

MEMORANDUM

To: Mr. Alexander Poichinok, State Tax Service for the Russian Federation

From¹: Mr. Allan Firestone, Russian Federation Fiscal Reform Project

Date: 1 May 1998

Re: Introduction of Large Taxpayer Inspectorates

1. The purpose of this memorandum is to address questions raised in the meeting of 22nd July 1998 with respect to the introduction of Large Taxpayer Inspectorates (LTIs) in the Russian Federation. This memorandum addresses four general issues:
 - 1.1. What are the legislative issues are specific to large taxpayers in OECD and other countries, to include the powers of tax administrations to assess the liability of large taxpayers, procedures for registering large taxpayers, and the conduct of field audits?
 - 1.2. What legislative basis exists with respect to the collection of large taxpayer delinquencies, to include issues of parent companies liability for the debt of their subsidiaries and subsidiaries responsibilities for their parent company's debt?
 - 1.3. What is the existing practice of field audits with respect to large taxpayers, their branches, subsidiaries, and related companies?
 - 1.4. What is the legal status, organizational structure and functions common to most Large Taxpayer Inspectorates?

2. Definition of Large Taxpayers

A wide variety of criteria have been developed to select taxpayers for inclusion in the monitoring program of Large Taxpayer Units (LTUs). In Latin America, many countries with LTU's use previous tax payments as the primary selection criteria, however, other countries select specific taxpayers of interest, and one (Peru) uses sales reported for income tax purposes (Table 1). In the United States, the Internal Revenue Service's Coordinated Examination Program uses a multi-faceted selection mechanism that allocates points based upon the complexity of the taxpayer (Table 2). The International Monetary Fund (IMF) has recommended that the State Tax Service (STS) use business turnover, federal tax payments, and arrears as basis for selecting large taxpayers. The IMF also recommends that the 50 largest gas and oil excise, alcohol excise, payers of import VAT and excises be included in the list of large taxpayers (Table 3).

As evidenced by a review of the selection criteria in Tables-1 – 3, a single criterion or multiple criteria can define a large taxpayer. What is important is that the selection

¹ Contributors to this memo include Mr. Robert McNab (Georgia State University Consortium) and Mr. John Ramos (Georgia State University Consortium).

criteria be as simple as possible yet retain sufficient flexibility to adapt to changes in the economic environment. With this in mind, we do not recommend that the STS adapt a selection mechanism as complex as the Coordinated Examination Program of the United States Internal Revenue Service. We also do not recommend the adoption of a single selection criteria such as previous tax payment as in the case of the Latin American experience.

Definition of 'Large Taxpayer': The first step in introducing a Large Taxpayer Inspectorate in the Russian Federation is to correctly define what exactly is a 'large taxpayer.' First, we recommend that Gross Receipts be used as the first primary method of defining a taxpayer as 'large.' Gross receipts should be determined by combining the gross receipts of the principal taxpayer with those of all effectively controlled domestic and foreign entities. This is a clear, concise measure that can practically applied through the use of publicly available and taxpayer information.

Step 1 (Federal): For the Federal Large Taxpayer Inspectorate, rank all taxpayers with gross receipts over 100 million Rubles². Include those taxpayers at the top of the ranked listing in large taxpayer roll until greater than 50% of the sum gross receipts for all taxpayers is contained in the large taxpayer roll.

Step 1 (Regional): For regional Large Taxpayer Inspectorates, all taxpayers within the specific region would be ranked by gross receipts. Those taxpayers that had been selected for monitoring by the national Large Taxpayer Inspectorate would then be removed from the ranked list. Include those taxpayers at the top of the ranked listing in the regional large taxpayer roll until greater than 50% of the sum of gross receipts (after those taxpayers under the purview of the national Large Taxpayer Inspectorate had been removed) is contained in the regional large taxpayer roll.

Second, we recommend that Previous Tax Payments be used as the second primary method of defining a taxpayer as large. Previous tax payments should be determined by combining the previous tax payments of the principal taxpayer with those of all effectively controlled domestic and foreign entities. Previous tax payments should include the Value Added Tax, Enterprise Profits Tax, Excise Taxes, and the Personal Income Tax (Withholding). The large taxpayer inspectorate should be responsible for collecting federal and local taxes, hence the inclusion of Personal Income Tax payments in the criteria.

