


### Why Did the Consolidated Tax Regime Cause Massive Losses in Tax Revenue in Russia?

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#### ABSTRACT

In Russia, the consolidated tax regime was introduced in 2012 but in 2019 the decision was made to abolish it from 2023. The initial reform purported to discourage companies from using transfer pricing for domestic transactions between companies of one group and to ensure a more just allocation of the corporate income tax across Russian regions. In practice, however, the government's shortfall in tax revenue reached two billion US dollars in certain years or 0.15% of Russia's GDP. Our analysis has shown that the publicly available data are, unfortunately, insufficient for assessing the success of this reform, in particular, whether the two above-mentioned goals were achieved. However, we can focus on the role the following two factors played in the budgetary losses. The first such factor is that profits and losses of group members can be consolidated within one accounting (fiscal) period. The second factor is that consolidated taxpayer groups shift their tax bases to regions with lower tax rates (in some cases, regions established tax preferences explicitly for the purpose of attracting members of these groups). These loopholes reveal the deficiencies of the Russian consolidation model: for example, the 'everybody or nobody' principle is not applied in Russia and consolidated taxpayer groups are allowed to form the perimeter of tax consolidation themselves. In this paper, statistical tax reporting data are used to estimate the total amount of the shortfall in tax revenue caused by the regional tax preferences granted to members of consolidated taxpayer groups. In some cases, as our analysis of regional tax legislation shows, these tax preferences were intended to 'steal' the tax base from other regions or at least to prevent the regions' own tax bases from being 'stolen' by rivals. Judging by the total figures, regional tax competition had a negative influence on budgetary revenues. This, however, was not the main factor as the shortfall in revenue was mostly caused by the possibility of immediate offset of losses within consolidated taxpayer groups.

#### KEYWORDS

tax consolidation, budget federalism, interregional tax competition, regional tax preferences, revenue equalization


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### Почему применение механизма налоговой консолидации в России привело к существенным потерям для бюджета?

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#### АННОТАЦИЯ

Россия ввела механизм налоговой консолидации в 2012 г., а уже в 2019 г. приняла решение о его полной отмене, начиная с 2023 г. Вводя данный механизм в налоговое законодательство, правительство планировало устранить стимулы для

применения трансфертных цен по внутрироссийским операциям между компаниями одной группы, а также обеспечить более справедливое распределение налога на прибыль между регионами России. На практике же оно столкнулось с выпадающими доходами бюджета, которые в определенные годы достигали двух миллиардов долларов США (0.15% от ВВП России). Авторы анализируют данные, доступные для независимого исследователя и делают вывод, что их недостаточно для оценки того, насколько были достигнуты две вышеупомянутые цели для бюджета, ради которых механизм консолидированных групп налогоплательщиков и вводился. В то же время, существует возможность оценить вклад факторов, которые привели к потерям бюджета. Первым таким фактором является возможность суммирования прибылей и убытков между участниками одной консолидированной группы налогоплательщиков в рамках одного отчетного (налогового) периода. Вторым же фактором является то, что консолидированные группы налогоплательщиков перераспределяют свою налоговую базу в регионы с пониженной региональной ставкой налога на прибыль: в ряде случаев региональные льготы специально устанавливались для членов консолидированных групп налогоплательщиков. Это возможно в силу ряда несовершенств модели консолидации, используемой в России. К примеру, правило «все-или-никто» не действует в России, и группы могут произвольно формировать периметр налоговой консолидации. Авторы используют данные статистических форм налоговой отчетности для определения общей величины выпадающих доходов бюджета от предоставления региональных льгот участникам консолидированных групп налогоплательщиков. В ряде случаев региональное налоговое законодательство свидетельствует о том, что региональные льготы по налогу на прибыль вводились специально для того, чтобы «перетянуть» налоговую базу других регионов или, как минимум, предотвратить «перетягивание» своей налоговой базы другими регионами. Итоговые цифры говорят о том, что региональная налоговая конкуренция имела негативное влияние на доходы бюджета. В то же время, это не было определяющим фактором. Основная сумма выпадающих доходов бюджета связана с возможностью мгновенного зачета убытков в рамках консолидированной группы налогоплательщиков.

### КЛЮЧЕВЫЕ СЛОВА

налоговая консолидация, бюджетный федерализм, межрегиональная налоговая конкуренция, региональные льготы, выравнивание доходов

## 1. Introduction

The introduction of a consolidated tax base is now widely debated in relation to taxing the digital economy. In 2019, the OECD proposed to reallocate taxing rights in digital-oriented sectors, which came to be known as the Pillar One Unified Approach to Taxing. This initiative is expected to entail solutions that go beyond the arm's length principle and to address the issue of fairness in terms of the apportionment of IT giants' tax base across the countries where they conduct their digital operations and prevent accumulation of profits in the jurisdictions engaging in aggressive tax competition<sup>1</sup>.

<sup>1</sup> *Secretariat Proposal for a 'Unified Approach' under Pillar One: Public Consultation Document*. Paris: OECD Publishing; 2019. Available at: <https://www.oecd.org/tax/beps/public-consultation-document-secretariat-proposal-unified-approach-pillar-one.pdf>

The regime of tax consolidation in Russia is quite close to the one proposed by the European Commission, which makes the analysis of the Russian experience both theoretically and practically pertinent [1].

