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BASICS OF TAXATION

Elementary Course

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ACADEMUS
Publishing

Academus Publishing
2018

Academus Publishing, Inc.



California, San-Francisco
303 Twin Dolphin Drive, Suite 600, Redwood City, CA 94065
E-mail: info@academuspublishing.com

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ISBN 10: 1-4946-0009-9

ISBN 13: 978-1-4946-0009-9

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Introduction

Historically, taxes have developed from the simplest most uniform forms to more and more diverse and sophisticated types as people's economic activities types and forms have also diversified and become more complicated. Tax systems of all countries progressed in this way.

The current tax system is complicated and diverse. Many types of taxes and special regimes are applied, and tax accounting on some types of taxes is extremely difficult; determination and use of regulative and fostering functions of various tax types is not coordinated.

A shift from separate taxes to tax systems (that is, from specific taxes to systemic taxes) is the most notable trend in the modern taxation field. Similar taxes are grouped and unified rules, taxation, and reporting regimes, etc. are applied to the group, potentially leading to a unified system-forming tax.

To develop such a tax system, scientific studies in finance and taxation theory, tax bodies' practical experience, and the introduction of new information technologies are available.

The use of advanced information technology systems is widespread nowadays. Such systems bring significant change to national tax systems and the international tax environment. Consequently, advanced countries formulate demands for new legislation and elaborate laws adapted to informatization of social life. New technologies, tools, and data significantly improve the effectiveness of tax process, and support taxpayers to meet their tax obligations.

A comprehensive overview of modern taxation and the primary ways and methods of tax administration are presented in this textbook. Along with the basics of general theory and practice of taxes and taxation, general information on taxes and their types are provided in the first two parts of the textbook. The third part deals with the problems

of tax administration, and effective work regarding various types of taxes. Essential information on international tax relations and agreements to reduce (or eliminate) the effect of international double taxation is given in the fourth part.

Part

1

Theoretical Basics of Taxation

1.1. Historical Origin of Taxes

1.2. Commodity, Money, Credit, and Financial Relations

1.3. Concepts and Definitions

1.4. Elements of Tax

1.1. Historical Origin of Taxes

Historically, modern taxes stem from early initial forms of taxation in the states of the ancient east, and from European taxes, collected by clerical authorities in the Catholic countries and by municipalities in free (Protestant) cities.

Economically, the essence of taxes consists of replacing some private forms of consumption with public ones. In a legal sense, taxes are the instrument used to transform some part of personal property into public property. Consequently, taxes evolve along with people's common, social demands, which creates various forms of communities — clan, tribe, principality, kingdom, empire, etc.

Administering of justice and waging wars were the first people's *social needs*. Neither of these were regular activities; thus, occasional fees were enough to support these needs. Fees in natural or monetary form were collected by judges directly from participants in civil property lawsuits; or from persons found guilty of criminal offenses. In “Rus Truth” [Russkaya Pravda], the law code by Prince Yaroslav Mudry [the Wise], the full list of judicial duties is presented. Those duties were collected and deposited to the princely treasury as a fee for consideration on crimes.

Waging war was at first a public duty of all the men able to bear arms. Later, professional fighting teams were established and special fees were set during the periods of preparation for war and war itself, whether offensive and defensive.

Aggressive wars were often financed via loans; those were returned to creditors out of seized property or at the expense of tribute from conquered people. As the saying goes, if a nation doesn't want to feed its own army, it will soon feed an alien one.

Conducting religious ceremonies was the first *regular social need*. Initially, sacrifices, i.e. monetary and natural duties, were connected with periodic religious ceremonies; then duties' frequency was adjus-

ted with economic processes (successful hunting, harvest, cattle issue, etc.).

In the countries of the ancient east (Egypt, Babylon, China, India, and others) governmental and church powers were inseparable, as the head of state was considered to have a divine origin. Taxes there were collected by special governmental officials. In the other countries where governmental power was not centralized, taxes were collected by priests or monasteries directly.

So, primary regular taxes were hallowed by their divine origin, as reflected in ancient religious sources. Thus, in Moses' Pentateuch we read: "And all the tithe of the land, whether of the seed of the land, or of the fruit of the tree, is the LORD'S: it is holy unto the LORD."

In Europe, tax collection was an exclusive privilege of the Christian Church for a long time. Saint Thomas Aquinas considered the collection of taxes by princes and counts in their feudal estates to be a sinful occupation, a specific type of "robbery." German religious writer Ludwig von Seckendorf wrote at the end of the seventeenth century that with the help of "glorious Christian virtues" the "former situation should be redeemed when nobody knew about taxes."

Consequently, priests, and later monasteries, turned into the first collectors of regular taxes. During the Reformation period, the struggle against the Catholic Church was also the struggle against taxes collected by the Church. In time, regular taxes began to arise in cities to provide for the needs of municipal self-government bodies and the municipal economy.

During the period of feudalism, excise duties (taxes on consumption) and trade duties dominated. Along with the development of capitalism, land taxes obtained an important place in taxation strategies as an instrument to supplant feudal nobility. When regular armies arose, new taxes came into usual practice, such as taxes on financial capital, on profits, and on citizens' individual income.

Monetary taxes did not emerge all at once, but rather evolved sequentially. Historically, *natural duties* arose first, and eventually, they took the form of *natural taxes*. In medieval Europe, counts and princes didn't pay taxes to the king, yet they were obliged to accept the king and his entourage as lodgers at their estates, and to provide a well-equipped regiment for the army in case of war. Evident-

ly, such requirements were an object of outrage, and for this reason they were gradually unified and *formalized*—at first, by size (e.g., two weeks of lodging per year became a kind of standard; the number of armed soldiers was also limited, for example, to ten horsemen and twenty infantrymen). Then, these duties were transformed into contributions of universal *monetary* goods, such as grain, cattle, silver, and gold.

Nowadays, *monetary taxes* are the primary form in place; taxes are collected from individuals and organizations. These reflect a specific compulsion-based form of monetary *fiscal relationship* between the governmental power and the people. Hence, monetary taxes are a specific, distinct type of *individuals' material property duty*.

Taxes are a part of the cumulative public material product, which is concentrated by the government. Along with development of production processes and the evolution of government's role and functions, taxes have also changed both in quantity and quality.

Qualitatively, forms of taxes have been modified from harvest taxation (a tithe, or one tenth of annual product) to trade turnover taxation (trade taxes and municipal, bridge, border levies, etc.) to today's income taxes (taxes on corporate profits and on personal income above the living wage minimum). Consequently, *the tax system* has also transformed, meaning the number of taxes and their types and forms have changed as well.

Quantitatively, the government's share in the cumulative public product of its citizens and corporations is calculated as an average share of taxes in national income. This share has largely increased from 10 percent (tithe) to 15–25 percent (with the accent on turnover taxation, i.e. indirect taxes) and to the current 35–50 percent.

At the same time, the so-called psychological limit of taxation was set; A. Laffer defined it as one-third of personal income. Taxpayers are ready to pay whatever the government needs when taxation is lower than this level, but if taxation becomes higher, taxpayers tend to optimize (lower) their tax payments. If they succeed in lowering tax payments via various tax-avoiding schemes, legal or illegal, they intensify tax avoidance greatly; in this case, all the governmental “compensation measures” and attempts to raise tax rates are in vain, and can even lead to lowering of tax revenues.

And if taxpayers don't manage to lower their tax payments, they tend to leave the country or to shrink their production and other activities under taxation.

While the relationships between the government and taxpayers are evolving and even worsening, *tax administration* is also changing and becomes more complicated. It has developed from a control on production volume (directly, through harvest accounting [tithe tax], or indirectly, through land property accounting [land tax]) to a control on economic turnover (sales taxes and turnover taxes), and further, to a control on corporate and personal incomes.

1.2. Commodity, Money, Credit, and Financial Relations

Tax administration directs *tax process*. The tax process is a part of *tax relations*. Tax relations are one of the constituent parts of *financial relations*. Financial relations are a part of *monetary relations*. Monetary relations are the result of the evolution of *commodity relations*, at the stage when exchange of commodities was supplanted by exchange of commodities for *money*.

Money is a specific commodity with a function of common equivalence, a reference standard of commodities' *exchange value*. A material product (commodity) functioning as money (grain, furs, gold) is not only a *means of exchange*; it also guarantees that any trade (exchange of commodities) is *comparable* and *backed*.

Nowadays, money mediates all the economic relations between persons, even if money as a specific commodity—a universal equivalent—is going out of commercial circulation (or is out of it already). Moreover, various spheres of non-economic relations are also mediated through money. In the Middle Ages, the holy fathers were selling absolution; present courts often hand down a sentence of monetary compensation for moral harm (e.g., give monetary estimation to human feelings such as harm to dignity, causing depression, character assassination, etc.).

“Commodity-for-commodity” and “commodity-for-money” deals constitute a sphere of *exchange relations*. Such deals' most notable feature is their *reciprocal character* (each part gains equivalent value for assignment of the good) and *simultaneity* (simultaneous exchange of good-for-good or good-for-money).

Money is still involved in every deal, in each transaction, but indirectly. Physically, money is almost out of circulation; *representative money* is used in transactions instead. Typically, *credit documents* (CDs) are applied; such documents are presented in various instruments of *credit turnover*.

Public, standard, and special CDs can be distinguished among these. Public CDs are the *token money* issued by a public authority. These are banknotes (bank bills) and coins (small change). They are distinguished from true money by their exceptionally low material cost compared to their nominal value. For example, the production cost of a 100-dollar banknote is not more than 3 cents, and the production cost of a bank-drawn check is even less, yet it can be signed for millions of dollars, etc.

Standard CDs include credit instruments that are issued and circulate according to special law; these are trade bills of exchange, bank-drawn checks, letters of credit, etc.

Special CDs can be issued and used by any individual according to common civil legislation norms. These include promissory notes, IOUs, bonds, and coupons from shopping malls and gas stations, gambling houses' "chips," etc.

CDs of any type can be used for payments, yet a CD holder who has received one in exchange for his goods can never consider the deal to be closed. In fact, he depends on the CD issuer, like a lender depends on a borrower. For example, the government could drop the currency exchange rate and money purchasing power, or even nullify their value, e.g. with monetary reform; a bank or any other financial institute could refuse to carry out its obligations or declare bankruptcy; the same is true with companies or individuals, who can also reject obligations or just "vanish."

Hence, CD deals form the sphere of *credit relations* (or *crediting*), and its first main feature is a *time lag* between the moment when monetary obligation arose and when it is repaid (futures); the second is a *payment* for it, i.e. interest payment due on the debt sum is calculated during the debt period until its repayment in full. Standard and special CDs are presumed not to be perpetual, yet in practice, some of them can be prolonged permanently according to legislation, until the debtor/creditor is finished with its activities or is dead.

Repayment falls into the category of credit relations because main debt and interest are presumed to be repaid (as a compensation for profit a lender could get from using the lent asset). At the same time, payment for public CD-based deals can be called only conditional as far as a government introduces laws; government can fix its right not to pay

interest on its issued CDs (banknotes) and not to accept banknotes for repayment. (Yet the latter norm is not in force in international relations because sovereign rights of the state are limited by country borders.) Given this circumstance, government can be considered to use the free and perpetual credit of its citizens when it issues CDs as a mandatory means of intrastate circulation, and such credit is equivalent to the issued CDs' full sum.

