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DIGITAL ECONOMY: RUSSIAN TAXATION ISSUES

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Abstract

The relevance of the research is determined by the results of the review of the “digital economy” concept and the constant increase of its role in the global economy and the Russian economy in particular. Every year, digital economy occupies an increasing share of both retail and wholesale trade market, raising new issues in its taxation. The purpose of this paper is to identify the specific challenges in taxation of developing digital economy and determine the direction of further improvement of the tax regulation of digital economy in Russia. Specific characteristics of digital economy, problems of tax regulation of this type of economy and tendency of enhancement of tax administration for the subjects using in the business activity the Internet resources are considered. The text covers several problems arising from the specific features of the functional segments of the crypto currency market, of particular importance among which are the problems of taxation of the Internet currency. The above analysis confirms that there is an urgent need for a change in the tax legislation related to arising field of electronic commerce. Development of digital economy taxation makes a lot of concerns. For one thing, it deprives governments of much-needed tax revenues and for another, it gives foreign-based digital businesses an advantage over their tax-paying domestic competitors.

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Keywords: Digital economy, taxation, VAT, e-commerce, taxation of internet currency, regulation of crypto currency.



1. Introduction

In today's world the national governments are forced to deal with challenges caused by the steady growth of digital economy. Trade in goods is being replaced by services, as digital information transferred over the Internet takes the place of various tangible goods.

The field of digital economy taxation has been improving along with international cooperation, but such areas of digital economy as e-commerce, operations with cryptocurrency are still characterized by uncoordinated approaches to definition of both taxable transactions and tax jurisdiction.

Digital businesses need no factories, stores, or other fixed places of business in order to sell their goods and services to consumers in a country. Since current international tax rules still rely on the old concepts of a permanent establishment to recognize tax jurisdiction, the digital economy makes it possible to operate a cross-border business virtually with low taxation or even tax-free. Businesses still tend to be taxed where they have a physical rather than virtual presence and taxation continues to be built on traditional product and service lines.

Both businesses and tax authorities are finding it difficult to define where value creation occurs and how to align that with traditional tax administration. Tax authorities of different countries including Russia believe that they're missing out significant amounts of tax from digital businesses that operate under their jurisdiction, but don't have the physical presence and hence permanent establishment status under current rules.

A research held by the European Commission found out that the average effective tax rate for tech businesses was only 9.5%— it is less than half of the average tax rate (23.2%) for traditional businesses (Analytical statement, 2013).

Since around 2012, tax experts and negotiators from different countries have been working to develop an optimal international approach to solving these issues (Analytical statement, 2014).

The OECD's Base Erosion and Profit Sharing (BEPS) Action Plan recognizes the need for modernization and has achieved quite a lot since the issue of the reports in October 2015 (Analytical statement, 2015).

So, development of digital economy taxation makes a lot of concerns. For one thing, it deprives governments of much-needed tax revenues and for another, it gives foreign-based digital businesses an advantage over their tax-paying domestic competitors.

2. Problem Statement

Today, the concept of "digital economy" is being actively discussed. In scientific sources, there are three approaches to the definition of "digital economy": digital economy as the way of doing business on the Internet; digital economy as a system of relations based on the use of digital technologies; digital economy as a specific production organization (Nikolaichuk, 2017).

Komarov & Pokopyev (2017) and Krivenko (2015) understand digital economy as the symbiosis of the virtual and real economy, based on the interaction and creation of social values.

According to Leonova (2017), the digital economy should be described as the set of social relations that develop when we use electronic technologies, electronic infrastructure and services,

technologies for analyzing large amounts of data and forecasting to optimize production, distribution, exchange, consumption, increase of social and economic development of countries.

In the OECD Digital Economy Outlook (Analytical statement, 2015) publication, the term “digital economy” is used to refer to markets that operate on information and communication technologies basis, which are used to trade digital goods or provide services via the Internet.

In order to develop the digital economy in Russia, the Decree of the President of the Russian Federation of 05/09/2017 No. 203 approved the Strategy for the Development of the Information Society of the Russian Federation for 2017–2030. It provides the following definition of the digital economy: “Digital economy is an economic activity in which digital data is the key factor of production. Processing of big data in comparison with traditional forms of doing business can significantly improve the efficiency of various types of production, technologies, equipment, storage, sales and delivery of goods and services”.

According to the research of the consulting company McKinsey in Russia, by 2025 the digital economy can reach 8–10% of the country's GDP. At the same time, Russia's GDP in the period from 2011 to 2015 grew by 7%, and the volume of the digital economy over the same period - grew by 59%, or 1.2 trillion RUR in 2015's prices (Analytical statement, 2017).

Information and communication technologies are penetrating in all spheres of life. It changes not only the economy and entrepreneurship, but also the tax system (Starkova, 2017). It becomes more evident that the digital economy does not fit into the existing framework of the tax system due to the following circumstances: business processes are changing; new goods and services appear.