First, the reform affected the regional component of the corporate tax (up to 18% in 2009–2016 and up to 17% in 2017–2024). The corporate tax makes up the majority of regional tax revenue, accounting for about 30% of the revenue. The experience of the EU and Canada demonstrates that it is difficult to reconcile the interests of different regions if consolidated taxation entails a substantial reallocation of their tax revenues [2; 3].

Second, the consolidated tax reform was deemed unsuccessful in Russia, which would in all probability entail the cancellation of the regime in 2023. Lear-

ning from Russia's mistakes could help the EU authorities to avoid similar pitfalls in the course of the forthcoming European tax reform, especially in addressing the problems that may occur as a result of re-allocation of taxing rights among national jurisdictions.

This study aims to describe the fiscal effects of the tax consolidation regime on the corporate tax base on the regional level and test the hypothesis about the competition between Russian regions for the tax base of consolidated taxpayer groups.

The tax consolidation regime was introduced in order to reallocate corporate tax rights between Russian regions and thus discourage transfer pricing. There are, however, several limitations that impede comprehensive analysis of the reform's outcomes.

**Limitation 1.** *Lack of publicly available data on the reapportionment of the tax base across Russian regions*

Estimating the reapportionment of the tax base across Russian regions is a challenging task since the size of the tax base for each region is determined by a variety of factors, which need to be taken into account apart from the apportionment formula itself. It is necessary to evaluate each consolidated taxpayer group's contribution to the tax base of each region, since these contributions can differ. Moreover, it is necessary to conduct factor analysis within each group, that is, describe and evaluate the reasons behind the changes in the tax base, for example, changes in sales volumes and prices, new tax preferences, offset of tax losses and so on, as well as the reasons behind the changes in the coefficient of tax allocation across the regions, for example, realization of large investment projects in certain regions, companies joining the consolidation perimeter and replacement of the indicator in the apportionment formula. Ideally, we should be comparing the indicators that reflect possible changes in the tax bases of consolidated groups and their apportionment across Russian regions under the consolidation regime and in the absence thereof. Such calculations, however, can be only

made either by taxpayers themselves or by the Federal Tax Service, which has access to taxpayers' reporting data.

The Ministry of Finance made calculations regarding the re-allocation of taxing rights by using the data provided by the Federal Tax Service. The Ministry, however, provides the data only for 2012–2014, showing only the total number of regions that gained or lost from the tax consolidation regime and the respective amount of their gains and losses<sup>2</sup>. The Ministry calculated these values as the difference between the corporate tax revenue under the consolidated tax regime and in the absence thereof, but provided no detailed description of the methodology.

The report of the Accounts Chamber of 2012–2013 lists the regions that gained or lost the most after the regime was introduced. The main 'loser' is Moscow region since it has by far incurred the biggest losses of all other Russian regions.

Thus, the lack of public access to the necessary data impedes independent research of the reform's influence on the allocation of taxing rights across jurisdictions in 2015–2019.

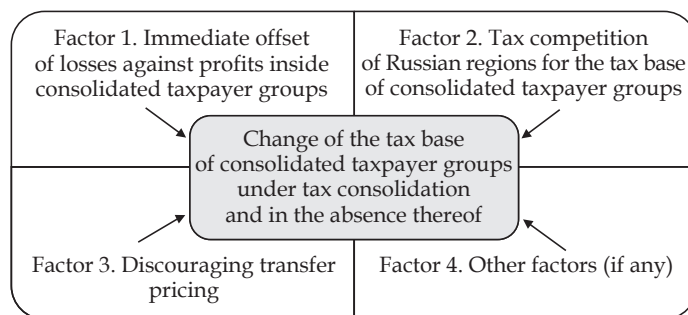
**Limitation 2.** *Lack of empirical evidence to assess the reform's outcomes*

Intuitively, it is clear that the reform should be effective, although in the absence of the necessary data, it is difficult to empirically estimate the extent of the resulting tax base increase. Potentially its efficacy might be assessed by the following analysis:

1. Calculate the changes in the tax base of consolidated taxpayer groups under the consolidated tax regime and in the absence thereof (this is in fact the calculation made by the Ministry of Finance of Russia).

2. Determine all the factors that influence this indicator (apart from Factor 3 'Discouraging transfer pricing') and estimate their effects. As Figure 1 illustrates, Factors 1 and 2 reduce the resulting sum, while Factor 3 increases it.

<sup>2</sup> Focus areas of the Russian tax policy in 2016–2018.



**Fig. 1. Factors that determine the indicator 'Change of the tax base of consolidated taxpayer groups under consolidation and in the absence thereof'**

3. The contribution of Factor 3 'Discouraging transfer pricing' equals the difference between the sum and the other summands.

If at all possible, this procedure could be performed only by taxpayers themselves or by the Federal Tax Service. Thus, the available empirical evidence is obviously insufficient to evaluate the outcomes of the reform regarding the two key goals set by the government.

The last reservation that needs to be made is that in Russia, taxpayers have a right to decide whether their companies should join the consolidation perimeter or not (provided they meet the necessary criteria). Consolidated taxpayer groups, however, often tend not to disclose which companies are included in the consolidation perimeter. Therefore, even though many members of consolidated groups are public companies with public reporting obligations, these data remain unavailable since the perimeter of the groups is unknown.

