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A COMPARATIVE STUDY OF TAXATION IN FOREIGN COUNTRIES AND THE REFORM OF THE RUSSIAN TAX SYSTEM

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In our opinion, one of the reasons for the current crisis situation in the Russian economy is too high a share of taxes (including all compulsory, non-equivalent and regular components, paid by private individuals and corporations for the benefit of state financial institutions) in the value added. Such a high share impedes enterprises to reinvest profits, narrows the tax base and induces a decrease in fiscal revenues. Thus, the taxation system under construction in Russia must not set the fiscal liabilities of enterprises heavier than under the tax systems of industrial countries. Consequently, it becomes necessary to compare various national tax systems, both from theoretical and practical points of view; the question of optimal tax rates remains one of the most debatable in determining the directions of the tax reform. For the creation of an optimal tax system, we consider it necessary to analyse the interrelationships between its elements and to create the methodological tools for the evaluation of a total tax burden on taxpayers.

For the measurement of tax burden, we introduce the concept of *effective tax rate* as the ratio of the total value of taxes and compulsory payments (paid by the enterprise, employees and shareholders, i.e. the consolidated taxpayer) to the value added generated by the enterprise during production of goods and services. As defined, the effective tax rate (ETR) shows the breakdown of the total value added, its various components siphoned off to the state, to local budgets and to extra-budgetary state funds.

The static model for the evaluation of the effective tax rate at the enterprise level is based on the following assumptions: absence of tax privileges and of infringements on taxes and payments, of surtaxes and payments on specific kinds of activities and goods such as excises and surtaxes on sales, of VAT at increased rates; absence of foreign trade activities; distribution of all profits as dividends; absence of incomes other than the proceeds from the realisation of production and of costs not connected with production and the sale of products; absence of debts; a uniform distribution of earnings between employees; tax exemption for individuals who do not derive incomes from employment or from

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business assets; annual assessment of tax liabilities (therefore, payments in advance and withheld taxes which are creditable against final tax are not taken into account). In other words, we consider the taxation of a manufacturing enterprise producing for the domestic market.

In the analysis of the effective tax rate, the revenues from production accrue, in the absence of a VAT, to the following factors: depreciation, wages, taxes, rent payments, profits, and material costs.

The calculation of taxes is made pursuant to the tax legislation of various countries. The calculations are carried out on the basis of the actual working parameters of a Russian enterprise from light industry for 1994. This Russian enterprise is 'immersed into the tax environment' of other countries.

In many countries, there are participation exemptions (affiliation privileges) for substantial shareholders, which influence the effective tax rate. Therefore we assessed ETR in two versions: one with this privilege taken into account and another without it. However, for a more precise evaluation of ETR in foreign countries, we did take into account the average annual wage in the manufacturing sector for each country in 1993.

The results of ETR calculations and of the factor analysis are given in the table. The lowest ETR appears to be in effect in Hong Kong at 22.5%. In other countries, ETRs are above 31%. Low ETRs are in Singapore and Switzerland. The moderate ETRs are in the UK, Spain, and Norway whereas all other countries exhibit relatively high ETRs, namely in Italy, Belgium, Germany and Poland (above 50%). The non-weighted average ETR for Western Europe is equal to 46.4%. These figures are 3.5% below those in version 2 (without the participation exemptions). For countries with a classical tax system, this difference appears in 9 to 12 items; for countries with an imputation system, it is for 0 to 8 items, i.e. the affiliation privilege permits to reduce the ETR considerably for substantial investors.

The highest ETR has appeared in Russia (1994) at 58.9% (at the rate of the profit tax of 35% for version 1) and 60.3% (at the rate of the profit tax of 38%), i.e. more than 12 items above the average level for Western Europe. The reduction, in 1995, of the rate of the special tax on value-added from 3 to 1.5% has lowered the ETR only to 58.4%, hardly a noticeable change. In 1996–1997, after the abolition of the special tax and of the tax on the wage fund, the permitted norm for ETR is 54.2%, i.e. 4.2 items lower.

At the level of the whole economy, the concept of value-added corresponds approximately to GDP. A comparison of these indicators (see table) shows that the calculated values of ETR in its two versions for the majority of countries deviate from the ratio of tax receipts to GDP at the level of 1 to10 items (5 items higher on average). Therefore, the suggested model of ETR intended to apply to a majority of countries appeared to be a good approximation to reality; yet the tax privileges accorded to some taxpayers are partially compensated by surtaxes for other taxpayers and, hence, the rates of taxes payable remained rather high. An opposite situation is, however, observed in Russia: the computed values of

ETR are 21 to 29 items (about 1.8 times) higher than the ratio of tax revenue to GDP. Hence, *taxes collected in Russia remains low at about 60% of the amount payable.*

Factor analysis allows the identification of the components of the value-added which are taxed to a lesser extent and of those taxed independently of the value-added structure. Amongst other factors, depreciation is the least taxed, at about 0 to 20% (more often around 16% and, in Russia, at 20.2%). The ETR on 'wages' is usually about the same as on dividends and a little higher than the integrated ETR. The lowest taxation of wages is in Switzerland (17.9%) and in Hong Kong (26.1%). Low tax burdens on wages (30–37%) appear to exist in the USA, the UK and Singapore whereas the average burden (40–47%) in the Netherlands, Spain, Luxembourg, Ireland, Portugal, Norway, Greece and Iceland. Very high burdens on wages are in Italy, Belgium, Sweden, Austria and Russia (at more than 55%). In Russia, the ETR is 12 items above the average European rate and, hence, represents too high a total charge on wages (see table) and the ETR on the factor 'dividends paid to corporate shareholders', as a rule, is higher than 40%. The lowest tax burden on dividends is in Hong Kong (17.5%) and the highest are in Germany (61.9%), Poland (60.7%) and in Russia (55.9%). The non-weighted European average ETR on dividends at 46.7% (see table) appears to be 9 items lower than in Russia.