3. Research Questions

The research questions for the present study are:

- To define the term ‘digital economy’ and determine its role in Russian economy development in the nearest future.
- To review the current state of tax regulation of digital economy in Russia and the issues associated with it.
- To distinguish cryptocurrencies taxation as one of the directions of tax regulation and administration improvement in Russia.

4. Purpose of the Study

The purpose of this study is to identify the specific challenges in taxation of developing digital economy and determine the direction of further improvement of the tax regulation of digital economy in Russia.

5. Research Methods

The following methods were used in the research: theoretical (dialectical logic, rational knowledge, etc.); diagnostic (diagnostic analysis of the condition and causes, questioning and testing); empirical (description of facts, measurement and synthesis of research results).

6. Findings

Due to the rapid development of information technologies in the modern economy, many changes have taken place. In particular, a new phenomenon called e-commerce has emerged. Such development of the digital economy has created a lot of problems, e.g. the lack of legal norms, taking into consideration the specifics features of the Internet business, has resulted in serious tax losses for many countries.

Firstly, it should be noted that so far there is no consensus on what should be understood by the term "electronic commerce". There is no legislative definition of the term "electronic commerce" either. In our opinion, one of the most appropriate definitions of e-commerce has been given by Tedeev (2002). According to him, e-commerce should be understood as "entrepreneurial and closely related non-entrepreneurial form of activity (other economic activity not prohibited by law) form - using modern communication tools, including the information environment of the global network Internet."

According to Kuznetsov & Yakubov (2016) forecast, by 2020, the market size of traditional B2C e-commerce trade could reach \$ 3.2 trillion and the global B2B e-commerce market will reach \$ 6.7 trillion. Online sales in OECD countries are now estimated to make up 18% of total trade. Among the measures contributing to the development of the segment, representatives of the OECD note the decision of strategies for the development of e-commerce by small and medium-sized businesses, creating an e-partner infrastructure, and supporting Internet start-ups. By 2020, the EU intends to overcome the remaining barriers to e-commerce, create an adequate Internet infrastructure and improve security options for end customers.

The importance of electronic commerce for the economy development is also noted in the documents of the BRICS countries, which include Russia, China, Brazil, India and South Africa.

Tax authorities of most countries have come to a conclusion that activities in the field of electronic commerce form the basis for the obligation to pay taxes (Akins, Chapman & Gordon, 2014). Analysis of tax evasion schemes in the framework of electronic commerce show the main methods of tax evasion:

- use of uncertainty or differences in regulation in national legislations regarding taxation of income from electronic business;
- withdrawal of Internet resources for e-business and bank accounts outside the state that is the place of actual activity, including offshore jurisdictions;
- the redistribution of income from e-commerce among countries;
- opening of foreign offices by International companies without a representative office, which is monitoring supply market and target buyers information, and at the same time concluding transactions through foreign Internet resources and conducting regular business activities in the country;
- the use of the individual digital products developer's labor, whose services are paid with electronic money.

In this regard, the main problems arise when taxes on profit and VAT are being collected. In terms of corporate income tax, the main concern is transfer pricing, which permits to concentrate profit in convenient jurisdictions. In addition, the problem of transfer pricing formation in this case appears to be more complicated in contrast to the market for ordinary goods. Mainly because tax authorities find it difficult to determine the actual market value of electronic services as they often are unique.

In terms of VAT, the main difficulty is simultaneous administration of a large number of other jurisdictions residents supplying both physical and digital products to consumers of the jurisdiction in question.

At the moment Russia follows the EU path choosing the indirect type of taxation for electronic business.

The experiment on the introduction of VAT for foreign companies providing electronic services in Russia showed that there are 143 foreign companies registered with the Federal Tax Service during 2017, including Apple, Google, Microsoft, Samsung, Bloomberg, Amazon, Alibaba, and others.

Since 2017 the new rules for determining the place of sale of electronic services in the framework of electronic commerce (Article 174.2 of the Tax Code of Russian Federation) have come into force. It is now stated that the place of sale is the location of the buyer. At the same time, the Tax Code of the Russian Federation states that in cases where the buyer's network address is registered in the Russian Federation or - the international country code of the telephone number is assigned to the Russian Federation, the Russian Federation is considered the place of sale of services. There appears a problem: in case of Internet commerce, the buyer's network address does not give a definite answer to the question of his location, and in the case of buying through e-wallets, an indication of the telephone number of the buyer is not a prerequisite.

The results of VAT administration for 2017 showed a necessity of change in the procedure for VAT payment. Foreign Internet companies provide electronic services not only to individuals, but also to Russian organizations and individual entrepreneurs. To identify the consumer from Russia, they are forced to refine their accounting systems. In turn, consumers of electronic services - Russian organizations and individual entrepreneurs, including ones that use special tax regimes have to fulfill the duty of a tax agent for VAT. Yet, it is still easier to administrate international Internet companies rather than a huge number of representatives of small and medium-sized businesses in the Russian Federation.