**Limitation 3. Lack of transparency regarding the losses of regional governments**

As far as we can see from the discussions in government circles, Russian state authorities approach tax consolidation from a somewhat different perspective than the one described above. What matters most is the losses of regional consolidated budgets due to the introduction of the consolidated tax regime: in 2012–2016, these losses amounted to 8, 16, 65, 126 and 78 billion roubles each year respectively (estimates of the Ministry of Finance of Rus-

sia). This means that the tax receipts from consolidated tax groups are lower than the revenues the budgets would have received if the mechanism of tax consolidation had not been implemented. In 2012–2015, regional budgets faced a spike in losses.

The Ministry of Finance contends that the decline in tax receipts may be caused by the following factors: the first is the immediate offset of losses of some members with profits of others within consolidated taxpayer groups and the second is shifting of the tax base to those Russian regions that offer reduced corporate tax rates<sup>3</sup>. However, none of the available documents known to us provides a breakout of the factors causing the losses.

It should be noted that the possibility of immediate offset of losses within consolidated taxpayer groups was something that could have been expected from the very beginning and it was even described as one of the reform's goals. It is, therefore, important to make a breakout of losses by factor.

The causes of losses identified by the Ministry of Finance correspond to Factor 1 and Factor 2 as shown in Figure 1. The impact of Factor 1 'Immediate offset of losses against profits inside consolidated taxpayer groups' cannot be estimated because the necessary data constitute tax secret. Nevertheless, we are able to estimate the impact of Factor 2 'Tax competition of Russian regions for the tax base of consolidated taxpayer groups', at least its upper boundary.

<sup>3</sup> Focus areas of the Russian tax policy in 2016–2018.

As it was said above, the Ministry of Finance does not disclose its calculation methods, which means that we don't know whether Factor 3 and Factor 4 were taken into account in the calculation of the general indicator. Since only Factors 1 and 2 are mentioned, it can be supposed that the answer to this question is no. Theoretically, the effect of Factor 3 'Discouraging transfer pricing' should enhance the indicator 'Change of the tax base of consolidated taxpayer groups under consolidation and in the absence thereof'. Thus, Factor 3 should not cause an increase in losses of consolidated budgets under the tax regime but, on the contrary, lead to lower values in this indicator. If we suppose that the impact of Factor 4 is insignificant, the difference between the general indicator and Factor 2 estimate will reveal the lower threshold of Factor 1.

## 2. Literature review

In general, there is a considerable body of research on the subject of tax consolidation in Russia. These studies can be divided into three groups.

The first group (see, for example, [4–8]) includes studies that focus on the introduction of the tax consolidation regime in Russia and the reasons behind this reform. Most of these studies were published in 1997–2013, that is, the immediate pre- and post-reform period, until the first official estimates of the results were obtained. These studies consider the potential of tax consolidation in Russia, discuss the advantages and setbacks of this measure. Most of them rely on international research evidence and do not provide any empirical data of their own.

The second group comprises studies published after 2013. Many of them, in the way similar to that of the previous group, consider the strengths and weaknesses of tax consolidation [9; 10], mechanisms and types of consolidation used by different countries [11–13] as well as the budgetary implications for specific regions [14–17]. These studies explore the Russian experience of tax consolidation (which by the time of their publication had already been introduced in Russia) and compare it with

international practices. They describe in detail the advantages and drawbacks of consolidation for taxpayers and the state budget. Some new shortcomings were detected after the regime was introduced and in the process of its implementation. These were primarily associated with legislative limitations (e.g. tax base for which tax is subject to consolidation; companies entitled to benefit from the consolidation regime; restrictions on offsetting losses and so on).

These studies draw from the data published by the Ministry of Finance of Russia, mentioned above, and the reports of the Accounts Chamber of Russia on operation of consolidated taxpayer groups in 2012–2013. These studies do not provide empirical estimates of their own.

The third group consists of the studies that describe the possible improvements to the existing consolidation mechanism [18; 19]. For instance, suggestions are made that membership in consolidated taxpayer groups should be based on 'everybody or nobody' principle and that to enter these groups, members should meet the criteria '50% plus one', that is, hold 50% plus one of the stocks in a company [20]. Some exceptions from the 'everybody or nobody' rule are possible if the volume of trade between the dependent legal entities is negligible [21]. Furthermore, it is proposed to exclude any possibilities of manipulations with the tax base distribution by setting rigorous rules on how it should be calculated according to the existing formula.

The government's decision to abolish the consolidation tax regime in Russia was followed by a decline in scholarly attention to this topic, although the reasons behind this decision still remain largely unexplored.

Thus, our review of the research literature shows that there is considerable research interest in the topic of consolidated taxation in Russia. Most studies, however, do not provide empirical estimates of the reform's consequences, which could be explained by the problem indicated above, namely the authors' limited access to the data.

### **3. Data and methodology**

Our analysis relies on the data of statistical reporting forms of the Federal Tax Service '5-PM' and '5-KGN' on tax base and accrued corporate tax in Russian regions. These forms are available on the agency's web-site. Our analysis also draws from the data of the Federal Treasury on corporate tax receipts, which include receipts from consolidated taxpayer groups to regional consolidated budgets.

These data can be used to calculate effective corporate tax rates in each region for taxpayers in general and for taxpayers from consolidated groups. The difference between the computed values and the maximum possible values of regional tax rates (in 2009–2016, 18%; in 2017, 17%) shows the extent of tax preferences that regional authorities are willing to grant to their taxpayers. The results show that regions are actively competing with each other for the tax base of consolidated groups.