The nature of *financial relations* is completely different. Participants are not equal; their relations can be based on dependence, subordination, or coercion before the *financing* act and at the moment of financing as well. At the same time, the very relations of dependence, subordination, or influence can be a result of the financing, and, in this case, a refusal to accept financing (if it's possible at all) can eliminate these relations. But if relations have no connection with the particular act of financing they will still exist no matter whether the subject of the relationship refuses or accepts financing.

Financial relations can be regarded as mandate, control, or supervision depending on the type of relationship between the object and subject of financing.

Regarding the *mandate* level, the subject of financing imposes its will on the object of financing. It can be a mandatory condition for financing (e.g., a direct instruction or order is given regarding how and for what purpose financing can be used) or regular execution of powers, including relations on financing (possibility or obligation of the latter). For example, the only working member of a family can demand his instructions be executed because other members of family live at his expense. If they fail to execute instructions it can be a reason to refuse to finance them. In this case, financing can be stopped if possible according to legislation or carried on strictly according to the norms of law.

At the level of *control*, the subject of financing provides monetary resources (assets) at the full disposal of the object but keeps the function to set general conditions, norms, and limits of financing and reserves the right to control how the provided resources (assets) are used. Direct democracy gives an example of this situation. Citizens decide all together at a general meeting through direct voting how to collect and use monetary resources (material assets) and can demand a report

from the bodies authorized to execute these decisions and spend resources.

A relationship of full association (partnership) can be one more example. All the full partners can control personally and directly how the authorized partner conducts monetary (or property) affairs of the association. The reason is that all the partners together and each of them personally bears equal unlimited responsibility for the partnership's obligations

At the *supervision* level, subjects of financing have no capacity to control how the provided financial resources are used. They can only appoint their representatives, and the latter will act themselves on behalf of the subjects of financing. These representatives will carry out decisions regarding the use of provided resources (which make public funds of monetary resources). They will also determine norms, rules and limits of additional payments and contributions to the abovementioned fund (or funds).

Relationships in joint stock companies give an example of this. Shareholders pay for their shares and then choose board members or a board of directors. The board runs the business and makes decisions. Results are presented later, at the annual shareholders' meetings.

Bottom Line

Hence, in *commodity-money relations (property relations)*, parties are equal, and fully free in decision making; these relations result in a single act and each of parties gains equal satisfaction, meaning the quantity (or value) of the received product, but greater profit, meaning its quality (utility).

In *credit relations*, parties are equal, and free in decision making, but these relations regard two acts divided by a time lag. As a result of the first act, one party (a lender) provides to the other party (a borrower) a sum of monetary (or commodity) assets on a certain time interval. The second act results in repayment of the lent sum and preliminary agreed remuneration. The latter represents a fee to a lender for "unused" assets (calculated as a fixed percent of the lent sum) and also for the lender's "risk" of the borrower's insolvency (calculated as an insurance fee depending on the particular case). Finally, in credit relations, utility of money (or commodity asset) is traded for profit.

Unlike the abovementioned relations, *financial relations* presume parties' inequality (one party is the subject and another is the object of financing) and only one party (the subject) is free in decision making. These relations result in one act of free money (or material) resources' provision. Parties are connected through relations of subordination, dependence, or coercion, and these relations have the same nature notwithstanding the act of financing.

1.3. Concepts and Definitions

Tax can be generally defined as a specific form of financing the common needs of some group of individuals. Yet due to the complex political, legal, financial, and economic nature of taxation, various definitions can be chosen for particular purposes.

Legally, tax can be defined as a special law-based mechanism for transferring a part of private property to a public use.

From a social and economic viewpoint, tax is a means of common financing of governmental functions by organizations and individuals. Such financing is distributed in a prescribed manner to maintain law and order and other common social needs.

Fiscally, tax is a mandatory payment collected by special governmental bodies from legally recognized taxpayers who are obliged to pay taxes according to current legislation.

Tax is a basis and cause for *tax relations*. Tax relations can be characterized by their *specific features*. These are the following obligations established by law: (a) duty to pay tax; (b) mandatory registration of any person or legal entity with the appropriate governmental body and performing other actions for a fee; (c) according to law, the fee amount is higher than the normal costs of governmental bodies for performing these functions.

In a tax relations system, *tax* is a legally established unilateral commitment to participate in financing governmental activities (tax obligation). The obligation is executed if a legally fixed amount of money is paid to the corresponding budget according to law (tax payment).

Each tax type is presented via the complex of basic and additional elements. Differentiation of basic tax elements defines the type of tax or of an alternative tax regime, i.e. each tax and each alternative tax regime are specified by their own set of basic tax elements. Differentiation of additional tax elements defines the type of “built-in” tax regime in the frames of the established tax.

Each tax is constituted of elements which are necessary and also satisfactory to establish fully and exactly taxpayer’s obligation regard-

ing a particular tax. These tax elements can be divided into *basic tax elements* and *additional tax elements*.

Basic tax elements are inherent in every type of tax; these include *object of taxation*, *rate of taxation*, and *time of tax payment*. Initially, many types of taxes, such as trade duties, per capita taxes, and land and real estate taxes, were defined by this minimal set of elements.

Taxpayer, *tax base*, *tax period*, *order of tax calculation and payment*, and *tax incentives* are additional elements of tax. At least some of these additional tax elements turned out to be necessary for defining taxes introduced in the later stages of state development. Income tax, corporate profits tax, tax on capital, turnover tax, sales taxes, VAT, and others are the examples of these. The tax period is not applied, for instance, to tax on inheritance or gifts and to stamp duty, and tax incentives are usually not provided for tax on motor vehicles.

Tax is presumed to be established when the object of taxation and time of payment (basic elements of tax) are defined. Tax rate (basic element of tax) can differ if either another type of tax is meant or some other (built-in) regime is applied in the framework of this tax. Differences in additional elements of tax define more or less preferential regime in the framework of the same tax. Differences in basic and additional elements of several taxes define any special tax regime.

Tax regime means allocation of a part (share) in the taxation object; a special tax rate is applied to it either instead of usual rate of the particular tax (built-in tax regime) or instead of one or several taxes (alternative or special tax regime).

In tax systems within developed countries so-called special tax regimes are applied. These are established to control specific spheres, industries, types, and forms of activities for public entities and individuals, taking into consideration their role and importance in production processes, market share, etc.

Such regimes can be as follows: (a) consolidated balance taxation (for connected groups of companies); (b) special order of taxable income calculation for banks and insurance companies; (c) special order and taxes for mining of raw materials, especially for the oil and gas industry; (d) special order for forestry and agriculture; (e) special order for small business enterprises.

1.4. Elements of Tax

Basic elements

Objects of taxation can be presented in the form of some types of property (taxpayer's total property), some types of income (taxpayer's total income), and some types of deals (total sales, total turnover). Taxation on *incomes* can be substituted for taxation on *expenditures* (the sum of *expended income*).

Formerly, individual could also be an object of taxation in some countries. *Per capita tax* was usually applied to able-bodied men as a substitute for military duty. Nowadays, per capita taxation (e.g., an evenly applied tax on everyone living in a particular area) is introduced quite rarely; in developed countries, such an attempt took place in Great Britain and Margaret Thatcher lost her position as a prime-minister shortly after that.

Property as an object of taxation means any types of property and property rights recognized according to the norms of civil legislation. A particular type of property, a set of property types, or total property (capital, total assets, and fortune) in the frames of the particular period can be an object of taxation.

An income as an object of taxation refers to economic gain in the form of money or in the natural form which has resulted in the increase of property or consumption of the gain by the recipient of such gain or his dependents. A certain type of income, total income (in the country or in the world), or total corporate net profit can be a taxation object of a particular tax.

As an object of taxation, a deal implies a transition of property or property rights between separate taxpayers. A deal or set of deals, a special deal type or set of deal types, or gross (trade) corporate turnover can be a taxation object of a particular tax.

Tax rates can be divided into two groups: *ad valorem* and *specific* tax rates. Depending on the particular tax type, *simple*, *complex*, or *combined* rates can be applied. In recent years, development of infor-

mation technology has provoked discussion regarding tax rates, which can be calculated *graphically* (or according to mathematical formula or an equation of functional dependence).

Specific tax rates are defined as a fixed sum of money per unit of taxation object (property, income, deal). In ancient times, when taxing property or goods, tax rates could be expressed as a function of their shares (*share tax rates*). Nowadays, such rates are applied quite rarely (e.g., in production sharing agreements); at the same time, withdrawal of property (or goods) can be used by tax authorities for repayment of a money tax obligation (for instance, at the taxation of an inheritance, or goods crossing the border, etc.).

Ad valorem rates are established as a share of the taxation object's money value. Usually shares are calculated in percent (or per mile), but other methods can also be used for calculation.

A simple tax rate implies a uniform share of tax in taxation object notwithstanding its value (price) and taxpayer's identity.

Complex tax rates presume a changing share of tax depending on the changing value of the taxation object either taxpayer's identity. In the first case, tax rate progression (e.g., for personal income tax) or regression (e.g., for unified social tax) can be applied. In the second case, tax rates are differentiated depending either on the type of taxpayer (e.g., person, legal entity) or on the relations between the parties of a deal as an object of taxation (e.g., transition of property due to inheritances and gifts).

Combined tax rates are applied as a combination of specific and ad valorem rates (for some types of excises) or as a combination of simple and complex rates (free minimum and tax rate progression for personal income tax).

The duty to pay tax (tax obligation) is strongly connected with the period of fulfilling the obligation (*tax payment due date*).

Tax obligation arises for a taxpayer based on grounds prescribed by law for various types of taxes. These baselines can include expiration of the established tax period (for income and turnover taxes) or circumstances defining the moment when a tax obligation arises (e.g., the moment of purchasing property for property tax, carrying out the contract or crossing the border for some deal taxes and custom duties). The mo-

ment of tax obligation fulfillment is defined as a final calendar *payment due date* (tax payment deadline). After the tax payment date expires, the sanctions provided by law for overdue tax payment come into force.

The date of tax payment can be set as a fixed calendar date (e.g., not later than some date) or in connection with some act or event, related to the taxation object's transition (e.g., purchasing of property, gaining income, carrying out a contract). The dates of advancing money on account of tax payment, full tax payment amount installment, and final fulfillment of tax obligation are distinguished.

Advanced payment is used for payment of income taxes, whereas payment installment relates to some property taxes. The date of final tax obligation fulfillment presumes the ending of all the accounts related to a particular tax; all the paid advances and all the changes in value and characteristics of the taxation object during the expired tax period must be taken into account.

Additional elements

Defining of a *taxpayer* is necessary for those types of taxes which do not relate to all the subjects of taxation for some reasons or baselines or which presume differentiation of some taxation conditions (e.g., for individuals or families, for natural persons or public entities, etc.).

As an element of taxation, a taxpayer is an entity which is legally obligated to perform payment of tax (itself or in favor of the tax obligations of some other entity). In some cases, a payer of a particular tax is not defined by law directly, though a payer should be defined on discretion of entities participating in activities which generate income; or being owners, proprietors, or users of the taxation object; or parties in a taxable deal. In this case, real recipient of income (beneficiary), the direct beneficiary (related to a particular property object of taxation), or a party obliged to pay tax according to the deal contract will be recognized as a taxpayer.

