System of Indirect Taxation of Exports in Russia

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Researchers supplement the theoretical and methodological foundations of the transformation of the system of indirect taxation of exports in the Russian Federation based on the analysis of legal precedents.

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1. Methodology

In order to identify trends in Russia's foreign trade, we analyzed the volume, dynamics, geography, and structure of export and import shipments of goods. According to customs statistics, Russia's foreign trade turnover in 2020 amounted to US$568 bn. In 2020, it decreased by 34.3% compared to the last pre-crisis year (2013); 2020 exports were US$336 bn, a decrease of 35.8%, and 2020 imports were US$231 bn, a decrease of 37.0%.

Traditionally, Russian net exports are positive—despite a certain crisis in foreign trade and unfavorable market conditions for Russia's main exports (Zasko et al. 2021). Currently, Russian exports have fallen to the levels last seen after the imposition of economic sanctions against Russia in 2014. Most measures taken by the Russian government post-2014 aimed to overcome the negative developments in relations with key sovereign trade counterparties that initiated the above-mentioned economic restrictions. These measures led to some improvements, but a new challenge for the global economy as a whole, and for Russia in particular, was presented by the COVID-19 pandemic, which led to a slowdown in global trade and to significant changes (Bejger 2021; Korauš et al. 2021). Energy commodities, food commodities, medical products, etc. again enjoyed top demand worldwide. These changes favorably affected Russian exports, but the impact of economic sanctions should also be borne in mind, given that these sanctions tend to become stricter with time.

Analyzing the structure of Russian exports (Russian Export Analytics 2021) over the last three years, a pronounced shift is clearly visible in the diversification of Russian exports; in our opinion, these export levels are an indisputable indicator of the level of competitiveness of the Russian economy.

In particular, during 2020 the share of non-resource non-energy commodities increased by 10 percentage points compared to 2017.

In an environment of declining exports of Russian energy commodities, it became possible to increase the exports of finished goods and, just as important, high value-added commodities, which account for 48% of total non-resource non-energy exports (according to the classification of the Russian Export Center, non-resource high value-added products include finished goods that underwent extensive processing of raw materials: machine-building industry products, pharmaceutical products, household chemical products, garments, footwear, furniture, toys, printed materials, many food products (canned foods, confectionery and baked goods, cheese etc.); this category also includes a number of high-technology materials and semi-finished products, such as radioactive compounds and drug ingredients (Classification of Export Goods 2021).

Analysis and assessment of the above-mentioned statistical and analytical materials lead to the following conclusions: first, Russian exports are rapidly contracting—this necessitates radical changes in its structure; second, currently, exports of raw materials and finished goods in most cases are exempt from VAT, or there are various tax privileges for such exports; third, the Russian government's intention to stimulate growth of exports of high value-added products (using various privileges and exemptions) shall inevitably lead to abuse and irregularities.

Value-added tax is a key budget-forming tax: the share of VAT collections in the consolidated budget of the Russian Federation is ca. 20%, and the share of VAT in national GDP is 3–5%. VAT is also the most complicated tax in the Russian tax system in terms of its forecasting and administration.

Fundamentally, the tax basis for VAT calculation at the macrolevel is the volume of final consumption in the domestic market, less applicable privileges, and exemptions. For example, in international practice, the C-efficiency indicator is widely used; it is defined as the ratio of VAT collected and divided by the volume of final consumption obtained from the system of national accounts multiplied by the average tax rate—which, in its turn, is an indicator reflecting the quality of tax administration (Ueda 2017). According to this methodology, the C-efficiency indicator in Russia increases annually and currently is at ca. 0.3. The average level of this indicator for The Organisation for Economic Co-operation and Development (OECD) countries is 0.6. New Zealand has the world's highest C-efficiency ratio at ca. 1.0.

Such comparisons, however, are not always justified, because they do not take the legislative environment into account: the tax rates and privileges may differ significantly even between countries that have a comparable level of economic development. In addition, the domestic final consumption as a metric does not account for an important time factor—tax receipts that occur at different intermediate consumption stages involved in the creation of the final product's added value. Said final product is subsequently exported. It is important to note here that in Russia, the volume of export transactions is taxed at a 0% VAT rate and on the macrolevel, exports have a neutral impact on total VAT receipts, because in an ideal model of administration the VAT reimbursement claimed by exporters should be equal in value to the VAT payable accrued at the exporter's counterparty.

Similar to export transactions, import volumes also have no impact on total VAT receipts, since in a general case the importer pays "import" VAT to the customs authorities, which subsequently is deducted as input VAT on the importer's VAT return upon the subsequent onward sale of goods into the domestic market.

In recent years, VAT receipts show faster growth rates compared to key indicators of domestic macroeconomic activity. In particular, if we compare VAT receipt growth rates to total retail turnover growth rates, VAT receipts increase by 40% to 50% faster in different years.