If a region's effective corporate tax rate for members of consolidated taxpayer groups is below the maximum level, it means that this region offers special tax preferences for members of such groups. If a region's effective corporate rate for members of consolidated taxpayer groups is lower than the rate for all taxpayers, it means that members of consolidated taxpayer groups enjoy more tax preferences in this region than other companies. In this case, the region should be checked for tax preferences for consolidated groups. If we compare the dynamics of the tax rate for consolidated taxpayer groups and the corresponding tax base, we may find that the tax base has been shifted to the regions with lower rates, although to prove this fact, we need to look at the regional tax legislation, budgetary and tax policy reports to find what caused these changes.

Our study covers the period of 2012–2018 and the first half of 2019.

## **4. Results**

### **4.1. Dynamics of corporate tax receipts from consolidated taxpayer groups**

Table 1 shows the data on corporate tax receipts of regional governments in absolute values and in proportion to GDP

from 2009 to the first half of 2019. The data illustrate that corporate tax receipts declined in 2012–2015 (as a percentage of GDP), which can be partially explained by adverse global economic and political conditions. Nevertheless, corporate tax receipts from organizations outside the consolidated taxpayer groups started to rise in 2016 and in 2017 they almost reached the level of 2012. In 2016–2017, consolidated taxpayer groups paid noticeably less corporate taxes than in 2012, which was a disturbing trend if seen from the perspective of budget revenues in the first half of 2018. In 2018, receipts from consolidated groups (as a percentage of GDP) almost reached the level of 2012 and in the first half of 2019, even exceeded it.

It should be noted that the corporate tax revenue (including consolidated taxpayer groups) in the given period reached its maximum in 2018–2019.

Before making any conclusions, it is necessary to clarify the reasons behind the downward trend demonstrated by corporate tax receipts from consolidated groups in 2013–2017. This trend may reside in the mechanism of consolidation itself (for example, offset of losses within a group or reduced tax rates offered by regions to participants of consolidated groups) or in the macro-economic situation in the sectors group members belong to. The latter supposition about the role played by sector-specific characteristics of consolidated groups is supported by the fact that 14 out of 16 groups are engaged in oil and gas and metallurgical industries and there are no banks among them.

### **4.2. Reduced corporate tax rates for consolidated taxpayer groups in Russian regions**

While the regime was in force, that is, from 2012 to 2019, from 14 (in 2012 and 2019) to 24 (in 2018) Russian regions offered reduced corporate tax rates to members of consolidated taxpayer groups. In this period, 31 regions offered some kind of tax preferences to consolidated taxpayer groups and in 13 regions, the effective tax rate was reduced by 2 percentage points or more. The remaining 52 out of

83 Russian regions that had consolidated taxpayer groups always applied the maximum corporate tax rate to these groups (18% in 2017; since 2017, 17%).

The shortfall in corporate tax revenue from consolidated taxpayer groups in the given period was largely determined by the choices made by specific regions, pri-

marily Khanty-Mansiysk Autonomous District and to some extent Leningrad region (Fig. 2). The remaining 29 regions that in different periods granted tax preferences to consolidated taxpayer groups accounted for 4.2 to 12.2 billion roubles (that is, not more than 0.01% of GDP) of tax expenditures.

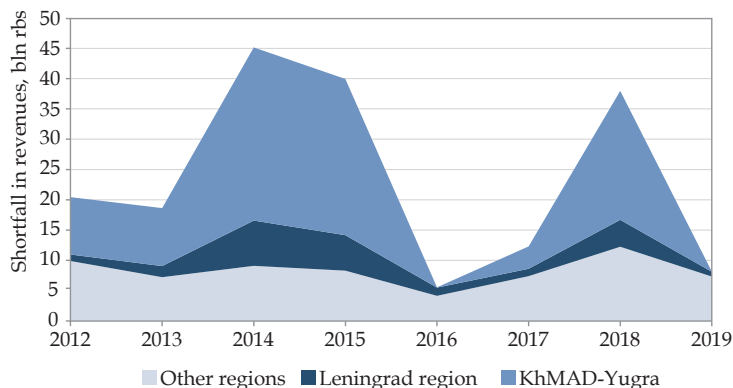
Table 1

**Corporate tax receipts of regional governments from all taxpayers and from consolidated taxpayer groups in 2009–2019**

Period	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019*
Corporate tax receipts of regional budgets, bln rbs	1067.9	1517,8	1926.3	1977.0	1702.6	1901.1	1981.1	2205.5	2489.8	3069.6	1723.5
% of GDP	2.55	3.04	3.20	2.90	2.33	2.40	2.38	2.56	2.71	2.96	3.40
including receipts from consolidated taxpayer groups, bln rbs	-	-	-	432.0	397.2	415.2	395.4	365.0	420.2	625.8	333.4
% of GDP	-	-	-	0.63	0.54	0.52	0.47	0.42	0.46	0.60	0.66
including receipts from non-members of consolidated taxpayer groups, bln rbs	-	-	-	1544.9	1305.4	1485.9	1585.6	1840.5	2069.6	2443.8	1390.1
% of GDP	-	-	-	2.27	1.78	1.88	1.90	2.14	2.25	2.35	2.74
Number of regions offering reduced rates for consolidated taxpayer groups**	-	-	-	14	16	15	16	20	23	24	14
Their share in the tax base of consolidated taxpayer groups, %	-	-	-	41.5	49.4	56.6	61.4	31.5	59.8	67.4	21.4
Share of the Khanty-Mansiysk Autonomous District and Leningrad region in the tax base of consolidated taxpayer groups, %	-	-	-	13.3	15.2	37.2	35.0	4.8	8.2	24.1	4.9
Amount of shortfall in revenue due to reduced rates, bln rbs	-	-	-	20.4	18.6	45.2	39.9	5.6	12.3	38.0	8.1
including Khanty-Mansiysk Autonomous District and Leningrad region, bln rbs	-	-	-	10.5	11.4	36.1	31.6	1.4	4.9	25.7	0.8

Note: \* The data of 2019 covers only the first six months; \*\* Including the regions with the effective tax rate lower than the maximum at least by 0.05%.

