loses is not illegal; costs must be focused on generating revenues, but there is no company which knows for sure what and how it should to get profit. Courts add that the tax authorities are required only to monitor law compliance in accordance to Articles 30 to 33 of Russian Tax Code, but not to value their activities from their personal point of view. Anyone can make a mistake (see decisions of Federal Commercial Court of the Central District on 09.02.2010 No. A14-14803/2008/500/24, Federal Commercial Court of the North Caucasus District on 02.03.2010 No. A32-26302/2008-63/376, Federal Commercial Court of the Moscow District on 19.01.2009 No. KA-A40/12832-08, etc.).

Decision of the Constitutional Court of the Russian Federation on 04.06.2007 No. 320-O-ɉɭɪɢɧɚ says, "The reasonableness of costs must be analyzed under circumstances that give evidence of taxpayer’s intentions to receive economic benefit from a real business."

Tax deductible expenses breaking the law cannot be recognized.

An example is an advertisement considered as inappropriate and banned by anti-monopoly authorities.

The court may take a taxpayer’s side in other cases, too. Thus, a coal-mining firm repaired a public roadway from its own resources. The Court rejected the tax authorities’ argument that the company does not own the road, and decided that the costs had been economically reasonable because the company’s operations would be impossible without the road repairing (see decision of Federal Commercial Court of the Far East District on 06.02.2009 No. Ф03-6187/2008).

However, disputes arise not only about the economic reasons of costs. Business trips, bonuses, employees’ mobile communication, website creation, marketing, hospitality and many other costs may become a serious problem.

These algorithms were described and studied in detail in my previous papers (Пурна, 2012).

6. The T., Ltd. case

One interesting case occurred in a T., Ltd. company. A significant proportion of the firm’s employees work on rotation system drilling oil and gas wells, so they have to be accommodated near the well for a few weeks. Under the Labour Code, an employer is obliged to provide to its employees accommodation, food, transportation (RF Labor Code, 2014). However, recognition of these costs for tax purposes can become a problem. For example, information on transport and catering must be specified in employment contracts. The costs on personnel camps (their construction, repairment, fees, meal, medical examinations of employees, etc.) are recognized only within the limits set by local authorities (Russian Tax Code, article 264, paragraph 1, sub-paragraph 32).
In Tomsk region, which is one of the largest oil and gas suppliers in Russia, these limits were not established, although it is strange. Therefore, tax authorities refused recognize these costs. However, T., Ltd. has won a case (see decision of Federal Commercial Court of the West Siberia District on 13.06.2007. No. Φ04-3836/2007(35158-A67-26)). After a series of similar cases MF RF published a letter on 10.09.2010 No. 03-03-06/1/583, which permitted full recognition of these costs in case of absence of the standards.

7. Interaction with the tax authorities

It is clear that such problems require a special algorithm for interacting with the tax authorities. The main points of this procedure are also briefly presented here.

First, you need to understand that the tax inspections’ mechanisms might sometimes be used to influence on "inconvenient" business. Therefore, accountants and lawyers should carefully check whether requirements of inspectors are objective. If they find out that a tax inspection in fact violates the law they must inform the police.

What should we do if tax inspection does not intent to commit a crime? It is necessary to try to resolve the case by inquest firstly. To appeal the tax authority’s decision, we should contact the higher tax office. The new decision will be issued within 30 days. If the taxpayer is not satisfied with it, he has a right to file a claim to the court.

The risks and results of the process need to be assessed carefully. If a rule is clearly stated in the legislation, chances to appeal against it are extremely small.

The company's interests should be defended by qualified lawyers.

We also have to examine judicial practice. As I have mentioned, according to the order of FTS RF on 09.02.2011 No. MMV-7-7/147/1 tax authorities cannot take legal action if the tax inspection has not often won such cases.

8. Assumptions and schemes of tax optimization in Russia

Russia has increased fiscal control recently. In 2013, bank secrecy was canceled – now tax authorities or police can easily get information about the accounts of natural or juridical persons. Some information can be given only with court order, but existence and state of accounts is not a secret any more (Federal Law of the Russian Federation on 28.06.2013 No. 134-ФЗ).