For personal income taxes or personal property taxes, one individual separately or a family as a whole (household) can be recognized as a taxpayer. The taxation regime for physical persons can also be expanded to property in transition from one owner to another (e.g., inherited property and income during the period before it's accepted or shared among successors).

Tax base is an estimated value or quantitative definition of the taxation object; such values or definitions are carried out by one of the parties of tax relations or jointly by parties according to the norms and procedures established in law. The estimated value of the tax base is a foundation for applying the ad valorem tax rate. Quantitative definition of the tax base makes a ground for tax duty calculation and application of a specific tax rate.

For taxes related to legal entities, the legal entity itself, its separate department (division, business establishment), or a group of legal entities (consolidated taxpayer) can be recognized as a taxpayer.

Tax period is considered to be a period of time during which or relatively to which an object of taxation is set, tax base is defined, and final amount of tax liability is calculated. Tax period determines the frequency or period of application for a particular tax or alternative tax regime.

Reporting period is used together with some types of taxes as a method to determine periods for preparation and presentation of intermediate reports regarding the dynamics of the taxation object (or of its tax base) within a legally established tax period. In cases provided by law a *payment period* can be established for some types of taxes when advance tax payments are presumed.

Tax period can be established as a calendar year or budget year (if it differs from a calendar one); sequence of twelve months; or four, two, one quarter; or some other time period. The tax period for a particular tax can coincide with the reporting period or include two or more reporting periods.

Tax obligations and obligations on tax accounting reports for every tax are determined according to the tax period established for the tax. Reporting period determines only a taxpayer's obligations regarding tax accounting reports; payment period determines the frequency of advance payments.

Tax period can be determined by law for every tax, either as a fixed time period or as a set of rules (norms) for determining it according to particular conditions or circumstances (e.g., in the case of establishing of new public entity, merge or division, or liquidation of an organiza-

tion). In cases provided by law, the tax period can be determined according to an agreement between the taxpayer and tax body (e.g., in case of especially long production cycle).

The *order of tax calculation and payment* is established by law for every type of tax.

The order of tax calculation includes the way to calculate money obligations on tax and some other norms, such as norms defining the mechanism of compensation and amount of compensated expenses in case of overpaid tax; or norms defining incentives for early tax payment and sanctions for failure to pay by the tax payment due date.

The order of tax payment covers advance payments' frequency and amount, the order of recalculation for particular tax (refunding, or overpayment offset, or additional payments), as well as a method and place for depositing money to repay tax obligations. At the same time, a taxpayer has the right to repay tax obligations via any available and legally possible way, e.g. to deposit money to the bank account of the tax body in cash or non-cash; by bank cashier's check or by confirmed promissory note maturing before the tax payment due date; by personal or corporate credit card; in a single amount or separately, in different payments; independently or through a representative or intermediary; or in other way.

The tax body is obliged to provide a taxpayer with all legal ways to make payments in order to fulfill his tax obligations; to give immediate and full confirmation of all the monetary payments received; to make offset independently and at its own expense in case of overpayment of the one particular tax and the other tax becoming due; and to inform a taxpayer immediately about an offset performed.

The tax body is also obliged to consider taxpayers' suggestions regarding the repayment of tax obligations via different ways and means taking into account circumstances and a taxpayer's given situation and to accept suggestions if possible. These ways and means imply, for example, offsets, transfer of material assets, debt obligations of third parties (including the obligations of the state and its bodies), payment in foreign currency, providing services, performing work for government agencies, etc.

Tax incentives are an important element of modern taxes. For instance, a tax revenue “shortage” of personal income tax and tax on corporate profit due to tax incentives can be estimated as making up 30-40 percent of total potential tax revenue for these taxes.

The following types of tax incentives are usually applied in developed countries: tax exemption—exception from the payment of a particular tax or recognition that the taxation object of the particular tax is nontaxable; *tax deduction*—reducing a taxable base; tax credit—reducing tax liability; *tax deferral*—changing the tax payment due date; *tax annulment*—tax debt write-off.

Tax incentives (except for tax write-offs) cannot be used as a means of encouragement for some types of taxpayers (or groups of taxpayers), or in place of social benefits and grants. A tax annulment can be applied at the discretion of tax bodies in case of an insignificant debt amount, obvious discrepancy between debt amount and withdrawal expenses, or in consideration of the taxpayer’s specific situation (e.g., threat of inevitable bankruptcy). Each case of tax debt write-off is to be fixed in special agreement between the chief of the tax body and the taxpayer (or his representative, successor, etc.) and confirmed by the upper level of the tax body under personal responsibility of its chief.

Part

2

Main Types of Taxes

2.1. Classification of Taxes

2.2. Property Taxes

2.3. Income Taxes

2.4. Deals Taxes

2.5. Special Tax Regimes

2.6. Systemic Taxes

2.1. Classification of Taxes

Economic classification of taxes implies an order and set of rules to classify all the taxes and similar duties and fees included in the tax system for analytical or statistical purposes. Classification should be performed as a way to distinguish separate groups (classes, categories) on the basis of essential traits (elements). This sort of unified or commonly accepted economic classification of taxes does not yet exist on a broad scale.

For a long time, taxes related to extraordinary income needs of the state (for war, or recovery after natural cataclysms, etc.). In ancient Rome, free citizens considered it shameful to pay taxes. In the middle of the sixteenth century, French economist Jean Bodin postulated only customs duties to be taxes (yet he permitted taking tribute from conquered nations). Generally, until income taxes were introduced, only classification depending on the type of taxed property (e.g., real taxes on immovable property and personal taxes on individual movable items) was commonly recognized.

Physiocrats considered land property taxes to be the basic taxes; all the other taxes were additional, and less important for economic policy. Along with the development of capitalism, indirect taxes on large-scale goods (e.g., salt, grain, beer, tea, kerosene, etc.) gained importance; direct taxes on capital or personal income taxes seemed unacceptable, and the first attempts to impose a unified tax on personal incomes were claimed as a “socialist” ideal; at the same time, taxation of workers’ wages was not even on the agenda, because it led to an indirect increase of labor costs for capitalist entrepreneurs.

Scientists, practitioners, and statesmen have used various tax groupings depending on tax policy purposes and their own aims. So, scientists were dividing taxes into domestic and external (on local and on foreign trade), and into groups regarding property and consumption, production and turnover, etc.

Nowadays, tax group and type are defined according to the object of taxation.

Tax groups include taxes related to common taxation objects (or group of objects), determined according to the *origin*. The type of tax is determined according to the kind of its specific taxation object within the group.

The groups of taxation objects according to the origin of taxation object are as follows: *property, income, and deals*. Within the different groups of taxation objects for various kinds of property, income, or deals according to their kind, a unified tax or various taxes can be imposed, introduced, and applied.

Scientific classification distinguishes property taxes, income taxes, and taxes on deals. For the first two types of taxes, taxpayers and tax-bearers coincide, and in the third case, the so-called tax arrangement is possible. The latter means that a taxpayer making payment to budget can shift his tax burden to his counterparties, e.g. including tax in the price of trading goods and services. In practice, various situations are possible depending on the economic conditions: sometimes personal income tax can be shifted to consumers (e.g., taxes on private doctors and dentists) and sometimes taxpayers are required to pay taxes on deals themselves.

Taxes can be also classified into direct (on property and income) and indirect (deals) groups, and such classification is in widespread use.

For purposes of *economic analysis*, taxes can be classified depending on the main production factors—labor taxes and capital taxes. In Sweden, classification based on a combination of these criteria has been developed and is currently in use. In the USA, federal taxes are classified into income taxes (on corporations and on individuals), taxes on employment (payroll taxes), taxes on property and capital, excise taxes, and fees.

Depending on the taxpayers' *legal status*, taxes on individual proprietors and entrepreneurs (their groups), taxes on companies (limited liability-based companies), and taxes on financial intermediaries (banks, insurance and investment companies, etc.) are distinguished.

In *accounting* practice, taxes paid via costs accounts and taxes attached to income and losses accounts are distinguished.

For *tax planning* purposes, taxes are classified into taxes on the business results of a company, an entrepreneur, or an investor, such as taxes on property or on corporate profits; taxes related to deals with business counterparts, such as sales taxes, turnover taxes, VAT, excises, custom duties, etc.; and taxes related to payments to other persons, such as taxes on dividends, on interest gains, on payroll, etc.

Along with the introduction of the unified European (EU) national accounts system, specific basic tax classification has become accepted: taxes on capital (on property), taxes on income and taxes on turnover, related to trade (commercial) turnover, also called taxes on deals, on expenses, on consumption, etc. are recognized.

In statistical reviews of international organizations and for international comparisons, taxes are classified into the following groups: a) taxes on income, profits, and capital gains; b) social security contributions; c) taxes on domestic consumption of goods and services; d) taxes on foreign trade; e) other taxes (on property, capital, etc.).

Hence, various approaches to systemic tax classification are used nowadays. Most widespread classifications are based on economic (direct and indirect taxes) and legal characteristics (taxes on property, on income, and on deals).

2.2. Property Taxes

Real estate tax. This type of tax emerged in ancient times. Objects of taxation for this tax include land areas with buildings and construction projects. Tax is withdrawn annually. The money value of the real estate object is estimated by the taxpayer him- or herself or according to the land cadastre; this estimation provides the tax base. Typically, the cadastre estimation makes up not more than 40–50 percent of the maximum market value. The tax rate varies from 0.3 to 1.5 percent. Tax incentives are provided for the sole real estate object (house, apartment) used for accommodation by the taxpayer himself or for the objects used for charity or other socially useful purposes.

Merits. The object of taxation cannot be hidden; the taxation base is easily defined (according to cadastre value, information about sales of similar objects, insurance documents, etc.); progressive scale of taxation is possible.

Demerits. Objects must be divided according to purpose of use into social (personal accommodation, charity) and commercial. Personal property can be hidden under the guise of commercial property.

Tax on motor vehicles. Motor vehicles are means of land, water, and air transport equipped with mechanical engines or motors. Tax is withdrawn annually. The tax base is usually determined by engine power or, rarely, by the price of the means of transport. Tax rates are established in money amount per power unit of engine power, e.g. per horsepower. Incentives can be introduced depending on engine type (e.g., its ecological cleanliness) or type of necessary fuel.

Merits. Motor vehicles must be registered with a specialized state body and their technical condition must be checked regularly; hence, they cannot be hidden from taxation. The purpose of tax revenue spending (for developing the road network, port infrastructure, etc.) can be identified, thus exerting a positive influence on the tax discipline.

Demerits. The tax body must constantly control or monitor changes of vehicle ownership.

Tax on capital. Objects of taxation include monetary capital of physical persons and legal entities. Initially, this was used as a tax on the trade capital of merchants, but was supplanted by income tax. Now it is applied mainly to the registered capital of joined stock companies and banks. Tax is withdrawn annually. The tax base is defined as a sum of paid stock emission (initial and additional issues). Tax rates are comparatively low, usually not higher than 0.5 percent. Tax incentives are not provided.

Merits. Taxation objects are easily controlled because all the stock emissions are subject to registration. The tax is a disciplinary tool which may be used to fight abuse related to stock emission and revocation.

Demerits. This tax's fiscal importance is low.