Source: compiled by the authors on the basis of the data of the Federal Tax Service of Russia.



**Fig. 2. Shortfall in tax revenues of regional consolidated budgets from reduced rates offered to members of consolidated taxpayer groups**

It should be noted that this sum comprises the tax expenditures from all tax preferences in the regions, including industry-specific tax benefits. Therefore, in our study, this sum will be used as the upper threshold value to evaluate the effects of the fierce competition between Russian regions.

#### **4.3. Reduced corporate tax rates in Russian regions**

In this section, we are going to concentrate on the tax losses resulting from lower rates offered by certain regions to members of consolidated taxpayer groups (CTGs) (the so-called 'CTG-based preferences'). By CTG-based preferences we mean special tax rates offered to members of consolidated taxpayer groups or, on the contrary, to those organizations that choose not to join consolidated taxpayer groups, in other words, tax preferences related to the tax consolidation regime.

In Leningrad region, for instance, since 2012, the reduced corporate tax rate has been 14% for those oil and gas companies that belong to consolidated taxpayer groups, provided that one or several members of the group and (or) their subsidiaries are established in the territory of the region. In Arkhangelsk region, the reduced rate is available for members of consolidated taxpayer groups specializing on diamond mining and wholesale trade of precious gemstones. We can suppose that this strategy was chosen by the

regions that were hoping for tax receipt gains if enterprises on their territories joined consolidated taxpayer groups.

Some regions offered lower tax rates to companies in exchange for non-joining consolidated taxpayer groups. For example, in Krasnoyarsk region and in the Republic of Sakha (Yakutia), reduced corporate tax rates were applied to the sums paid to regional budgets by the organizations in the crude oil and associated gas (exploration and production) industry that were not members of consolidated groups. It can be supposed that this measure was used by the regions to prevent tax revenue losses which would occur if certain companies established in their territories decided to join consolidated groups. This fact is supported by our analysis of the regional legislation. According to the Ministry of Industry and Geology of the Republic of Sakha (Yakutia), such approach would be conducive to fairer reallocation of the corporate tax rights and the republic would not lose its tax receipts since they cannot be redirected to cover the consolidated group members' losses in other regions.

These examples are quite illustrative of the tax competition between Russian regions for the tax base of consolidated taxpayer groups.

The analysis of regional tax legislation of 2012–2018 has revealed the following regions that granted 'pro-CTG' preferences: the city of Moscow, the Republic



of Komi and Sakha (Yakutia), Arkhangelsk, Irkutsk, Leningrad, Samara and Saratov regions, Yamalo-Nenetsk and Khanty-Mansiysk autonomous districts, Krasnodar, Krasnoyarsk, Stavropol and Khabarovsk regions.

After the adjustment, this sum still remains the upper limit (although it is a bit lower than the result of the previous iteration) rather than an accurate estimate of the effects of reallocation of taxing rights among Russian regions and the reduced tax rates they apply. For a more accurate estimation we would need the breakout of tax revenues by type of regional tax preferences or by type of taxpayers entitled to such preferences.

Further in our study we are going to focus on the case of Khanty-Mansiysk Autonomous District.

#### 4.4. Consolidated tax regime in Khanty-Mansiysk Autonomous District

Khanty-Mansiysk Autonomous District (further referred to as KhMAD) has been the most generous in terms of tax preferences for members of consolidated taxpayer groups. The shortfall in corporate tax revenue from consolidated tax groups in 2012-2018 varied between 0% (in 2016) to 65% (in 2015) and on average was 44.60% from the total shortfall in corporate tax revenue in all Russian regions (Table 2).

Tax preferences for members of consolidated taxpayer groups specializing in oil and gas production were introduced by the law of KhMAD-Yugra № 23-03 of 31.03.2012, that is, three months after the regime came into force. The law took effect on 01.01.2012. This measure was justified by the need to stimulate organi-

zations to create consolidated taxpayer groups in KhMAD to increase the region's tax revenue.

Despite the fact that this tax preference was in effect in 2012–2018, a significant growth in the tax base was observed only in 2014–2015 and in 2018. It should be noted that in KhMAD, effective tax rates are set low not only for consolidated groups but for other types of taxpayers as well, although the former still enjoy more tax benefits. This can be explained if we take a closer look at which companies joined consolidated taxpayer groups and which didn't: the average value of effective rates for all taxpayers in 2009–2011 was 14.9%, which is exactly the same as in 2012–2018.