This difference in growth rates is explained via the metric of the weighted impact of tax privileges: between 2017 and 2020, this metric decreased by 2.3 percentage points. Reduction of this metric is defined by the Russian Federal Tax Service as one of the main drivers of an increase in VAT collections that also minimizes the risk of a taxpayer's failure to fulfill its tax obligations.

In this situation, we must pay special attention to the practice of VAT reimbursement which indicates a significant proportion of cases when taxpayers wrongfully apply tax deductions and cases of unjustified VAT reimbursement. The main reasons include failure to submit a complete set of documents confirming the right to apply the 0% VAT rate in compliance with Article 165 of the Russian Federation Tax Code and wrongful application of VAT deductions for goods allegedly purchased because of formal documentation (in order to significantly increase the cost of goods passing through a sequence of suppliers in artificially created schemes of the procurement of goods). Export operations account for the majority of such cases.

The analysis of the problem of VAT-exempt exports from the Russian Federation via application of the 0% VAT rate shall be based on a review of the court cases involving a denial of recognition of export transactions as having taken place (Judicial Department of the Russian Federation 2021).

This practice came into active use after the introduction of Article 54.1 of the Russian Federation Tax Code that allows tax authorities to challenge transactions aimed at obtaining an unjustified tax benefit. Since the introduction of this Article, Russian tax authorities received an opportunity to view transactions of taxpayers not only according to formal criteria, but also based on the economic essence of such transactions, thus discovering the premeditated tax schemes.

We used qualitative analysis of court cases in order to highlight the main problems in the tax administration of export VAT. The standard procedure for analyzing qualitative data includes three stages, which are not necessarily carried out sequentially (they may overlap each other):

- Data reduction (coding)—reduction of text volumes to a key phrase (word) based on the selection of semantic units. So, a rather verbose description can be coded according to the key word.
- Reconstruction of subjective semantic systems—the search for regular connections between different semantic units.
- Putting hypotheses about possible basic generalizations and conclusions based on the establishment of regular connections between various semantic units (Artemenko and Razogreeva 2021).

This method was chosen as the most suitable for analyses of court cases.

2. Discussion

In our analysis of the practice of applying a reduced VAT rate of 0% to goods exports, it was found that Russian tax legislation is periodically amended—which eliminates the inaccuracies that previously caused disputes and issues between taxpayers and tax authorities. At the same time, currently, there are certain legal provisions that may be ambiguously interpreted by the taxpayers intending to legally minimize their tax liabilities; on the other hand, such ambiguity could be an obstacle for good-faith taxpayers willing to build the most favorable business relationships with foreign counterparties for manufacturing projects.

Tax authorities have an opportunity to analyze transactions not only from a formal point of view, but also based on the investigation of the substance of transactions. This opportunity facilitates tax authorities' identification of premeditated counterparties' actions aimed at obtaining unjustified tax benefits. The other side of this approach consists of the subjective approach to assess a taxpayers' actions—this may lead tax disputes even in situations where the actions of an organization were in fact motivated by business reasons.

In order to improve the Russian system of VAT taxation of export operations, provisions of EU regulations in this area have also been analyzed. In the EU, exportation of goods is subject to VAT at the rate of 0%, and the input VAT on goods, work, and services used for exports could be offset in full. The primary document regulating VAT taxation in the EU is the relevant EU Directive (The Council Directive of the EU on the Common System of VAT 2006).12 The provisions contained in that Directive apply in all EU countries and are similar to legal provisions that apply in the Russian Federation. However, it is worth mentioning the key differentiating factor, specifically—the requirements for proof of transactions. According to Chapter 10 of the Directive, input VAT amounts could be offset, in a general case, if the following conditions are met:

- goods, work, and services being acquired must be used in an activity that is taxable with VAT or in some certain specific types of activities, including exports;
- the taxpayer has a VAT invoice filled in according to the provisions of the legislation;
- the taxpayer has filed the VAT report containing the information on volumes of transactions, the applicable VAT rate for said transactions, and the tax basis for the tax reporting period.

At the same time, in the EU regulations, there are no requirements regarding the filing of any supporting documents proving the legitimacy of an application of a reduced VAT rate for exports. This partially confirms the problem of documentary proof of reduced VAT rates for exporters in a situation when control over its administration is tightened—it is precisely that problem which the present study attempts to resolve.

Most countries with a significant share of the global exports volume share certain common fundamentals of export VAT taxation, but each jurisdiction has its own specifics. Legislative provisions of the Russian Federation have the highest similarity to the European approach of export regulation—this is explainable by the fact that both regulatory systems have been generally guided by the OECD recommendations (van Doesum and Nellen 2021). At the same time, the Russian Federation employs an approach that is more demanding from the taxpayer's viewpoint in terms of documenting the fact of exportation. Thus, there is a need for transparent procedures enabling the sustainable operation of exporters and their interaction with foreign counterparties.