Tax on wealth. The object of taxation is the net value of total property of natural persons. Tax is withdrawn annually. The tax base is defined as a sum of estimated values of various assets composing a taxpayer's property reduced by the amount of the taxpayer's debt. Assets estimation is performed by the taxpayer himself, but it can be controlled by the tax bodies. Real estate objects are estimated according to their value for purposes of taxation or insurance value; motor vehicles are estimated according to tax value; bank deposits are estimated according to information provided by the bank; stock shares are estimated according to current stock exchange rates; antiques, jewelry, etc. are estimated according to insurance value. Tax rates are progressive, usually from 0.3 percent to 1.2 percent. The nontaxable minimum is rather high, usually not less than €400,000–€500,000.

Merits. This tax is very socially fair. Poor and middle-income individuals are not among its taxpayers. The tax is also a powerful disciplining tool due to severe sanctions that may be imposed in cases of hiding assets or lowering their value. Abuse can be easily discovered when assets are sold, transferred as an inheritance, or if an insured event occurs, etc. Together with inheritance and gifts tax, it gives profound support to the income taxation system.

Demerits. It's often difficult to reveal the foreign assets of individuals. Serious contradictions between taxpayers and tax bodies are possible concerning the fair value of old assets brought out of trade turnover, stocks of companies which are not rated, intangible assets, etc.

2.3. Income Taxes

Tax on total income of individuals (tax on personal income). Here, the taxation object is the total income of an individual during a particular reporting period (e.g., year) received from all sources in the country and abroad. Tax is withdrawn annually. The tax base is composed of all money incomes and monetary estimation of material profit in any form. Income from employment is taken in a gross minus nontaxable minimum, usually USD \$6,000–\$10,000; entrepreneurial and investment income is calculated as a net income minus expenses related to this type of activity; income from copyrights, patents, etc. is taken in a gross (sometimes unified deductions are applied). Tax rates are progressive, up to 70–80 percent (for the highest incomes). Tax incentives are normally provided to pensioners, disabled persons, persons with dependents, recipients of foreign income, for charity contributions, etc.

Merits. The tax is very socially fair. The system of universal accounting and registration of taxpayers can be used for tax control purposes for any type of tax. Control on foreign incomes and taxpayers' activities abroad is possible.

Demerits. Taxpayers must do much accounting and reporting work. There are high demands on the control activities of tax bodies. There is a high possibility to shelter income from activities related to unregistered commodity values and money obligations; service activities; operations using cash payments; barter transactions; freelancers' activities, etc. Conflict with tax interests of other countries is inevitable.

Tax on inheritance and gifts. The object of taxation is composed of property and other assets transferred to other individuals due to a natural person's will according to donation or testamentary order. The tax event determining tax application is a moment of accepting the inheritance in full; gifts can be summed up during a legally established period (usually a year). The tax base is a sum of money and value estimations of transferred assets. Inheritance taxation presumes summing up

all assets including foreign ones. Real estate is always a subject for taxation in the country of its residence; hence, any arising problem of double taxation can be settled according to national norms of both countries or norms of special tax agreements. Gifts can be levied both in the location of assets and in the country where the property title was transferred.

To estimate material assets, data from registers, cadastres, stock exchange rates of commodities and securities, recent tax authorities' estimations for property taxes, and special estimations for particular case can be used. Tax rates are progressive, depending on the transferred property value and on the relationship between parties (e.g., if they are relatives or not). Maximum rates can be up to 70–80 percent of the property value. No tax is usually levied on property transfers between spouses (of different sexes); lowered rates are applied to transfers to direct (blood) relatives.

Merits. The tax documentary base is same as for personal income tax and property tax. Consequently, tax is a powerful controlling mechanism to disclose tax evasion related to personal income and property. (For instance, a taxpayer explains a sudden appearance of capital as diamonds left by his grandmother; but in such case, he was obliged to pay taxes after her death.)

Demerits. Tax control on transfers of money and unregistered assets is complicated in general. The degree of tax evasion is high. Estimation and levying of material assets and property rights can lead to conflicts both inside the country and abroad.

Tax on capital gains. The object of taxation is a profit from the sale of an asset (securities). The tax event occurs when the asset is sold; a “sleeping” (not sold) asset usually is not subject to tax if its value increased. Tax base is calculated as an asset sales price minus its purchasing price and other expenses related to transaction (broker's commission, etc.). Tax rate is fixed, usually at 30–50 percent. In many countries, this tax is integrated in the system of personal income taxation. In such cases, a special or progressive tax rate can be applied. Incentives can be provided for the assets which belonged to a taxpayer for a long time.

Merits. The fixed tax rate is a stimulus for private investment. An increase in asset price is not subject to tax until the asset is sold; hence, this tax encourages long-term investment.

Demerits. It's hard to control taxpayers' foreign investments and transactions via intermediaries like offshore companies and trusts.

Tax on corporate profit. The object of taxation is the net (entrepreneur) profit of legal entities. Tax is levied annually, following the overall results of the reporting period, i.e. calendar or financial year. Advance tax payments can be made quarterly. Tax base is calculated as a difference between gross revenue and total expenses related to the organization's activities. The tax rate is usually 25–40 percent; it's higher than lowest rate of personal income tax but lower than its highest rate.

In a large number of countries, a reduced tax rate for small business enterprises is applied. The tax is a part of the income taxation system and is often levied in coordination with personal income tax, e.g. through an imputation system, reduced tax rate on distributed profits, or taking this tax into account when calculating tax on personal dividends, etc. Tax incentives are related to investments in modern equipment, R&D expenses, exports, and company foreign activities; accelerated depreciation is widely used as well.

Merits. The tax rate is fixed, and is lower than the personal income tax rate; it encourages individuals to invest in corporate business. Thus, from this viewpoint, the corporate tax rate is a special tax incentive for personal income tax (additionally, shareholders' liability is limited).

Demerits. Thorough coordination with personal income tax is necessary; it has even been suggested that this tax should be cancelled in favor of including corporate taxation in the unified system of personal income taxation. Two taxation regimes are applied at the same time: for individuals and their associations, and for public entities. Control is difficult, and abuse related to tax incentives is widespread (a special minimal tax was introduced in the USA specifically to deal with such cases). Tax authorities are forced to be involved in business regulation (meaning control on conditions of intra-corporate transactions, on reasons for investment, on tax optimization, etc.). Finally, administrating the tax is very expensive.

Tax on distributed profit. Object of taxation is corporate profit distributed among the shareholders of the company. Tax is levied annually. The tax base is shareholders' accrued incomes in the form of div-

idents and in other forms (e.g., credit benefits, compensations, price discounts, etc.). The tax rate is usually 20–30 percent less than corporate profit tax rate. Tax incentives are not provided.

Merits and Demerits. These are same as for the corporate profit tax.

Tax on insurance award. The object of taxation is an insurance award, paid by the policyholders under an insurance contract. The tax base is the total sum of insurance awards collected by insurance companies. Tax rate is 3–5 percent of the collected insurance awards. Tax incentives are not provided.

Merits. The tax ensures the necessary and guaranteed level of insurance companies' income taxation. Taxation of profits is almost useless for those companies, because many types of insurance activities result in net loss. Profit emerges as a result of investments of the accrued insurance fund and reserves; moreover, profit is arbitrary for medium- and long-term types of insurance, such as life insurance, property insurance, etc. In developing countries, this tax is used as a means to tax foreign companies' insurance awards brought out of the country ("at the source" regime).

Demerits. It's necessary to administrate an additional type of tax and coordinate it with personal income tax and corporate profit tax.

Taxes on incomes transferred abroad. The taxation object is investment income ("passive" income) which is transferred abroad. The tax base is a gross sum of transferred income (e.g., dividend, percent income, rental payments, payments for using author's rights, trademarks, patents, etc.). Tax is levied by the income payer from every transferred sum (or those accrued in favor of a foreign recipient). Tax rates are usually 25–30 percent. Rates can be reduced under international tax agreements on the reciprocal basis. Tax incentives are not provided.

Merits and Demerits. Taxes play an important role in regulating tax relations between countries, especially taking into consideration that foreign trade share in GDP exceeds 50 percent in many developed countries. Taxes applied directly affect the interests of capital and technology exporters, which is why such countries are interested in tax rate reductions and even cancellation, e.g. through international tax agreements. In contrast, capital importers consider taxes to be a neces-

sary tool to protect their material interests. Taxes are easily levied (on banks' and companies' foreign transactions; there is no need to get income recipients' reports or even to know their origin and legal status). At the same time, tax control on operations aimed at tax evasion is still required, e.g. for shell companies in tax havens, income sheltering under trade and investment transactions, etc.

Value added tax (VAT). The taxation object is value added in the production process. It's calculated as a difference between total revenue of the company and its full material expenses (except for salary). Tax is levied quarterly or monthly. The tax amount due is calculated as VAT included in price of sold goods minus VAT paid to suppliers of consumed material resources. The tax rate can be standard, usually 12–25 percent; reduced up to half of the standard rate; and zero—for the export of goods and services. In the EU, no member country can apply a standard rate lower than 15 percent. Companies with low turnover can choose the VAT-free special regime.

Merits. The tax rules and their application are completely unified in the EU. Export can be promoted automatically (it's reasonable if the export's structure is worth promoting).

Demerits. This tax requires a huge amount of calculations and documents, including confirming the amount and kind of trade deals (bills on each transaction must be kept). Constant and prompt control on foreign and domestic operations is required; operations as subjects for different tax rates must be accounted for separately.

Tax on total sum of expenses. This tax has not been put into practical application to date. The project was suggested by N. Caldor in 1955. It is intended as a substitute for personal income tax. The taxation object is the total sum of personal consumption expenses per year, including expenses through credits, loans, gifts, etc. The tax base does not include savings and investments (e.g., share in company's capital, securities, insurance policies, etc.). Tax rates can be moderately progressive, the same or lower than rates of personal income tax. Nontaxable minimum and tax incentives are not provided.

Merits. Savings and investments are promoted automatically. It's hard to hide the expenses of wealthy individuals (main taxpayers); ex-

penses can be controlled more easily than incomes. Such a tax can be a tool to fight the super-consumption trend.

Demerits. A system of control on purchases is required. It's hard to get information about purchases made online, abroad, etc.

Agricultural tax. In a majority of countries, this tax is used as an alternative to profit tax. It is a simplified kind of craft tax, without any serious demands regarding accounting and reporting for small farmers. The tax amount is calculated as contingent rent of a piece of land according to the land square or as a net income calculated in a simplified way. Tax rates are proportional, usually much lower than profit tax rates. In European countries, the tax is not important because farmers receive substantial budget support (“negative” tax).

Merits. As tax base is easily accounted for, expenses on tax control are reduced dramatically. Agriculture is a base for food security of the country and a sector of family economy (with higher share of families with several children) and it is treated under a favorable tax regime.

Demerits. The favorable tax regime provides opportunities for aggressive tax planning in related areas.

Social security taxes (fees). The object of taxation is individuals' personal income from employment and entrepreneurship. The tax is paid by a tax deduction from the paid income in the moment of any income payment or by the taxpayer personally. The tax base is the total sum of personal incomes and remunerations obtained as a result of individual activity. The total tax rate (to all funds) is 15–30 percent. Tax rates are generally proportional, yet moderate regression can be used. A maximum of nontaxable income is usually set; sometimes nontaxable minimum can also be used.

Merits. The tax provides an independent financial source for pensions and social benefits. It gives the impression to citizens that their labor efforts are important for the amount of their pension.

Demerits. The tax puts an additional burden on organizations' salary funds, which can have a negative impact on production competitiveness. As a form of pension insurance, the tax is less effective than private (independent) insurance. As a trust tax, it loses its efficiency as the number of recipients of pensions and benefits increases.