Our analysis shows that changes in the shortfall of KhMAD's tax revenues due to tax preferences granted to members of consolidated tax groups correlates with the changes in the corporate tax base of the companies that had licenses for oil-field development in this region. A spike in tax losses in 2014–2015 was linked to improvements in the financial performance of the largest taxpayers, which, in their turn, were caused by an increase in their revenue from non-sale operations due to the rising dollar.

The tax consolidation regime in KhMAD had either a neutral (2012) or negative (2013, 2018) effect on the region's budget revenues. Unfortunately, the regional authorities do not publish the data for other years.

We believe that there is a high probability that the above-described sharp increase in tax losses 2014–2015 in KhMAD is associated with the operations of the corporate taxpayer group 'Surgutneftegaz'

Table 2

#### Indicators of consolidated taxpayer groups' performance in KhMAD

Indicator	2012	2013	2014	2015	2016	2017	2018
Effective corporate tax rates for members of consolidated taxpayer groups, %	14.9	14.7	14.2	14.2	17.9	14.5	14.2
Effective corporate tax rates for non-members of consolidated taxpayer groups, %	15.2	15.7	15.4	15.1	15.6	14.7	13.9
Tax rates difference (tax rates for members minus tax rates for non-members), %	-0.3	-1.0	-1.2	-0.9	2.3	-0.2	0.3
Corporate tax base for consolidated taxpayer groups, bln rbs	303	291.5	753.8	679.4	53.6	149.3	764.0

(further referred to as CTG 'Surgutneftegaz'). This supposition could be confirmed if we had access to the following data:

(a) companies included in the consolidation perimeter;

(b) financial performance data of CTG 'Surgutneftegaz';

(c) coefficient of allocation of corporate taxes paid by CTG 'Surgutneftegaz' to the regions where the group's enterprises operate;

(d) share of tax revenues from CTG 'Surgutneftegaz' in KhMAD's overall corporate tax revenue.

The assessed corporate tax paid by the group to the governments of KhMAD and Leningrad region correlates with the values of the current corporate tax paid by the company 'PAO Surgutneftegaz'. There was a dramatic increase in these indicators in 2014–2015 and 2018, when the company got substantial income on its foreign-currency deposits due to positive foreign exchange differences. A sharp fall in these indicators in 2016–2017, when the rouble grew stronger, led to a significant decrease in profits in 2017 and in 2016, to zero values (Fig. 3).

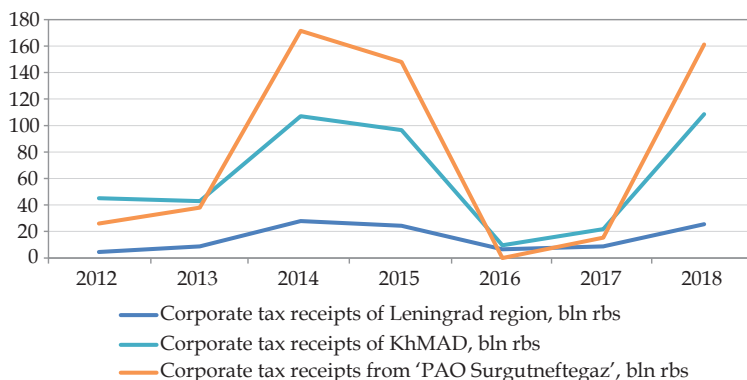
It is interesting that despite the fact that 'PAO Surgutneftegaz' is one of the largest taxpayers in both regions, we ob-

serve similar dynamics of indicators in both regions (except for 2013). In other words, even if one of these regions supposedly 'stole' the tax base of CTG 'Surgutneftegaz' from the other, it had no perceivable effect on regional tax revenues.

It should be noted that KhMAD had granted corporate tax preferences to oil and gas companies long before the consolidated tax regime was introduced. For instance, in 2007–2011 the nominal corporate tax rate in the region for this category of companies was 13.5–14% with the maximum rate of 17.5–18%. The only requirement companies had to meet to become eligible for this tax benefit was to spend funds on natural resource development or to invest in capital assets. Moreover, since there were no quantitative requirements, companies could make expenditures in accordance with their own plans and needs. The average effective corporate tax rate in the region in 2007–2011 was 14.5–15% and it remained at the same level in 2012–2018 (see Table 3).

Based on the above, the following conclusions can be made.

First, a dramatic rise in corporate tax losses faced by KhMAD due to the rate reduction in certain years was caused by the significant growth in the tax base in the same years and by the fact that tax



**Fig. 3. Correlation between the financial performance of Surgutneftegaz and consolidated corporate income tax receipts of KhMAD and Leningrad region**

Table 3

Effective corporate tax rate in Khanty-Mansiysk Autonomous District												
Period	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Effective corporate tax rate, %	14.4	14.5	14.6	15.2	15.0	15.1	15.2	14.6	14.5	15.9	14.6	14.1

preferences were granted to those taxpayers that enjoyed such tax base growth. The tax base grew as a result of the increase in these companies' non-sales revenue from foreign currency deposits. The reverse is also true: the region lost less tax revenue when the corporate tax base of organizations entitled to tax preferences started to decline. Second, members of consolidated taxpayer groups were entitled to preferences throughout the whole tax consolidation period, not in specific years. Third, KhMAD had started to grant tax preferences to oil and gas companies long before the regime was introduced. The average effective corporate tax rate for all taxpayers in 2009–2011 was the same as in 2012–2018.

Thus, the hypothesis that the dramatic expansion of the tax base in KhMAD in 2014–2015 and in 2018 was caused by this region's 'stealing' of the tax base from other regions is not confirmed.