Step 2 (Federal): For the federal Large Taxpayer Inspectorate, rank all taxpayers with by combined annual historical tax payments for the previous year over 50 million Rubles³. Include those taxpayers at the top of the ranked listing in large taxpayer roll until

² Note that this figure can be adjusted as necessary to ensure that a sufficient number of taxpayers are included in the ranking list. As information exchange improves between the levels of the State Tax Service, the Federal Large Taxpayer Inspectorate can obtain the regional taxpayer lists to determine which taxpayers may be included in the large taxpayer roll.

³ Note that this figure can be adjusted as necessary to ensure that a sufficient number of taxpayers are included in the ranking list. As information exchange improves between the levels of the State Tax Service, the Federal Large Taxpayer Inspectorate can obtain the regional taxpayer lists to determine which taxpayers may be included in the large taxpayer roll.

greater than 50% of the sum by combined annual historical tax payments for the previous year for all taxpayers is contained in the large taxpayer roll.

Step 2 (Regional): For regional Large Taxpayer Inspectorates, all taxpayers within the specific region would be ranked by combined annual historical tax payments for the previous year. Those taxpayers that had been selected for monitoring by the national Large Taxpayer Inspectorate would then be removed from the ranked list. Include those taxpayers at the top of the ranked listing in the regional large taxpayer roll until greater than 50% of the sum of by combined annual historical tax payments for the previous year (after those taxpayers under the purview of the national Large Taxpayer Inspectorate had been removed) is contained in the regional large taxpayer roll.

Lastly, we recommend that Tax Arrears be used to include those taxpayers that may have not been captured by the previous two criteria. Tax arrears (or more correctly, delinquent taxpayer accounts) should, as with the other criteria, be determined by combined the tax arrears of the principal taxpayer with those of all effectively controlled domestic and foreign entities. As with previous tax payments, the tax arrears category should include the Value Added Tax, Enterprise Profits Tax, Excise Taxes, and the Personal Income Tax (Withholding). While tax arrears may add several firms that may have otherwise not been included in the list, the merit of this measure is somewhat questionable, in that if a firm does not have a significant level of gross receipts or a history of paying taxes, its capacity to resolve its tax delinquencies may be limited.

Step 3 (Federal): For the federal Large Taxpayer Inspectorate, rank all taxpayers with by annual historical tax arrears for the previous year over 5 million Rubles⁴. Include those taxpayers at the top of the ranked listing in large taxpayer roll until greater than 50% of the sum by annual historical tax arrears for the previous year for all taxpayers is contained in the large taxpayer roll.

Step 3 (Regional): For regional Large Taxpayer Inspectorates, all taxpayers within the specific region would be ranked by annual historical tax arrears for the previous year. Those taxpayers that had been selected for monitoring by the national Large Taxpayer Inspectorate would then be removed from the ranked list. Include those taxpayers at the top of the ranked listing in the regional large taxpayer roll until greater than 50% of the sum of by annual historical tax arrears for the previous year (after those taxpayers under the purview of the national Large Taxpayer Inspectorate had been removed) is contained in the regional large taxpayer roll.

3. Procedures for registration

There are two issues to consider with regard to registration: (1) legal requirements for registration and (2) collections and distribution of taxes belonging to the central government and to regional and/or local governments or revenue sharing arrangements in the current laws.

⁴ Note that this figure can be adjusted as necessary to ensure that a sufficient number of taxpayers are included in the ranking list. As information exchange improves between the levels of the State Tax Service, the Federal Large Taxpayer Inspectorate can obtain the regional taxpayer lists to determine which taxpayers may be included in the large taxpayer roll.