2.4. Deals Taxes

Custom duties. The taxation object is formed by export, or import, or transit operations with commodities crossing a border of the state. Duty is paid on each operation. The tax base is commodities' batch volume for every batch of commodities crossing the border. Batch volume can be quantitative or estimated in money. Duty rates (tariffs) are established in the customs code. The government has a right to change such rates promptly. Incentives can be provided on some commodity groups, in some regions and within special zones of privileged taxing for some taxpayers, both legal entities and natural persons. For the latter, norms of duty-free import of goods are usually set.

Merits. Duty is easy to collect once, at the moment of crossing the border. The regime is unified for public entities and natural persons. It's possible to respond quickly to external economic conditions (e.g., changes in world prices, protection of certain industries from unfair competition, etc.).

Demerits. If manipulations with duty rates are too aggressive, trade partner countries can respond in kind.

Retail sales tax. The object of taxation is retailers' sales turnover. Tax is paid monthly. The tax base is composed of total revenue of stores, shops, other retailers. Tax rates are set as a share of sales, up to 5 percent. Tax incentives can be provided to cooperative vendors.

Merits. The real sector of the economy (industry, construction, transport) is excluded from taxation.

Demerits. Retailers' accounting must be controlled; the number of retailers is huge, so, mass introduction of cash machines is necessary. It's difficult to identify cash sales.

Turnover tax. The taxation object is wholesalers' and retailers' turnover. Tax is normally paid monthly. The tax base is composed of commodities sales revenue, and direct sales to customers. The tax rate

can be set for certain groups of goods as a wholesale price premium, as a retail price discount, or as price difference when retail prices are fixed administratively. Tax rates are generally 15–20 percent; for luxuries or for “unwelcome” goods (e.g., tobacco, alcohol), rates can reach 100 percent or more. Tax incentives can be provided for goods sold at fresh markets.

Merits. The industrial sector is excluded from taxation. Taxation can be differentiated for various groups of goods. Tax can be a tool of control on retail prices on the large-scale goods of mass demand.

Demerits. Separate accounting is necessary for groups of goods taxed under various rates. Certain tax control difficulties are likely in identifying cash sales, barter deals, etc.

Excises. The taxation object is retailers’ turnover. Tax is typically paid monthly. The tax base is the total sum of trading companies’ sales revenue, including direct sales to customers. Tax rates can be set for certain groups of goods as a wholesale price premium, as a retail price discount, or as price difference when retail prices are fixed administratively. Tax rates are generally 15–20 percent; for luxuries or for “unwelcome” goods (e.g., tobacco, alcohol), rates can reach 100 percent or more.

Merits. It’s possible to differentiate the tax burden on various groups of goods. Unwanted kinds of consumption can be limited by means of taxes (e.g., alcohol, tobacco).

Demerits. Separate accounting and tax calculation is necessary for many groups and even kinds of goods.

Stamp tax (duty). This is one of the most ancient taxes. Formerly, it was levied through sales of special revenue stamps; it was mandatory to use these stamps for documents to confirm special legal rights, such as bequests, deeds of gift, deeds of conveyance, etc. Nowadays, it’s sometimes used as a duty or special fee. The taxation object is an object of the deal, which is executed through a special document. Tax base is an estimated value of the deal object or fixed fee for every file (or application), document, or single document page. Tax rates are 2–3 percent of the deal sum; money fees are different for various types and levels of documents. Tax incentives can be provided as different rates for natu-

ral persons and public entities; tax exemptions can be applied for poor people partially or in full, etc.

Merits. Persons who overexploit documents' preparation and copying in the appropriate state bodies bear additional tax burden. State bodies can partly compensate their expenses for document services.

Demerits. Special control measures are necessary for the collection and payment of tax fees to budget.

2.5. Special Tax Regimes

Imputed income tax. The tax is applied as a simplified alternative to general taxation. It substitutes for profit tax, turnover tax, some property taxes, etc. It's used for some types of business activities, mainly for services to individual clients, when control on transactions is difficult and a full accounting system is not applicable. The taxation object includes transport services, advertising, small hotels, retail shops, cafes and restaurants, craftsmen workshops, etc. The tax base is set on physical indicators of particular activities (e.g., sales area, bedroom areas, number of trading places, number of employees, etc.). Tax rates are fixed in money per unit of natural indicator. Tax incentives can be provided at the discretion of local authorities.

Merits. The tax presents a simplified regime of reporting and taxation for small business enterprises. Various levels of taxation are possible according to local conditions.

Demerits. A multiplicity of accounting indicators, difficulties in controlling small businesses, and high tendency for bribery are negative traits of the tax.

Patent fee (tax). This is often used as a special simplified regime, in which several types of taxes are substituted with one fixed fee (fee for patent or license). The taxation object is activities of small business entrepreneurs (usually an upper limit of activities scale, revenue, and sales turnover is set). The tax base is revenue (turnover) and net income. Tax rates are typically lower than profit tax rates (not taking into account other substituted taxes). Tax incentives can be provided at the discretion of local authorities.

Merits and Demerits. These are same as for imputed income tax.

Production sharing agreements. Such agreements are usually used as a simplified taxation regime for exploration and exploitation of new deposits. Direct sharing of mined resources between the operating

company and government, along with cancellation of all other direct taxes, is established as a method of taxation. Production sharing agreements stipulate sharing proportions; the latter are usually changed within the term of deposit startup and mining. The production sharing start can be attached to the beginning of development, to exploitation, or to the period after direct costs for development are repaid by the operating company.

Merits. New mineral deposits can be explored and developed without raising budget resources.

Demerits. It's difficult to control activities and financial results of the operating company. The propensity to corruption is high.

2.6. Systemic Taxes

Systemic taxes differ from specific taxes because they introduce either a uniform tax regime for various taxation subjects or even summation of taxation objects.

There are a number of main features of systemic taxes, outlined here. Systemic taxes are established by one legislative act; order of taxation and tax amount calculation is unified; tax rates are either fixed or their grades are clearly defined; sometimes a special system of tax payments offsets and coordination is applied; and a special procedure for coordination with foreign tax analogs is provided.

Custom duty gives an example of the simplest and oldest systemic tax. Custom duties are established by single law, rates are regulated by unified custom tariff, and custom duties are charged once on every commodity. Custom duties are internationally discussed, and partners' tax regimes tend to be coordinated and brought together.

Value added tax (VAT) is the most recent example of a systemic tax. It substitutes several separate taxes, such as turnover taxes, excise taxes, duties; it is large scale, as it's imposed on a wide range of goods and services. A uniform order of tax amount calculation is provided; in majority of countries, a uniform order of tax offset for foreign trade operations is applied (e.g., uniform tax rate for export, zero rate for import). Usually, the tax rate is uniform (EU countries have proclaimed the goal of unifying their tax rate, yet some countries apply reduced rates for certain goods and services).

Income taxes provide an example of the most developed systemic tax. Initially, income taxation started with a special tax on some privileged, wealthy individuals, and then separate taxes arose for various types of income (e.g., salary, entrepreneurial profit, interest, dividend, capital gains, etc.).

In developed countries, income taxes are applied as a unified system of income taxation. In the system frames, the so-called advance taxes and total (final) tax are distinguished. Advance taxes are those

charged “at the source,” such as on employees’ wages, interest, dividends, royalties, payments for author’s rights, capital gains, etc. In the majority of countries, taxes on corporate profits are also connected with the income tax system to differentiate taxation of net and gross corporate profit, or to set-off or compensate tax charged on dividends. Those countries use uniform rules of taxation for base calculation, tax payment order, dispute resolution, etc.

Part

3

Tax Administration

- 3.1.** Tax Relations and Tax Administration
- 3.2.** Taxpayers' Rights and Obligations
- 3.3.** Rights and Obligations of Tax Authorities'
- 3.4.** Specific Features of Tax Authorities' Structure and Functions

3.1. Tax Relations and Tax Administration

Tax administration in its wider sense means the system of administering tax relations as a whole by the government and its bodies. Tax relations include relations between:

- a) Taxpayers and tax bodies;
- b) Various levels of tax system;
- c) States in the sphere of taxes.

Tax administration presumes activities of all state powers (executive, legislative, and judicial branches):

- a) To determine tax policy;
- b) To establish tax legislation;
- c) To regulate execution of tax legislation; and
- d) To resolve disputes between tax relations' parties.

Tax relations emerge between the executive power presented by tax bodies and the subjects of taxation. Subjects of taxation are individuals and public entities who bear an obligation to pay taxes on their own expenses. To execute control functions, a corresponding system of administrative and legal measures is adopted by the subjects of tax control before tax relations emerge.

Tax administration in a narrower sense means *tax process management*. A tax process is considered to be a sequenced set of actions by tax authorities, tax agents, taxpayers, and their representatives related to the execution of tax obligations according to tax legislation. The process is aimed at collecting taxes to be paid to a budget system and extra-budgetary funds.

The tax process includes the following stages:

- a) Taxpayers registration;
- b) Registration and accounting of taxation objects;

- c) Preparation, presentation, and verification of tax reports;
- d) Tax collection and payment to budgetary funds;
- e) Resolution of tax disputes and tax recalculation;
- f) Identification and prosecution of tax violations;
- g) Recovery of arrears and penalties on taxes.

Tax administration provides the tax process with:

- a) Human resources (e.g., professional training of tax specialists; enhancing of tax bodies' organizational structure);
- b) Mechanisms for its participants' informational and technical interaction (e.g., determination of information scales and types; establishment of and support for technical communication channels; software development);
- c) Accounting and money services.

Hence, tax administration in the narrow sense covers tax bodies' activities aimed at providing tax payments in full and in due time according to legislation and under the following conditions:

- a) Correct application of legislative provisions to encourage taxpayers to abide by the law;
- b) Proper control and execution of legislative tax penalties for entities violating tax legislation or prone to its violation.

Functions of tax administering include regulation, control, stimulation, and punishment.

Means of tax administration include management of human resources, information resources, and cash flows.

The *object* of tax administration is taxpayers' execution of their obligation to pay taxes.

Governmental tax bodies and other authorities running activities related to tax calculation and levies according to tax legislation, on the one hand, and taxpayers, on the other hand, are recognized as *tax relations parties*.

Entities and individuals authorized by tax relations parties to execute certain acts in the sphere of tax relations according to current legislation are recognized as *participants of tax relations*. Their rights and duties follow from rights and duties of the authorizing party of tax relations and are limited with respect to gained powers.

Certain functions, rights, and obligations of tax authorities regarding collecting and verifying taxpayers' tax reports, information support for tax control, and levying taxes and collecting arrears can be delegated to other entities and individuals.

Entities and individuals collecting and verifying taxpayers' tax reports and performing informational support of tax control on behalf of tax bodies or due to delegated powers are called *informational tax operators*.

Entities and individuals calculating and withholding taxes on paid income amounts on behalf of tax bodies or due to delegated powers are called *tax agents*.

Entities and individuals collecting taxes and arrears on behalf of tax bodies or due to delegated powers are called *tax collectors*.

3.2. Taxpayers' Rights and Obligations

Tax relations are fundamentally based on taxpayers' rights and obligations. Thus, a taxpayer's rights emerge only as a result of obligations imposed on him by law. Consequently, only if a particular taxpayer has an obligation to pay taxes do tax authorities have a right to control tax calculation and payment, and, as a result, have obligations to taxpayers.