It is clear that such pressure can cause a desire to escape from this control only, to reduce the amount of tax payable to the budget. However, words "tax optimization", "tax planning" used in a company’s documents are reasons for strict fiscal control. Possibilities for legal tax reducing in the same country are decreasing each year. That is why popularity of offshores grows. International tax planning (location of revenues and income at territories where taxes are low or do not exist) is widespread. There are many schemes allowing firms to reduce their costs with different levels of legality.

For example, Russian legal system allows companies to get rid of taxes. The entire legal basis (Roche & Duffau, 2013) is fixed in the Tax Code. Captive companies that insure risks of a limited number of people, mostly their owners, are used in the scheme. Russian firm owns an offshore insurance company and concludes a re-insurance contract with it. If an insurance event does not happen, the Russian company gets its tax-free profit share as a founder of the insurance company. Insurance premiums are tax deductible. Consequently, the total tax burden reduces. If an insurance event comes, insurer will pay a necessary amount. This is not a fraud, but a real insurance.

The Tax Code contains all the basics of this scheme: insurance premiums to foreign re-insurers are recognized as tax expense (article 294, paragraph 2, subparagraph 3), revenues are not considered as income from sources within the Russian Federation (article 309, paragraph 2) and they are not taxed with VAT (article 149, paragraph 3, subparagraph 7).

Judicial practice under this scheme is in favor of prompt taxpayers (if they met all the necessary conditions, signed contracts, etc.). For example, decision of Federal Commercial Court of the Moscow District on 25.04.2007 No. KA-A40/1889-07.

Certainly, legal using of offshore mechanisms should be considered as normal efforts to reduce costs. But when it comes to national security and socially responsible businesses, it is a different thing. Many Russian airports belong to offshore companies; see Table 2, made by me based on Russian mass media.
Table 2. Offshore shareholders of Russian airports

<table>
<thead>
<tr>
<th>Airport</th>
<th>Offshore owner</th>
<th>Owner's share, %</th>
<th>Source</th>
</tr>
</thead>
<tbody>
<tr>
<td>Vnukovo (Moscow)</td>
<td>Corwell Finance Limited (British Virgin Islands)</td>
<td>58.44 % (indirectly)</td>
<td>ITAR-TASS, 2013</td>
</tr>
<tr>
<td>Domodedovo (Moscow)</td>
<td>Five unnamed offshore firms</td>
<td>88 %</td>
<td>Соболь, 2013</td>
</tr>
<tr>
<td>Rostov-na-Donu Airport</td>
<td>Unnamed Cypriot firms</td>
<td>100 %</td>
<td>Иванов, 2013</td>
</tr>
</tbody>
</table>


More detailed information about offshores in Russian economy can be found at my other papers (Purina, 2013; Purina, 2014).

9. Conclusions

Role and importance of tax accounting differ greatly depending on the laws of every state. As an example of a country where this type of accounting is very important and necessary, I have described the Russian Federation. The essential difference from the Czech system is that in Russia, tax and financial accounting exist in parallel, and the tax base can be calculated by data generated in both types of accounting. Unlike IFRS, Russian accounting policies include the concept of permanent differences and allow using of IFRS only within certain limits.

Another problem is vagueness of Russian legal system, especially in matters relating to the tax expenses recognition, which raises a number of judicial proceedings between taxpayers and tax authorities annually. That is why every qualified Russian accounting must be a lawyer also in order to predict legal consequences of his decisions.

Legislative pressure is a natural cause of companies' efforts to reduce tax costs. Offshore companies offer a wide range of possibilities. As I have said, there are legal schemes allowing avoiding taxes. Nevertheless, offshore schemes are not risk-free, as recent crisis in Cyprus demonstrated. This crisis has shown once again that international tax laws have some gaps related to unregulated offshores. Conflict of interests of governments and business should be settled as quickly as possible, but there is no solution that would suit all parts. It is clearly impacted by corruption and lobbying, but some offshore zones can be a tool to stimulate enterprises to optimize their taxes legally and to release resources for investment.

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