Legal Requirements for Registration: It is generally international practice in the operation of Large Taxpayer Units to allow the tax administration to assign large taxpayers to the Large Taxpayer Unit as deemed necessary by the tax administration. Current legislation in the Russian Federation may prevent the State Tax Service from assigning taxpayers in this fashion. A firm with multiple subsidiaries might not be completely assigned to the Large Taxpayer Unit in that its subsidiaries are required by law to file their tax declarations in the region in which they are registered. We recommend that this legislation be modified to allow the State Tax Service to assign taxpayers as they see fit. We stand ready to assist you in drafting this legislation.

Revenue Sharing Issues: The second issue is one of establishing administrative accounting controls to ensure that taxes are collected for all levels of government and that revenues collected are promptly transmitted to the appropriate budgets. Currently, there is some measure of distrust between regional and federal levels of government that might result in serious concerns being voiced if a region's largest taxpayers were assigned to the Large Taxpayer Inspectorate. To ensure that there is support for the introduction of the Large Taxpayer Inspectorate at all levels of government, it will be necessary to adopt specific measures to ensure that collections are shared according to current law.

We recommend that the Large Taxpayer Inspectorate deposit collections directly in the Treasury and the Treasury will credit the regional governments in accordance with existing legislation or tax sharing arrangements. If this option is not acceptable, the Large Taxpayer Inspectorate could remit the entire tax payment to the regional STI where the taxpayer is registered and the regional STI could then credit the revenues to the appropriate levels of government.

4. Special procedures for dealing with large taxpayers

The objective of establishing large taxpayer inspectorate is to focus resources on the small number of taxpayers that can contribute a significant share of revenues to the budget. By focusing resources on those large taxpayers, the tax administration can realize significant gains in productivity and in compliance.

In general, tax administrations with Large Taxpayer Units require a consolidated return be filed at the LTU to which the taxpayer is assigned. Without this requirement, the ability of the LTU to effectively and correctly ascertain the tax liability of the large taxpayer is degraded. Otherwise, the rules, regulations, procedures, and instructions of the tax administration are enforced on the same basis, irregardless of the size of the taxpayer.

5. Review of draft regulations

The draft regulations are not clear on the respective responsibilities of the Head of the Moscow City State Tax Inspectorate and the Deputy Head of the Russian State Tax Service. This ambiguity needs to be resolved on a priority basis. In general, it is best not to have the headquarters office involved in operational management. Thus, international experience would dictate that the Moscow City STI should be

responsible for day-to-day operational management and the Russian STS should provide the strategic policy guidance. If this approach is taken in the draft regulations then paragraphs 1.12 and 3.2 should be re-drafted.

Following are our comments on specific paragraphs of the draft regulations:

- 5.1. Paragraph 1.3 should be revised to acknowledge other criteria for selection of taxpayers for the LTI and should read:
 - 5.1.1. The biggest taxpayers are organizations, enterprises and associations of any type of ownership whose financial and economic indices correspond to the established sizes ~~of qualitative~~ or quantitative criteria. The group of the biggest taxpayers to be served by the Inspectorate is formed according to the amount of their tax payments, the amount of their turnover, or the amount of their arrears....
- 5.2. Paragraph 1.5 should more precisely delineate the role of the Head of the Moscow City Tax Inspectorate and the Deputy Head of the Russian State Tax Service and a new subparagraph 1.5.1 should be inserted, as proposed below, and all other sub-paragraphs should be renumbered:
- 5.3. Paragraph 1.5.1 The Head of the Moscow City State Tax Inspectorate shall provide day-to-day operational oversight to the Head of the LTI.
- 5.4. It is not clear whether the intent of paragraph 1.12 is to create one LTI that supervises the largest taxpayers in all of the Russian Federation, or only those registered in the City of Moscow. If the intent is to supervise the largest taxpayers in all of the Russian Federation the word 'Moscow' should be replaced with 'Russian Federation'.
- 5.5. If the suggestion in the general comments above is accepted, everything after 'Russian Federation' in the first sentence in paragraph 1.12 should be eliminated.
- 5.6. It is not clear if the functions listed paragraphs 2.1 to 2.5 are unique to the functioning of the LTI. If they are common to the functioning of all TTIs, then they need not be listed here.
- 5.7. Same comment as in point 5 applies to paragraph 2.7.
- 5.8. If the suggestion in the general comments above is accepted, the phrase in paragraph 3.2 that begins with 'schedules of overall tax audits...' should be eliminated.