A taxpayer is an individual or an entity legally obliged to pay tax. In certain cases, taxpayers are obliged not only to pay tax but also to keep accurate accounting and submit reports for the purposes of control on tax amount calculations; they may also be obliged to provide the tax authorities with information related to their activities and taxation objects (e.g., information for registration with the tax authority, tax reports, and declarations).

Thus, taxpayers of the income and property taxes are obliged to register with the tax authority and to follow the rules and norms of registration; to keep records of their actions in compliance with the rules set for particular taxation objects; to keep and present necessary reports for particular taxation objects; and to collect and keep documents and confirming materials related to tax reports presented to the tax bodies during the period fixed in law.

The lists of particular actions and facts due to be reported to the tax authorities can be established by law within taxpayers' obligations. Such facts and actions can also relate to other parties who have contracts or property relations with the taxpayer or who receive income from him. A taxpayer can be obliged to inform tax authorities about opening deposits in banks and in other financial institutions, purchasing securities and participating in the capital of business companies, about commercial property and other assets, etc.

The identity of a taxpayer is determined by the type of tax. In the case of income and property taxes, a taxpayer is clearly defined as an income recipient or property owner. In the case of deal taxes, one of

the parties can be recognized as a taxpayer (e.g., an exporter for export custom duty, an importer for import custom duty) or both parties alternatively or jointly (e.g., in case of immovable property sale).

Taxpayers' *obligations* include the following: to pay taxes; to register with tax authorities; to keep records of their activities (operations) and submit them to tax authorities; to inform tax authorities about their property, income and about activities of other individuals and entities within the limits and conditions established by law; and to execute judgments of court and follow conditions of settlement agreements (pre-trial agreements) with tax authorities.

The obligation *to pay taxes* implies that the taxpayer must do the following:

- Execute in full and in a timely manner any tax obligations calculated by the taxpayer himself;
- Make in full and in a timely manner tax payments according to tax authorities' demands;
- Abide forms, conditions, and order of tax payments established by law or recommended by tax authorities.

The obligation *to register with tax authorities*, and to *keep records* of activities (operations) and submit them to the tax authorities implies that the taxpayer must do the following:

- Register with the tax authority in a timely manner and report all necessary information fully and properly;
- Maintain records of his activities as stipulated by law and provide necessary documents to register and account for taxation objects in his possession or charge;
- Submit tax accounting reports in full and in a timely manner to the tax authority according to procedure and conditions established by law.

The obligation *to inform tax authorities* about their property, income, and about activities of other individuals and entities implies that the taxpayer must do the following:

- Provide in reports submitted to tax authorities all necessary information to identify counterparties and partners in business activities for the purpose of charging taxes;
- Provide on tax authorities' demand all necessary information on prices, tariffs and other conditions of contracts and about other operations involving taxable objects for purpose of taxation;
- Provide information about other individuals and entities according to conditions and procedures stipulated by law for purpose of the tax authorities' control activities.

The obligation *to execute judgments of court* and follow conditions of settlement agreements (pre-trial agreements) with tax authorities implies that the taxpayer must do the following:

- Execute in full and in a timely manner a court's judgments on payment of prescribed amounts to the accounts of tax authorities;
- Inform tax authorities in full and in a timely manner about decisions of courts rendered in favor of the taxpayer;
- Execute in full and in the agreed term all conditions of the settlement agreements (pre-trial agreements) with tax authorities.

Taxpayers' *rights* include the following: to receive information; to use in their favor any norms and rules of tax legislation; to be compensated for any overpaid taxes; not to comply with unlawful requirements of tax authorities or to appeal them according to stipulated orders; to receive compensation for losses due to unlawful actions of tax authorities.

The main rights of the taxpayer can be distinguished as: the right to information (full and timely information from tax authorities about all obligations related to paying taxes; information should be provided free of charge and in an accessible form); the right to observe and preserve tax secrets related to submitted tax accounting reports and private information; the right to compensation for losses due to unlawful actions of tax authorities and their officials.

The right to information implies the following rights:

- To get information on related norms and provisions of tax legislation;
- To get written explanations of issues related to application of the tax legislation;

- To get information on existing or absent tax arrears to the date of the latest inquiry.

The right *to use in their favor any norms and rules of tax legislation* implies the following:

- To choose any of the legally stipulated forms of deals and types of activities;
- To choose any particular jurisdiction to conduct activities or possess and dispose of taxable objects;
- To use tax exemptions, deferrals, deductions, rebates, or other tax incentives or to choose favorable special tax regime.

The right *to be compensated for overpaid taxes* implies the following:

- To receive a refund for overpaid sums of money by transfer to his bank account;
- To demand to set off taxes paid in excess in favor of current or future tax payments of any taxes to any budgets or funds;
- To “keep silence” (to give tax authorities the chance either to return or to set off overpaid sums of taxes).

The right *not to comply with unlawful requirements* of tax authorities or to appeal them according to stipulated order implies the following:

- To refuse in writing to execute unlawful requirements of tax authorities;
- To demand a substitute official in place of a tax authority official who imposes unlawful tax demands;
- To appeal in stipulated order actions (or inaction) of tax authority’s officials.

The right *to receive compensation* for losses due to unlawful actions of tax authorities implies the following:

- To get compensation for material losses;
- To get compensation for moral hazard;
- To accrue and receive interest related to untimely payment of stipulated sums of compensation.

3.3. Rights and Obligations of Tax Authorities

Tax authorities' *rights* are evidently basic for them, in contrast to the taxpayers, whose rights are the result of an obligation to pay taxes. Tax authorities' rights include the following: to organize and administer the tax process and its particular procedures; to control; to collect and store information; to collect taxes; to exercise tax accounts and distribute tax revenues; to claim tax indebtedness, penalties, and other tax sanctions and to recover them; to cooperate with tax authorities of foreign states and with specialized international organizations.

The right *to organize and administer tax process* implies the following rights:

- To establish, reorganize, and abolish certain divisions of tax authorities; to define their functions, specialization, and territorial jurisdiction;
- To define the content and conditions of cooperation with other state bodies and local authorities;
- To file actions with courts and arbitration on issues within their competence.

The right *to control* implies the right to control the following:

- The process and conditions of tax accounting and tax report preparation;
- Correspondence between a taxpayer's declared income and expenses, including the process of accumulating property (wealth);
- Physical parameters of taxpayers' activities (including inspections ad hoc) to confirm they match declared information about their income and property.

The right *to collect and store information* implies the right to collect, save, and accumulate the following information:

- Information from “third parties” (e.g., banks, insurance companies, notaries, etc.) about taxpayers’ property, income, and activities;
- Information from other state bodies, local authorities, and databases maintained by state bodies;
- Information from foreign authorities and organizations and from international organizations.

The right *to collect taxes* implies the following rights:

- To collect tax revenues directly on behalf of the state and in favor of extra-budgetary funds, local authorities, and self-managed bodies;
- To define the order, methods, and instruments of paying taxes;
- To collect taxes through intermediaries (e.g., third parties, tax agents).

The right *to exercise tax accounts and distribute tax revenues* implies the following rights:

- To perform settlements (to refund and to set off) on tax payments recovered in advance;
- To carry out refunds on taxes which presume refunds (e.g., VAT, custom duties);
- To distribute recovered tax revenues to specific elements of the budgetary system, to extra-budget funds and to other organizations.

The right to claim tax indebtedness, penalties, and other tax sanctions and to recover them implies the following rights:

- To claim and recover tax indebtedness directly from a taxpayer’s account or at the expense of his other assets in ownership or disposal of other entities and individuals;
- To claim and recover penalties and other tax sanctions;
- To apply other measures for the purpose of recovering penalties and other tax sanctions, including suspension of bank account operations or property arrest.

The right *to cooperate with tax authorities* of foreign states and with specialized international organizations implies the following rights:

- To share information according to order and volumes defined by law or under the conditions of international treaties (e.g., agreements, conventions) with a particular state;
- To conduct joint analytical developments and tax investigations in order and volumes defined by law or under the conditions of international treaties (e.g., agreements, conventions) with particular state;
- To share experience and perform joint scientific, methodical, research, and educational projects within their competence.

Tax authorities bear a number of ***obligations***. Those obligations include an obligation to comply strictly with current legislative norms while executing their functions and enjoying their rights; to inform taxpayers; to perform tax settlements in full and in a timely manner; to bear responsibility for their actions according to the order and volume provided by legislation.

A tax authorities' obligation *to comply strictly with current legislation norms* while executing their functions and enjoying their rights imply the following:

- To exercise control over compliance with current legislation at all levels of tax system and in all its elements;
- To exercise control over compliance with current legislation on tax agents and other individuals (organizations) executing certain functions and enjoying certain rights of tax authorities;
- To comply strictly and to control compliance with the conditions of current international treaties (agreements).

The obligation *to inform taxpayers* implies obligations to inform taxpayers in full and in a timely manner on the following subjects:

- On carrying out one's tax obligations;
- On the results of tax audit and control procedures related to carrying out one's tax obligations;

- On discovered tax arrears and on imposed penalties and other tax sanctions.

The obligation *to perform tax settlements* in full and in a timely manner implies the following actions:

- To exercise all tax settlements;
- To refund to the taxpayer sums paid in excess; to make tax remunerations and compensations according to decisions of courts in strict compliance with the order and terms set by legislation;
- To inform the taxpayer promptly about the results of recalculation of his tax obligations and to refund sums of excess payments to his bank account in a timely manner or to inform the taxpayer about necessary additional payments.

The obligation *to bear responsibility for their actions* in volume and order provided by legislation implies the following:

- To inform the taxpayer in a timely manner about tax authority officials' wrong actions or mistakes related to him and to provide information about the taxpayer's rights and possible incentives and compensations established by law for similar cases;
- To bear liability in tangible form within the limits and conditions established by law.

Moreover, tax authorities are obliged to ensure taxpayers' rights related to their *private life and activities*.

Tax authorities are obliged to observe full confidentiality of any information about taxpayers' private lives and activities which was collected for levying taxes and for control over submitted tax accountings. Information provided by taxpayers and collected by tax authorities concerning taxpayers can be used exceptionally to execute tax legislation. Such information can only be provided either on the taxpayer's written permission (if he is informed about the request of a person or entity who is interested in that information) or by a court decision during resettlement of the tax dispute.

Information about taxpayers which is protected by a confidentiality regime is to be kept in a manner which ensures that information cannot

be used by unauthorized persons or for improper purposes. Tax authorities, represented by their heads and officials, are fully liable for ensuring a proper method of storing information.

The confidentiality regime does not cover information about tax base, total sum of taxpayers' tax obligations on particular taxes, or performing their obligations to pay taxes and repay tax arrears.

The taxpayer has a right personally or via his representative to find out about information related to him and his family that may be collected and stored by tax authorities; if either inaccuracy, mistakes, or excessive information is discovered, or the term of storage expires, the taxpayer can act according to current legislation on the protection of private life. He can demand to correct, eliminate, or terminate storage of corresponding collected or improperly kept information or its sources.

3.4. Specific Features of Tax Authorities' Structure and Functions

Operational management of the tax process is performed by *tax authorities*. This function includes control over tax accounting reports, collecting taxes, and pretrial resolution of tax disputes with taxpayers. The principles and order of tax authorities' internal structure depend on the constitutional structure of the particular state, on the tax authorities' place in the fiscal and budgetary system of the country, and on the purposes and priorities of the tax work.