#### 4.5. Analysis of the shortfall in corporate tax revenue after the adjustments

Table 4 summarizes our calculations of the maximum possible shortfall in revenue of regional governments due to re-allocation of the corporate tax base to regions with tax preferences for members of consolidated taxpayer groups.

First, we calculated the total shortfall in tax revenues due to tax preferences granted to members of consolidated tax groups. Then we adjusted the resulting value, focusing only on those regions that offered special 'pro-CTG' preferences. Then we conducted detailed analysis of KhMAD's legislation and other related indicators and found no evidence that the dramatic expansion of the region's tax base in 2014–2015 and in 2018 happened because the region was 'stealing' the tax base from other regions by attracting taxpayers with the help of tax preferences. KhMAD's special 'pro-CTG' preference alone cannot be seen as a loss resulting from the application of the consolidated tax regime. In fact, this region had been offering reduced corporate tax rates to oil and gas companies long before the regime was introduced and, therefore, this measure did not affect the average effective rate in the region.

The estimates we obtained at the third stage do not exceed 13.4 billion roubles a year (as of 2014). This value is an extremely conservative estimate of the shortfall in revenue resulting from shifting of the tax base of consolidated taxpayer groups to regions with lower tax rates. In addition to 'pro-CTG' preferences, this sum comprises other tax benefits in the given

Table 4

#### Calculations of the maximum possible shortfall in revenue due to re-allocation of the corporate tax base to regions with reduced tax preferences

Indicator	Period							
	2012	2013	2014	2015	2016	2017	2018	first half of 2019
Shortfall in corporate tax revenue of regional governments due to tax preferences to consolidated taxpayer groups, bln rbs	20.4	18.6	45.2	39.9	5.6	12.3	38.0	8.1
Shortfall in corporate tax revenue of regional governments due to tax preferences to members of consolidated taxpayer groups in regions with special 'pro-CTG' preferences, bln rbs	18.3	15.1	42.0	37.5	3.7	9.0	31.3	1.5
Shortfall in corporate tax revenue of regional governments due to tax preferences to members of consolidated taxpayer groups in regions with special 'pro-CTG' preferences, with the exception of KhMAD, bln rbs	8.8	5.6	13.4	11.7	3.7	5.3	10.0	1.5
Losses of the consolidated regional budget due to the consolidated tax regime, as estimated by the Ministry of Finance, bln rbs	8	16	65	126	78	n.a.	n.a.	n.a.

regions as it is impossible to break out the losses in regional tax revenue by category of preferences in tax statistical reporting.

The shortfall in corporate tax revenue hovered around 0.09% of GDP before the regime was introduced as well as afterwards, which means that the amount of revenue lost due to the application of reduced tax rates is negligible (Fig. 4).

### 5. Discussion

Analysis of the goals of the consolidated tax regime introduced in 2012 and its outcomes as of the second half of 2019 (Table 5) has demonstrated that three goals out of four were either fulfilled (simplification of tax administration; consolidation of losses and profits of group members) or partially fulfilled (fair apportionment of the tax base across regions). From the perspective of tax administration, the problem of transfer pricing was solved although we do not have enough evidence to evaluate the role of this step in the overall reapportionment of the tax base across jurisdictions.

The main drawback of the consolidated tax regime is considered to be the increasing losses in tax revenue, which may be caused by losses offset within consolidated taxpayer groups or by regional tax competition.

Our results show that out of 293 billion roubles lost by regional budgets in 2012–2016 due to the tax preferences offered to consolidated tax groups, the loss of at least 250 billion was caused by the

immediate offset of losses between members of consolidated taxpayer groups. It should be noted that this figure is an extremely conservative estimate and the role of this factor is even more significant. On the other hand, the scale of losses could be predicted from the very beginning. Moreover, the immediate offset of losses between members of consolidated taxpayer groups was initially declared to be one of the goals of the reform. We can suppose that the legislators misjudged the amount of losses as they were using the pre-crisis figures. This hypothesis is supported by the fact that before the recession year of 2014, the losses of regional governments due to the tax preferences for consolidated taxpayer groups had been quite low – 8 billion roubles in 2012 and 16 billion roubles in 2013. Most losses occurred in 2014 and in the following years.

This supposition agrees with the words of S.D. Shatalov, who was the Deputy Finance Minister in 2000–2015: ‘Not only consolidation is an economically sound solution but it also contributes to fairer allocation of the corporate tax among regions’ [22]. He also pointed out that ‘this new institution emerged not in the period of economic growth but with a considerable delay, which aggravated the problems of interbudgetary relationships even more, because the losses of individual consolidated group members decrease the general revenue of the whole group and, therefore, the amount of tax to be reallocated’ [22].