Table 1
Latin American Large Taxpayer Monitoring Systems⁵

Country	Selection Criteria	Percentage of Total Revenues	Filing Requirements	Information Systems
Argentina	Previous Tax Payments Taxpayers of Interest	51% of Total Revenues	File and Pay at Regional Large Taxpayer Office to which Taxpayer is Assigned	UNIX Operating System ORACLE Database
Bolivia	Previous Tax Payments	66% of Total Revenues	File and Pay at Regional Large Taxpayer Office to which Taxpayer is Assigned	UNIX Operating System INFORMIX Database
El Salvador		60% of Total Revenues	Taxpayer may file at either the Large Taxpayer Office or within the banking system	VMS Operating System Natural/Adabas Language
Nicaragua	Previous Tax Payments	77% of Total Revenues	File and Pay at Regional Large Taxpayer Office to which Taxpayer is Assigned	UNIX Operating System Natural/Adabas Lanaguage
Paraguay	Previous Tax Payments	60% of Domestic Revenues	File and Pay at Central Large Taxpayer Office	UNIX Operating System ORACLE Database
Peru	Sales Reported for Income Tax Purposes	67% of Total Revenues	File and Pay at Regional Office to which Taxpayer is assigned	UNIX Operating System INFORMIX Database
Uruguay	Previous Tax Payments Payers of Excise Taxes Taxpayers of Interest	83% of Total Tax Revenue	File and Pay at Regional Office to which Taxpayer is assigned	UNIX Operating System Mantis Language

⁵ Paulo De Santos, International Monetary Fund, Presentation on Large Taxpayer Units, 1997

Table 2
Coordinated Examination Program of the United States Internal Revenue Service⁶

Criteria	Definition	Scoring Range	Points
Gross Assets	Total assets are determined by combining the assets of the principal taxpayer with those of all effectively control domestic and foreign entities. For financial, utility, insurance, mutual fund, and stock brokerage companies, no more than 12 points will be assigned.	Up to \$500 Million \$500 Million to \$1 Billion \$1 Billion to \$2 Billion \$2 Billion to \$5 Billion \$5 Billion to \$8 Billion For Each Addition 3 Billion, Add One point	1 2 3 4 5
Gross Receipts	Gross Receipts are determined by combining the gross receipts of the principal taxpayer with those of all effectively controlled domestic and foreign entities. For financial, utility, insurance, mutual fund, and stock brokerage companies, no more than 10 points will be assigned.	Up to \$1 Billion \$1 Billion to \$2 Billion \$2 Billion to \$3 Billion \$3 Billion to \$5 Billion \$5 Billion to \$10 Billion For Each Addition 3 Billion, Add One point	1 2 3 4 5
Operating Entities	Included in this category are only separate and distinct major entities (major subsidiaries, branches, operating divisions) regardless of form, which are to be examined and will have 50 or more staff days of planned examination time. Domestic subsidiaries and service organization are not included unless transactions among these entities have potential tax consequences.	1 Operating Entity 2-5 Operating Entities 6-9 Operating Entities 10-13 Operating Entities Over 13 Operating Entities	1 3 5 7 9

⁶ Internal Revenue Manual, Internal Revenue Service, U.S. Department of the Treasury, April 1998

Table 2 (Continued)
Coordinated Examination Program of the United States Internal Revenue Service⁷

Criteria	Definition	Scoring Range	Points
Multiple Industry Status	Included in this category are only separate and distinct major entities that are to be examined and will have 100 or more staff days of planned examination time. Domestic subsidiaries and service organization are not included unless transactions among these entities have potential tax consequences.	One point per industry per tax cycle	
Team Members		Allow one point for each Primary District Revenue Agent who will devote 25 or more staff days to the examination of the taxpayer. This is limited to the number of Primary District Revenue Agents who spent 25 or more staff days on the most recent full examination.	
Specialists		Allow one point for each Specialist assigned to the taxpayer for this cycle. This is limited to the number of Specialists who expended on the most recent full examination of the taxpayer.	
Revenue Agents	In computing this factor, consider only non-specialist revenue agents. Points are computed based on the amount of support time for the examination irrespective of the number of examiners assigned to the taxpayer. Points are limited to the number of days spent in the last examination cycle.	0 – 49 Days 50 – 99 Days 100 – 149 Days 150 – 199 Days For each additional 50 days add 1 point	0 1 2 3