Along with general organizational principles, a *tax technique* plays an important role in tax authorities' activities. Tax technique presumes a set of specific ways, methods, customs, and traditions. Many of these are rooted in the system of political, social, economic, judicial, and moral relations specific to a given country and society. Nowadays, the ongoing process of informatization increases the speed and eventually defines many changes in tax techniques. Such changes can be seen at all stages and in all elements of the tax process, including specific forms of tax authorities' work, and also in the form of relations between all the parties and participants of the tax process.

To use the tax potential of the country in full, tax authorities should not only ensure execution of tax legislation but also efficiently perform the functions of tax administration. Hence, the internal structure of tax authorities should also be efficient and correspond to their purposes. The type of structure depends on what organizational scheme is the most convenient for various functions to be carried out.

Practical evidence demonstrates that tax administering authorities in many countries were established following the problems evinced by tax systems' development. For instance, introduction and further development of income taxes, sales taxes and VAT, tax incentives schemes, new means of tax evasion, and tasks to inform taxpayers adequately and to train tax specialists posed new challenges to tax authorities and, in general, the proper measures were not taken promptly.

A. Types of organizational systems

Tax administration can be arranged based on functions (functional type) or on types of taxes (specialized type).

Within the functional type, the so-called normative functions and operational functions are distinguished. The former are usually performed at the national level, whereas the latter include functions directly connected with taxpayers.

According to the approach based on specialization, particular departments deal with corresponding types of taxes within the system of tax bodies.

Combined types of *organizational* arrangements are also possible, e.g. certain specialized departments in a functional structure or functional departments in a specialized structure can exist as well.

B. Types of functions

Tax administration functions are usually divided into *normative* and *operational* and into *basic* and *auxiliary* types

Normative functions correspond to the first task of tax administration, i.e. to interpret and apply tax legislation and normative regulations. These functions deal with resolution of problems related to application of law; they ensure execution of operational functions through development and introduction of special methods and procedures to guarantee high efficiency of tax operational system. In turn, the operational system establishes the basis to achieve one more task related to tax administration, i.e. to maximize tax revenue for minimal expenses.

Operational functions are primarily related to practical activities of tax collection. They join both tasks of tax administration, promoting close interaction between tax authorities and taxpayers and encouraging taxpayers to voluntarily fulfill their obligations to pay taxes.

Hence, both normative and operational functions of tax administration have the same goal, yet normative functions presume normative (e.g., legal, organizational, and methodical) decisions while operational functions (e.g., tax audit, taxpayers' registration, and tax collection) are executed only at the operational (practical) level.

Basic functions of tax administration include accounting and registration of taxpayers, current tax control, and tax audit.

With the function of *accounting and registration of taxpayers*, consistent and proper accounting (identifying) of all taxpayers who have properly registered (or declined registration) is performed. This function forms a basis for relations between tax authorities and taxpayers.

The function of *current tax control* defines clearly, according to established order and considering updated information, all obligations of the taxpayer (e.g., declared or calculated taxes, monetary penalties, fees, etc.) and tax offsets as a result of a taxpayer's payments or provided incentives. The main goal of such control is to define properly and exactly existing tax arrears or failure to submit a tax declaration.

A *tax audit* involves all types of activities aimed at checking the correctness of tax declarations and defining tax amounts hidden from taxation while conducting an audit or investigation at the place of a taxpayer's or third party's residence or at the tax authority office.

Auxiliary functions provide the basis for performing basic functions.

Legal function. The legal function is extremely important, as it provides proper application of normative tax regulations both by taxpayers and by tax authorities. It also provides answers to the requests and appeals of taxpayers, assistance to all tax bodies, and ensures participation in processes of change in tax legislation.

Human resources. Human resources management is a key function of any organization. It's especially important for tax administration, as it plays a key role in education and training of tax authorities' officials.

Informing taxpayers. The function of informing taxpayers is necessary to ensure a high level of compliance with tax legislation. Tax administration bodies should have a specific department or divisions responsible for dissemination of normative regulations and assistance to taxpayers in carrying out their tax obligations.

Organizational and managerial function. In general, internal accounting divisions and departments responsible for logistics and maintenance of working equipment execute this function.

Internal information support. Informational systems are now a basic element required to perform the most important functions of tax administration and to make decisions at all levels. Any tax authority

works with a large number of taxpayers and that means a significant amount of documents; it's expensive and inefficient to process those documents manually. To develop a useful informational system, a tax database (e.g., previous tax declarations data, information from other sources, data on timely carrying out tax obligations, etc.) is crucially important as a basis for performing a function of control over taxpayers.

Science and technology developments provide procedures and equipment (e.g. computers, processes of microfilming and printing) which match the needs of all functional spheres of tax administration.

Part

4

Tax Jurisdiction of the State and International Tax Relations

- 4.1.** Tax Jurisdiction
- 4.2.** Tax Residents and Nonresidents
- 4.3.** Tax Liabilities of Foreign Entities
- 4.4.** International Tax Relations

4.1. Tax Jurisdiction

International tax relations are based on national norms (which define the area of tax jurisdiction for every particular state) and on bilateral and multilateral tax agreements and commonly recognized norms of international law.

Tax jurisdiction is an area covered by tax legislation of a particular state or its administrative subdivision which has tax power. The area is limited by the territory of the state or its division and by the set of tax rights concerning individuals, entities, and tax objects conducting activities within or outside that territory.

Self-limited tax jurisdiction (tax rights) is possible on the basis of reciprocity or international tax agreement, yet always under the condition of mutual benefit and direct or indirect compensation for missed tax revenues.

Territorial limits of tax jurisdiction of the *state* cover the territory of the state including territorial waters, as well as the economic zone and continental shelf, where sovereign rights of the state or rights for exclusive and other activities are applied.

Tax jurisdiction of the *administrative subdivision* of the state is determined with respect to its territorial limits and adjacent waters as established by law on the territorial arrangement of the state.

Tax rights of the state or its administrative subdivision concerning tax subjects conducting activities within or outside its territory are determined according to the connection of those individuals or entities, their activities, or tax objects to the territory of the state or its administrative subdivision. Such a connection can be indicated on the basis of *tax residency* of the individual or entity and property on tax objects.

Tax jurisdiction of the state is determined according to the territoriality principle and the principle of national connectivity.

The *territoriality* principle determines the right of a state to levy taxes on property, income, and deals within the territory of state sovereignty.

The principle of *national connectivity* determines the right of state to levy national individuals and entities that own property, receive income or make deals within the territory (territories) of state sovereignty of the other state (states).

The territoriality principle has priority over the national connectivity principle in intergovernmental relations. A government applying the principle of national connectivity can eliminate double taxation of its nationals resulting from taxation of property, income, and deals within the territory of other states according to norms of national tax legislation or through tax agreements with the other country (countries).

Methods of exemption (elimination) of international double taxation are as follows:

- Exemption out of taxation (tax object, taxpayer);
- Offset (tax paid abroad is accounted as costs for calculating taxpayer's taxable income);
- Tax credit (tax paid abroad is accepted in favor of the taxpayer's liability).

4.2. Tax Residents and Nonresidents

The tax residency of a person can be determined by his citizenship; the location of his permanent living apartment; the center of his family, economic, or financial interests; his usual residence; or his determination to stay in the territory of the state for not less than 183 days per calendar year (through the period of 12 months sequentially).

Tax residency of an entity can be determined by its registration (incorporation) place, the residence of its main activities (main assets), or residence of its head bodies (head office) or management (e.g., permanent residence of the company's president, place where meetings of directors' board are held, residence of main shareholders, etc.).

If disputable issues regarding the residency of persons or entities in two countries or more (dual residency) arise, substance criteria have priority over form criteria. If the involved governments have concluded international tax agreements, then questions of dual tax residency are resolved according to the order established by that agreement.

Tax residency can be used to distinguish tax rights and powers between administrative subdivisions of the same state. The regulating regime for those issues is established by tax legislation of the respective state.

Taxation of tax residents and nonresidents. Tax residents may be taxed on the total amount of their income received from any source, both in their country and abroad (principle of "worldwide" income) and total sum of their property (assets) both in their country and abroad (principle of "worldwide" property). Nonresidents may be taxed in the respective country only on income received in that country or from sources in that country, and only on property (assets) owned or used in the respective country.

Tax residents and nonresidents alike may be taxed on all deals carried out in the territory of the respective country. Nonresidents cannot be taxed in the respective country on foreign trade contracts with its tax residents. For residents, the taxation regime on foreign trade contracts is established by law for particular types of taxes.

When income tax is applied, tax regimes are differentiated as follows:

- For tax residents of the respective country, a *full (unlimited) tax liability* regime is applied; tax residents may be taxed on all incomes from all sources, including foreign sources;
- For tax nonresidents without a *business entity* in the respective country, a *limited tax liability regime* is applied; only incomes from the sources in the respective country are taxable;
- For tax nonresidents having a business entity in the respective country, two regimes can be applied: (1) all incomes are attached to the income of the business entity for taxation of net profit, and (2) incomes are taxable separately, as the business entity's profit and as income from sources in the respective country.

A special procedure is applied to identify the tax liability of foreign entities.

4.3. Tax liabilities of foreign entities

Commercial or investment activities in the territory of a particular state carried out by foreign entities as well as their property (assets) and income from the sources in that state provide a reason for taxation of the entity in that state.

A foreign entity's activities are defined on the basis of several criteria. The *place of activities* criterion presumes maintenance and use of a fixed place of business (e.g., an owned or rented place, mine, pit, building site, storage). The *regularity* criterion presumes performing constant operations repeatedly (e.g., organizing entertainment and theatrical events, sporting events, temporary exhibitions, advertising companies, etc.). The *agent relations* criterion presumes concluding contracts through agent.

The foreign entity is presumed to own property (assets) if immovable objects, ships, aircraft, or movable objects in the territory of the respective state are transferred to its property permanently or temporarily. Property (assets) of a foreign entity in the territory of the respective state can be taxed based on place of location (immovable property), registration (ships and aircraft), or involvement in activities of the foreign entity.

Foreign entity's income received from sources in the territory of the respective state is presumed not to be connected with the foreign entity's activities in that state. Investments in property, other capital assets, or use of the entity's intellectual property in that state can be sources of its income.

At the same time, regularity, or permanently gaining profits from the sources in the territory of the state, can be presumed to involve carrying out activities by the foreign entity (on the basis of the regularity criterion).

Generally, almost all countries consider any activities by a foreign entity in their territory to be taxable regardless of whether those activities are long-term, regular, or commercially aimed.

The following methods can be applied to determine tax liabilities of a foreign entity depending on its activities type:

- (a) On the ground of its accounting data submitted as a balance sheet (as a separate division of the business entity);
- (b) On the ground of imputed income, which is calculated according to quantitative indicators of the foreign entity's activities in respective state compared to indicators of its total activities (e.g., shares in sales turnover, in consumption of raw materials, in assets [capital], in total employees' wages, etc.);
- (c) On the ground of total amounts and types of income from sources in the territory of the respective state.