The amendments made to the Tax Code of the Russian Federation on January 1, 2019 fully imposed the obligation on foreign companies providing electronic services to Russian users to pay VAT. At the same time, Russian buyers of electronic services - legal entities and individual entrepreneurs - will be exempt from the tax agent functions for VAT. In turn, organizations and individual entrepreneurs that buy electronic services are entitled to deduct VAT, paid to a foreign organization, if there are documents that confirm transferred payments including taxes to foreign organization, as well as the contract or settlement document, highlighting the tax amount and including the special Tax ID numbers - INN (Individual Tax-payer Number) and KPP (Tax Registration Reason Code).

Foreign companies need to use special technologies to analyze and control of the completeness of tax declaration process when paying VAT.

Another problem is the use of digital currency. Digital currencies is an element of the digital economy and sooner or later they will have to be dealt with in the context of taxation.

Cryptocurrencies have traditional characteristics of offshore zones as there is no specific user identity in their turnover and it is impossible to trace the fact of gaining profit. The reason for this is the fact that Internet is extraterritorial (it does not belong to any jurisdiction). In addition, the cryptocurrency is sometimes called the "super-offshore" zone because of the independence of the cryptocurrency systems

from financial institutions, including banks, cooperation with which today can counteract the erosion of the tax base and the transfer of profits, and help to get an advantage in terms of tax minimization with respect to ordinary offshore territories (Marian, 2013).

At the present stage, the following reasons for impossibility of solving the cryptocurrency taxation issue can be considered:

1) the decentralization of new means of payments that change the settlement in the financial market and in the payment system, which was based on the traditional provisions of the Constitution stating that the state has a monopoly on the money issuance, causing the uncertainty regarding the legal status of operations with new means of payment,

2) the anonymity of users complicates the collection of taxes, given that the financial security authorities still tend to prefer conservative approach to cryptocurrency regulation.

3) the existence of opinion that the virtual currency has no impact on substantial macroeconomic risks does not speed up the elimination of this issue.

Solving the problem of decentralization and anonymity of users within the system is possible by:

- interactions with individual financial intermediaries that are involved in the system (e.g. websites where users fill information about their account number). Yet this is applicable only when cryptocurrency is exchanged for ordinary currency, in the status of digital goods for the purpose of taxation or in other status with exemption from direct and indirect taxation of all income from transactions without the involvement of money;

- licensing activities of money transfers, i.e. users who use cryptocurrency not only for paying for goods and services but also for other purposes – in contrary to the initial idea of Bitcoin as global and unregulated currency, this is an effective way of recognizing its legitimacy;
- buyout of cryptocurrency by the state, but this method does not guarantee the emergence of new cryptocurrencies.

In accordance with the letter of the Federal Tax Service of Russia “On control over the circulation of cryptocurrency (virtual currencies)” dated October 3, 2016, operations of acquiring and selling cryptocurrency can be classified as currency transactions in Russia (Gunko, Nazarov, & Stakanova, 2018).

With reference to the above, operations with cryptocurrencies are not subject to VAT, income for the purposes of personal income tax and corporate income tax is recognized when users create and receive cryptocurrency. However, the anonymity of users makes this approach difficult to implement. In this regard, it is advisable to introduce benefits for users who have a small cryptocurrency turnover, and to cooperate work of regulators to solve the problems of absence of intermediaries in information disclosure (Gunko et al., 2018). However, it is interesting how relevant the discussion on the taxation of cryptocurrency in Russia is, due to the draft law prohibiting operations with cryptocurrency in the Russian Federation territory.

Currently digitalization of the economy in Russia has touched the sphere of tax control. Due to implementation of digital technologies, it becomes possible to provide tax control at a new level. Digital technologies provide transparency in business and tax monitoring. One of the examples is widely used automatic control over VAT system – ASK NDS (Automatic Control System VAT). A distinctive feature

of this program is the empowerment of the tax authorities through the use of tools of special control over the participants of the entire chain of product and money transfers.

7. Conclusion

The above analysis confirms that there is an urgent need for a change in the tax legislation related to arising field of electronic commerce.

The digital economy poses the need for revising many well-established approaches to taxation. In order to create a single digital market, the European Commission prepared and submitted for consideration two legislative proposals:

1) reforming corporate tax rules. The essence of the long-term initiative of the commission is to ensure that the company's profits from user interaction through digital channels are recorded and taxed.

2) EU digital tax. It will cover all major digital activities that were not previously taxable in the EU.

The changes will affect not only the tax legislation, but also the provisions of the conventions on the avoidance of double taxation and approaches to the regulation of transfer pricing.

To ensure effective taxation of Internet resources, the authorities of different countries still have a lot to do, both legislative and technological.

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