In the current situation, it is necessary to develop more detailed requirements for the taxpayers' confirmation of the fact that a service has been rendered, so that the taxpayers could efficiently interact with foreign counterparties to obtain the documents required. Such rules could be specified directly in the Russian Federation Tax Code; these rules could be introduced in part 4 of Article 148 of the Russian Federation Tax Code or alternatively, an official detailed clarification from the Federal Tax Service (FTS of Russia) could be developed, similar to the document referred below and listing detailed requirements for confirmation of a taxpayer's compliance with counterparty verification rules (Letter of the Federal Tax Service of 10 March 2021. No BV-4-7/3060).13

Taking into consideration the established practice, in addition to the contract with the counterparty, the following documents should be included in the list of required documents: the acceptance certificate describing the services rendered with detailed breakdown by each specific type of service, the service provider's report with a description of services and forms of provision of deliverables of services rendered, and other documents confirming provision of services using the template provided in the report. Additionally, the official clarification of the Russian Federation Federal Tax Service should provide examples of other potentially suitable documents: a service order from a foreign entity; files

containing consultations, research results, and other information in text form; a schedule of events and presentation materials for such events; materials for training sessions conducted; screenshots of software programs provided for use, etc.

The revision of tax legislation is necessary for taxpayers to be able to efficiently and correctly draft and execute their contracts with foreign counterparties. Currently, this process is complicated by the imprecise wording in the legislation and by the possibility of the reclassification of one type of contract into another type by Russian tax authorities.

As researchers established earlier, exports of goods for which R&D work was required or for which a transfer of usage rights from the performer of work to the end user is necessary, may still be subject to tax disputes—specifically in the aspect of offsetting the input VAT. Russian tax legislation stipulates that any R&D work, including certain pre-defined elements of work, and the transfer of usage rights performed on the basis of a licensing agreement, are exempt from taxation.

Due to specifics of subjective interpretation of Russian tax legislation, certain taxpayers offset the full amount of input VAT on R&D work performed, provided said work was required for the creation and further sale of goods being exported, and also on a transfer of rights of use of intellectual property. Such a transfer was performed under the contract for sale and purchase as a measure to ensure that the goods have their required functionality and are capable to be used for a specific purpose.

On the one hand, this approach is in stark contradiction to the legal norms established by the Russian Federation Tax Code. On the other hand, taxpayers perform these operations under a sale-purchase agreement, taking the other parties of this agreement only as a manufacturing process to create export goods for which there is a zero rate of VAT. As a result, both sides of the tax dispute have grounds for defending their own positions based on subjective understanding of the rules of the tax legislation.

With the purpose of establishing a unified approach to understanding the rules of tax legislation, researchers hereby suggest to amend a number of articles of the Russian Federation Tax Code; these amendments would more precisely define, for the taxpayers' benefit, the interpretation of the approach, which is also supported by the application and interpretation of tax law. Specifically, the approach consists of identifying the costs of R&D work carried out or of the usage rights transferred under the contract for sale and purchase; afterwards the amount of such separate costs is subsequently used to correctly determine the amount of input VAT that could be offset.

Another controversial VAT taxation issue that was examined in current study is the taxation of transactions in which the transfer of goods to a foreign counterparty is performed under a processing contract involving customer-supplied raw materials.

International organizations with manufacturing cycles divided into separate companies located in different countries are frequently encountered in the business world today (van Doesum and Nellen 2021). Thus, it is important to have sufficiently detailed legislative provisions defining the nature of work in this area, including the provisions of the tax law. Researchers posit that it is necessary to provide more details in the provisions of the Russian Federation Tax Code to facilitate an understanding of methods used for VAT taxation of operations involving the transfer of customer-owned raw materials to a foreign entity with any possible type of documentation.

As was already established, such transactions could be documented in different ways, and may have a key impact on the tax treatment of that transaction. At the same time, there is no clarity regarding the taxation of certain types of operations involving the transfer of customer-owned raw materials because of the ambiguity of the term "exportation". There is no certainty whether the raw materials, that were earlier transferred to a foreign entity, could be considered exported and have their permanent location outside of the territory of the Russian Federation.

In view of the above considerations, researchers propose to introduce a separate type of agreement—a "services contract for processing of raw materials transferred by a customer". This type of contract must be introduced in Chapter 37 of the Russian Federation Civil Code. In the Articles forming that Chapter of the Russian Federation Civil Code, the main rules for documenting such types of transactions must be provided. At the same time, it is necessary to also amend the Russian Federation Tax Code; proposed amendments would set the general rules for VAT taxation of transactions involving the transfer of customer-owned raw materials:

To amend Subparagraph 1 of paragraph 1 of Article 164 of the Russian Federation Tax Code with paragraph No.6: "… exported outside the territory of the Russian Federation according to the contract for transfer of customer-owned raw

materials”.

These amendments would allow taxpayers to properly maintain the document flow with their foreign counterparts, taking into consideration the requirements of the Russian Federation Civil Code. This will also give taxpayers an accurate understanding of their VAT tax obligations for the above-mentioned transactions, whether the 0% VAT rate could be used when the title to raw materials is transferred to a foreign entity, or whether VAT-exempt status is available in situations when there is no transfer of title.

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