⁷Internal Revenue Manual, Internal Revenue Service, U.S. Department of the Treasury, April 1998

Table 2 (Continued)
Coordinated Examination Program of the United States Internal Revenue Service⁸

Criteria	Definition	Scoring Range	Points
Total Direct Examination Staff Days	Consider all revenue agents and specialists from primary and support districts. Do not consider case manager or audit accounting aide time. The number of staff days is based upon a two year examination cycle.	Allow one point for each 125 staff days planned for the examination, limited to the actual or anticipated time on the most recent full examination. Additional points are credited for only full 125 day incremented.	
Inclusion into CEP	Industrial Firm Financial, Utility, Insurance, Mutual Fund, Stock Brokerage Firm		12 or more 15 or more
Specific Taxpayer Inclusion	A firm may be included in the Coordinated Examination Program if it is of sufficient complexity to warrant inclusion and would benefit from the team examination approach. Note that the regional office must concur for the districts recommendation for inclusion		

⁸Internal Revenue Manual, Internal Revenue Service, U.S. Department of the Treasury, April 1998

Table 3
Recommended Criteria for the Selection of Large Taxpayers – International Monetary Fund⁹

Criteria	Inclusion in LTI
Business Turnover	Include in LTI those taxpayers with largest business turnover volume
Annual Federal Tax Payments	Include in LTI if sum of federal tax payments exceeded 10 billion Rubles in 1997
Annual Federal Tax Arrears	Include in LTI if sum of federal tax arrears exceeded 3 billion Rubles in 1997
Gas and Oil Excises	Include in LTI if among the 50 largest gas and oil taxpayers
Alcohol Excises	Include in LTI if among the 50 largest alcohol excise taxpayers
VAT, Excises, and Duties on Imports	Include in LTI if among the 50 largest payers of VAT, excises, and duties on imports.

⁹ “Improving Tax Collections in the Russian Federation,” International Monetary Fund, 1996

Table 4
Recommended Criteria for the Selection of Large Taxpayers – Russian Federation Fiscal Reform Project

Criteria	Definition	Selection Procedure
Gross Receipts	Gross Receipts are to be determined by combining the gross receipts of the principal taxpayer with those of all effectively controlled domestic and foreign entities.	Rank all taxpayers in the selected region by Gross Receipts. Proceed to select taxpayers from the highest amount of gross receipts to lowest until the sum of gross receipts from the selected taxpayers is greater than 50% of the total sum of gross receipts for all taxpayers.
Previous Tax Payments	Previous Tax Payments are to be determined by combining the previous tax payments of the principal taxpayer with those of all effectively controlled domestic and foreign entities. Previous tax payments shall include the Value Added Tax, Enterprise Profits Tax, Excise Taxes, and Personal Income Tax withholding for the previous annual tax period.	Rank all taxpayers in the selected region by Previous Tax Payments. Proceed to select taxpayers from the highest amount of previous tax payments to lowest until the sum of previous tax payments from the selected taxpayers is greater than 50% of the total sum of previous tax payments for all taxpayers.
Tax Arrears (Delinquent Accounts)	Tax Arrears are to be determined by combining the previous tax arrears of the principal taxpayer with those of all effectively controlled domestic and foreign entities. Previous tax arrears shall include the Value Added Tax, Enterprise Profits Tax, Excise Taxes, and Personal Income Tax withholding for the previous annual tax period.	Rank all taxpayers in the selected region by Tax Arrears. Proceed to select taxpayers from the highest amount of tax arrears to lowest until the sum of tax arrears from the selected taxpayers is greater than 50% of the total sum of previous tax payments for all taxpayers.