Sector of foreign entity's activities. Repeated deals and transactions by a foreign entity or its regular activities in a particular state make one or several sectors of its activities (SA) in the respective state. If the foreign entity runs one or several SAs, it's supposed to maintain and submit separate accounting balance sheets to tax authorities in the form and according to the term established by legislation of the respective state. The foreign entity should compile separate balances for each sector of activities or join them in one unified balance for all its SAs in a particular state.

The final result (balance sheet) for each SA is calculated with prices and tariffs that are applied (or could be applied) by an independent company running the same business under the same or similar conditions.

National legislation can establish requirements regarding permanent activities (type of activities) and/or fixed activities (place of activities). Those requirements are usually applied mutually on the basis of international tax agreements concluded between particular countries. The abovementioned requirements determine the concept of *permanent (fixed) place of activities (PPA, FPA)* concerning foreign entities of one or both respective states carrying out activities in the territory of the other state.

Indicators of permanent or fixed activities are provided by a bilateral tax agreement in general or for specific types of activities.

To observe the principle of mutual benefit, some tax rights of the state can be limited through a tax agreement:

- (a) Concerning foreign entity's activities (with application of the PPA [FPA] concept on the basis of respective criteria);
- (b) Concerning property owned by a foreign entity in the territory of the respective state (withdrawal of certain objects [e.g., premises and transport means of foreign embassies and international organizations] from taxation on mutual basis);
- (c) Concerning a foreign entity's income received from the source in respective state (reduced rates of taxes levied at the source of income).

Many governments tax "worldwide" income and "worldwide" property; hence, objects of taxation in the territory of foreign countries, i.e. in their tax jurisdiction, are also involved in relations between a taxpayer and tax authorities.

At the same time, the sovereignty of the state within its own national territory is also enshrined in tax law.

The right of the state to apply any taxes and levy any objects in its territory is not questioned. Naturally, any person or legal entity which carries out activities in the territory of a certain state is presumed to be its potential taxpayer. But conditions of its taxation are fully and completely determined by the host country; the latter can take or not take into consideration the foreign origin of the entity. Another state which considers entity in question to be its resident can do nothing about that fact. But it can levy foreign activities of the entity with the justification that it belongs to the state of origin.

To mitigate (avoid) the effect of international double taxation, the following methods are usually used: *tax deduction* (expenses on taxes paid in the foreign state are withdrawn from taxable base); *tax exemption* (foreign incomes and property are excluded from taxable base); or *tax credit* (taxes paid in the foreign country are set off against domestic tax on that income). Sometimes, the method of *tax deferral* of foreign income is used (taxation is delayed until foreign income enters the country of the taxpayer's permanent residence).

The first method is usually applied for taxes on gifts and inheritance, and it is the most disadvantageous to the taxpayer. The second

and third methods are applied to calculate the taxpayer's liability on income and property taxes. Tax agreements can either change the way those methods are applied or provide another legal method more favorable to the taxpayer (generally, tax agreements cannot be used to aggravate a taxpayer's conditions, yet if this occurs, the taxpayer can always choose between the domestic norm and the norm provided by the relevant tax agreement).

4.4. International Tax Relations

International tax relations consider the following types of relations:

- (a) Between tax authorities of the state and taxpayers—foreign entities carrying out activities or receiving income from the sources in its territory;
- (b) Between tax authorities of the state and its entities carrying out activities and receiving income abroad;
- (c) Between tax authorities of various countries;
- (d) Between tax authorities and international organizations.

International tax relations regulations can be provided by: unilateral norms and rules established in national tax legislation of each country; bilateral or multilateral tax agreement; or agreement between a particular state and international organizations.

International tax agreements. Agreements can be concluded between states in order to regulate the rules of charging and administering particular taxes (groups of taxes); charging and administering particular kinds of activities; cooperation on levying taxes and struggle against tax evasion; or the exchange information on tax issues.

Provisions and norms established via international tax agreements which have come into force have priority for tax authorities of each of the contracting states in case they contradict respective domestic tax norms. National entities of the respective states have a choice of applicable norms, either domestic or provided by the international tax agreement. Tax authorities have a right to limit the taxpayer's choice through conditions of time period or to prohibit the free choice approach (e.g., to use it for particular cases and not for overall taxpayer activities).

The tax agreement is in force only where it concerns entities and taxes established by its provisions. If a tax agreement covers taxes related to local authorities' jurisdiction, its force can be expanded to re-

spective local taxes, and corresponding procedures should be performed at the request of any contracting party.

International tax agreements can be concluded between two or more countries.

The first such agreements were signed more than 170 years ago between Belgium and France (1843) and Holland (1845). They dealt mainly with administrative assistance and tax information exchange.

Currently, all tax agreements can be divided into two groups. The first group includes tax agreements themselves; the second covers other international agreements and treaties addressing tax issues, among other concerns.

In the *first group*, there are tax agreements of various types: (a) on administrative assistance; (b) limited tax agreements; (c) general tax agreements; (d) agreements on inheritance taxes; (e) agreements on social insurance taxes.

Various international treaties partly addressing taxes comprise a *second group*.

First, there are widespread international treaties on the basis of relations between countries. Usually, such treaties presume tax non-discrimination, i.e. the same tax regime and “treatment” for citizens and companies of both contracting parties. However, it is specified that each country retains the right to provide tax incentives to its citizens and companies and not expand them to the residents of the other country.

Second, these are agreements and treaties on diplomatic and consular relations (including specific consular conventions); reciprocal tax benefits for diplomatic and consular missions and their staff are usually provided herein. The amount of benefits is usually limited by purposes and frames of presence in the territory of the foreign state. The list of benefits is provided by multilateral Vienna Conventions on diplomatic (1961) and consular (1963) relations. The vast majority of countries participate in those conventions. Benefits specified in conventions are usually included in general tax agreements in some form.

Third, there are trade treaties and agreements where a regime of the most favorable conditions is stipulated for goods and services exported from the contracting country. These agreements are usually related only to customs duties, but can establish more favorable condi-

tions regarding general tax rules and other norms of foreign trade (currency, banking, etc.).

There are also purely customs agreements, including multilateral ones (customs unions, etc.). The General Agreement on Tariffs and Trade is a well known example. This was a multilateral agreement on indirect taxation that has been substituted with the WTO agreement.

Some other types of agreements also relate to indirect taxation. These include European directives on “tax harmonization” in the EEC (European Economic Community) member countries: on introduction of unified VAT; on principles of levying VAT to eliminate double taxation; on limitation of tax subsidies for export, etc.

Fourth is a specific type of international treaty where principles of relations between international organizations and countries of their residence are defined. Agreements between the USA and UN on the UN headquarters accommodation in New York; between France and UNIDO and other specialized UN departments; between Belgium and NATO, etc. can give examples.

Along with norms and rules of accommodation and functioning in the host country’s territory, tax benefits for international organizations and their staff are defined in all the aforementioned agreements, as are incentives for representatives of other foreign countries who are appointed there.

The vast majority of tax agreements relate to income taxation. Such questions were put on the international agenda for the first time at the International Financial Conference in 1920. In 1922, within the financial committee of the League of Nations, a working group was set to tackle the problems of international double taxation and tax avoidance. Initially, it included seven high-level tax officials from Belgium, Czechoslovakia, France, Great Britain, Italy, the Netherlands, and Switzerland; later, representatives from Argentina, Germany, Japan, Poland, and Venezuela entered the group.

Further, a League of Nations permanent tax committee was formed in 1929 to build from the working group. The tenth and final session of the League of Nations tax committee was held in London in 1946. It recommended proceeding to address international tax problems within the United Nations. Consequently, on October 1, 1946, a special UN tax commission was founded. It studied problems of state finance un-

til 1954. At that time, the center of international tax cooperation was shifted to the OEEC (OECD since September 1961) tax committee. From 1958–1963, the project of creating a new Model Convention on the elimination of double income and capital taxation in the member countries was drafted (now it's employed in later versions with amendments and corrections). The same committee developed a Model Convention on elimination of double taxation of inheritances in 1966.

Greater attention has been paid to international tax relations at the global level (in the UN and its organizations) since the middle of the 1960s, when many newly liberated postcolonial countries arose. Typical model conventions drafted by various organizations took into consideration only the interest of industrially developed countries and relations among them. In 1965, the OECD tax committee admitted that traditional tax conventions were not intended for developing countries.

Because developing countries are mainly capital importers, it's extremely difficult to protect their interests in the framework of recommended OECD model conventions. That fact was taken into consideration, and in 1967, a special group of UN experts started to work on the new Model Convention. It was drafted in 1980 and became an official UN document which was recommended for use in setting tax relations between developed and developing countries.

Later, the UN Model Convention was widely used as a model for tax agreements between developed and developing countries, and between developing countries as well. Some amendments and modifications were implemented in the OECD Model Convention according to the UN example. Overall, more than 1,200 bilateral agreements have been concluded on the basis of those two model conventions. Tax problems are also studied intensively by the UN commission on multinational corporations and some other UN departments.

Conclusion. Is Unified Tax Feasible?

In the field of tax science, discussion has often arisen on whether a unified tax is feasible and advisable. Yet myriad obstacles to introducing the idea into practice exist, including disagreements among ruling elites and issues related to administering of public economy.

Nowadays, the idea of unified taxation has come on the agenda again, frequently on a practical basis, i.e. new aids of control are applied and information technologies are both widespread and continually developing. Thus, different forms of trade taxation can be substituted by a unified value added tax (VAT) with the help of bank control on trade turnover; meanwhile, universal registration of individuals and entities provides a basis to combine a unified income taxation network for all kinds of their income taxes. In some countries, taxation of *total property* (the so-called wealth tax) is established and successfully applied.

Those three basic taxes are applied simultaneously, which leads to certain difficulties both for taxpayers and tax authorities. At the same time, informatization of common civil life is already high enough to define precisely the tax ability of any individual notwithstanding his wealth and occupation. Hence, it's a matter of choice between unified tax and several basic taxes.

Considering those circumstances, a shift to taxation based on *unified tax on total (net) sum of individual property* can be assumed as a potential future prospect. Equality of taxation can be ensured this way because property ownership is the best indicator of an individual's tax ability; then, taxation will become total because it's impossible to avoid such a tax by hiding one's occupation and source of income. At last, tax control will be sufficient because all property and assets will be registered and accounted for several times via non-tax methods (e.g., securities are registered with a stock exchange, means of transport are reg-

istered with police authorities, immovable property is registered with land cadastres and insurance companies, assets of all types are tracked with registrations of transactions value, with inheritance, etc.).

This new tax will differ from wealth tax in several substantial ways. First, a nontaxable minimum is not imposed, but the initial tax rate will be rather low, e.g. 0.1%, and any inflation-caused increase in property value will be exempted from taxation. Second, it will be free of any benefits and privileges. This is a great merit of this tax because privileges usually provide a basis for malpractices, as is typical of existing taxes.

The idea of such a tax seems rather absurd from the traditional economic viewpoint: savings are “punished” by the tax and, on the contrary, spending is exempted from taxation. Yet on the one hand, saving is a typical habit of individuals—it has not been undermined with inflation, monetary reforms, or high taxes if the latter were not applied as an aid to confiscation. On the other hand, high consumer demand (individuals’ spending) is the best way to avoid crises of overproduction.

Naturally, proper social and economic prerequisites are necessary to apply such a unified tax. The majority of people should belong to the middle class, meaning they should own property; the level of individual economic activities should be high; governmental social, economic, and budgetary policy should be well balanced; tax discipline should be high; and consensus among various social strata should be achieved.

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