Thus, the general burden of taxes in Russia is estimated to be around 53–60% (i.e. 10 to15 items higher than in the majority of foreign countries sampled) and is considerably higher than 'a tax snare'. The degree of taxation of various factors (depreciation, wages and profit) is also higher in Russia than in these countries.

A comparison of changes in the ETRs for 17 Western European countries and the USA in 1991–1995 shows that the ETRs were reduced in 14 countries and increased in 4, but the magnitude of these changes is highly variable, as follows: very small changes at about 1 item (USA, UK, Spain, Germany and Netherlands); small increases at about 2.5 items (Norway, Belgium, Italy); small decreases at about 2.5 items (Luxembourg, Portugal, France); significant decreases with more than 3 items (Switzerland, Denmark, Finland, Sweden, Austria, Ireland and Greece, i.e. as a rule, countries with very high ETRs in 1991). Thus, the most common tendency is a small ETR decrease (Roughly 2 items) in the Western European countries. The Russian ETR in 1995 was 1.6 items higher than in 1991 and 4.5–5 items higher than in 1996.

A factor analysis of the changes shows that, in Western Europe as a rule, the ETR for 'depreciation' rose a little because of increasing VAT rates; while the ETR for 'wages' fell insignificantly, that for 'dividends' dropped significantly (1–12 items). A similar analysis for Russia revealed opposite tendencies for the period 1992–1996: the ETR for 'depreciation' fell slightly (1 item); that for 'wages' dropped significantly (12–13 items); and that for 'dividends' rose slightly (1 item).

TABLE 1
Effective tax rates in different countries in 1995, %

Country	Total tax revenue as percentage of GDP in 1993	Version of calculation: 1 with participation exemption	Version of calculation: 2 without participation exemption	Factor analysis of the effective tax rate for different elements of value added: Depreciation	Factor analysis of the effective tax rate for different elements of value added: Earnings	Factor analysis of the effective tax rate for different elements of value added: Dividend paid
Hong Kong 1993	–	22.8	22.8	0.0	26.1	17.5
Switzerland	33.2	30.2	42.8	6.1	17.9	40.0
Singapore 1993	–	31.9	31.9	0.0	35.3	27.0
UK	33.6	40.0	46.0	14.9	36.4	43.0
Spain	35.1	41.7	43.8	13.8	40.0	44.5
Norway	45.7	41.9	41.7	18.7	44.3	41.5
Denmark	49.9	44.8	56.0	20.0	53.2	47.2
Netherlands	48.0	44.9	58.8	14.9	52.9	44.7
Finland	45.7	45.2	45.2	18.0	52.9	38.5
Ireland	36.3	46.2	47.5	17.4	44.7	50.4
Sweden	49.9	46.3	57.5	20.0	59.2	42.4
*Europe**	*41.4*	*46.4*	*50.0*	*15.8*	*47.4*	*46.7*
Portugal	31.4	46.4	47.5	14.5	40.3	51.8
Austria	43.6	48.3	48.0	16.7	55.4	45.0
Luxembourg	44.6	47.5	50.2	13.0	37.9	48.6
Greece	41.2	48.0	44.8	15.3	47.1	44.9
Iceland	31.3	48.2	51.2	19.9	43.7	54.1
France	43.9	48.4	46.4	15.7	52.3	43.8
Italy	47.8	51.2	53.3	16.0	60.5	46.2
Belgium	45.7	53.3	61.9	17.0	64.2	51.3
USA	29.7	55.8	47.2	3.8	30.0	43.1
Germany	39.0	56.5	56.7	13.0	50.4	61.9
Poland	–	56.7	56.5	18.0	54.3	60.7
Russia 1994	29.8	58.9	58.9	21.1	59.8	56.4
Russia 1995	*28.0*	*58.4*	*58.4*	*20.2*	*59.3*	*55.9*
Russia 1996	–	54.2	54.2	20.0	49.6	55.8

* Unweighted average.
Source: Authors' own calculations.

Our comparative study thus shows that it is necessary to reduce the ETR in Russia down, at least, to the levels in the majority of foreign countries (i.e. 40–47%) in order to stimulate economic activity and, also, to harmonise the Russian tax system with other countries. Such a reduction can be achieved by an abolition of taxes on housing construction and on necessities, on contributions to the road fund (i.e. through VAT exemptions) and by imposing the following tax rates: VAT 15–16%, 25–30% on wages and profits. Moreover, in order to create a favourable atmosphere for the development of manufacturing in Russia, further reductions in each of these rates on 5–10% of goods and services thus appears to be necessary.