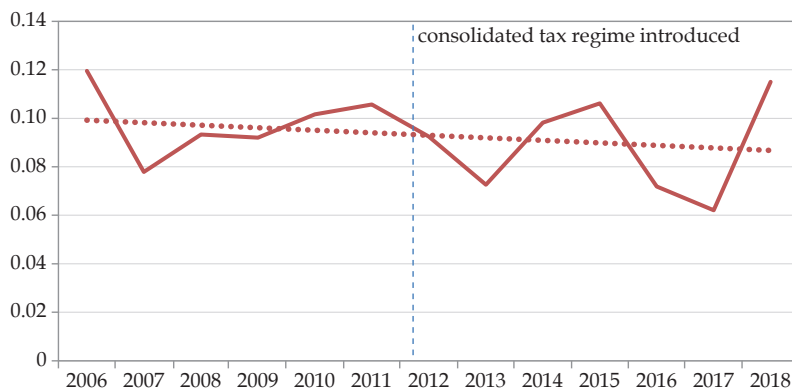


Fig. 4. Shortfalls in the corporate tax revenue due to reduced tax rates in Russian regions, % of GDP

Table 5

**Comparison of the reform’s declared goals in 2012 and its outcomes as of the second half of 2019**

Goal	Result	New shortcomings	Solutions to the new shortcomings
A fairer apportionment of the tax base	The goal was mostly achieved after the first two years. No publicly available data for the other years. The proportion of winners to losers was as follows: 65 against 18 in 2012; 63 against 20 in 2013; and 53 against 32 in 2014. The biggest ‘loser’ is the city of Moscow.	Apart from the major ‘profit centres’ – the cities of Moscow and St. Petersburg, the list of ‘losers’ also includes other Russian regions.	–
Discouraging transfer pricing to minimize the corporate tax	Theoretically, this goal was achieved. Participants of consolidated taxpayer groups no longer need to use transfer pricing since a formulaic approach is applied to the corporate tax allocation. No empirical data available.	Our analysis detected competition for consolidated tax groups’ tax base among Russian regions. The groups can to some extent influence their tax base allocation across the regions. Therefore, companies can reallocate a part of their group’s tax base to the regions with better tax preferences while the companies’ financial results remain virtually unchanged. Consolidated groups can take advantage of the following loopholes to influence their tax base allocation: first, membership of these groups is formed and changed in an arbitrary fashion; second, the indicator reflecting the factor ‘labour’ in the apportionment formula is also determined and changed arbitrarily; and, third, groups can influence their membership through reorganization and so on.	Starting from 1 January 2023, Russian regions will not be able to use reduced corporate tax rates, except for the cases that the federal legislation explicitly provides for. Thus, regions will have less opportunities for engaging in interregional tax competition. The remaining opportunities will be eliminated or minimized by further improvements to the tax legislation. For instance, it is proposed to deny consolidated taxpayer groups the opportunity to determine the apportionment factor (wage fund or average payroll count). Second, both indicators should be included in the apportionment formula with equal weights (1/4) assigned to each. Another possible measure is to establish a tougher control over formation of the consolidation perimeter.
Facilitation of tax administration	Achieved. Participants of consolidated taxpayer groups act as a single taxpayer. Facilitation of tax administration for the taxpayer and tax authorities. Tax authorities do not have to control companies’ compliance with the rules of transfer pricing in domestic transactions.	Increasing uncertainty in regional budget forecasts. Corporate tax receipts depend not only on the financial results of companies in the jurisdiction but also on the performance of the whole consolidated group.	Consolidated taxpayer groups are now obliged to report the forecast tax receipts to regional budgets in the current financial year, ensuing year and planning period as well as the factors that determine the planned corporate tax receipts.
Consolidation of profits and losses of the members of consolidated taxpayer groups to calculate the corporate tax base.	Achieved.	The federal government was unprepared for the massive losses in tax revenue when regions started taking advantage of this opportunity. In other words, the achievement of this goal turned out to be the regime’s drawback.	Since 2017, there has been a rule that losses of the previous years can be offset only against 50% of the tax base. The remaining 50% of the tax base is subject to tax. This restriction applies to consolidated taxpayer groups and to other taxpayers.

As our analysis shows, a substantial decline in tax receipts from consolidated taxpayer groups was in all probability caused by the general economic situation, which affected all Russian companies, and by now this downturn is all but over. At the end of 2019, corporate tax revenues from consolidated tax groups were expected to exceed the amount of the corporate tax paid by these companies in 2012, that is, 0.63% of GDP.

If the consolidated tax regime is fully eliminated, there will arise other problems besides those we have been considering in this paper. First, elimination of the consolidated tax regime in combination with limiting the perimeter of internal transfer pricing virtually brings us back to the practices of corporate tax apportionment before 2012, that is, to the situation when large vertically integrated corporations could influence allocation of taxing rights and there were no allocation rules set on the state level. Second, after the regime is cancelled, the tax base will be re-allocated, which means that there will be more losers than winners among the regions and the losers will end up with diminished corporate tax revenues. This situation will undoubtedly give rise to a more heated debate in the future.

## 6. Conclusions

Due to the lack of publicly available empirical data, it is quite difficult to evaluate the reform's progress, in particular to compare the goals with what has been actually achieved. The declared goals of the reform were to ensure a fairer apportionment of the tax base across Russian regions and to discourage transfer pricing in large holding companies. Most concerns about this regime are associated with the declining corporate tax revenues from companies belonging to the perimeter of consolidated taxpayer groups.

The decline in tax receipts could be determined by the two factors: first, the immediate offset of some members' losses against the profits of others within consolidated taxpayer groups and, second, shifting of the consolidated tax base to those Russian regions that offered reduced rates. Thus, the source of the problems resides in the defects of the current tax consolidation regime.

Our analysis of regional legislation shows that regions compete with each other for the tax base of consolidated taxpayer groups, offering them reduced tax rates. These measures are aimed at 'stealing' the tax base from other regions or preventing them from doing so.

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