

# DIGITAL TAX REGIMES: INTEGRATION INTO THE TAXPAYERS' NATURAL SYSTEMS

**Two-fold case study of the FTS of Russia dedicated to implementation of the (i) Digital Tax Regime for the Self-Employed and (ii) Automated Simplified Tax Regime for Small and Medium Enterprises**

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## **KEY WORDS**

Digital tax regime, gig economy, seamless tax administration, real time data, taxpayers' natural systems

## **ABSTRACT**

Traditionally starting a micro business involved a number of procedures requiring special knowledge about various tax regimes, business activities and accounting. This meant it might take several days to complete. With more and more people are monetizing their hobby in the gig economy, this was becoming increasingly burdensome.

The FTS of Russia (**FTS**) has decided to approach this category of taxpayers differently. The objectives were to establish a simple and convenient tax regime for self-employed, where taxation processes embedded within taxpayers natural systems.

New digital tax regime for self-employed allows tax administration to have a remote interaction with the taxpayers and means that individuals can run a business from anywhere, at any time with minimum effort. This process facilitates with the My Tax mobile application developed by the FTS.

Constantly growing number of the individuals that enjoy the digital tax regime for self-employed encouraging us to broaden its scope with Small and Medium Enterprises' (**SMEs**) by employing online cash registers capabilities and cooperating with banks. Currently, the FTS is piloting digital tax regime integrated into SMEs ecosystem that significantly reduces compliance burden for this type of taxpayers and pre-calculates taxes at the FTS level.

# DIGITAL TAX REGIME FOR SELF-EMPLOYED

## PROBLEM STATEMENT

The FTS has conducted a series of surveys to get more insights into the requirements of the target group of taxpayers, i.e., self-employed individuals. The results of the survey showed that the need to comply with traditional administrative requirements was the main factor deterring this category of taxpayers from legalizing their activities and paying taxes. The survey also demonstrated that this category of taxpayers does not want to make personal visits to tax offices, submit tax returns, or spend time on administrative requirements.

The majority of potential self-employed taxpayers also indicated that they expect to be taxed at a rate that did not exceed 6% because it is fairer for those who have just started their own business. Based on the outcomes, the FTS outlined the scope of the project as a technology-based solution with the goal of easy registration and seamless compliance that was launched in 2019.

## CASE ANALYSIS

The digital tax regime for the self-employed means that all interactions with the tax authorities, e.g., starting and terminating a business, keeping income records, generating receipts, paying professional income tax, and other online interactions with a tax authority could be done through mobile application.

My Tax mobile application (**My Tax app**) is software developed by the FTS and used by individuals through a computer device (a smartphone or a computer, including a tablet) with the access to Internet.

The Mobile app can be downloaded through App Store, Google Play, Huawei AppGallery, Rustore. It is also available through the FTS website.

The mobile application allows a self-employed to register with tax administration in just a few minutes with a mobile device, and keep income records, as well as pay professional income tax.

The digital tax regime for the self-employed includes the following features:

- » Integration with the banks and aggregator digital platforms
- » Establishment of the legal status remotely and in real-time
- » Preferential provisions for the self-employed

» No reporting and no online cash registers are required

FTS also had to create an effective legal framework to support the application and the legal amendments were required to facilitate this technology. The law included the description of a mobile app and provided that it enables all interactions with the tax administration.

Specific types of activities in Russia are subject to the digital tax regime. The main business activities of the self-employed include taxi services, delivery of goods, apartment rentals, repair and marketing services as well as selling goods of their own production.

The digital tax regime is not applied if the self-employed receives income under labor (employment) contracts or if the self-employed hires other people to his business.

There is also a limit on the amount of income for the purposes of the regime. Professional income tax is applied only if the annual total income does not exceed 2.4 million rubles (\$ 26 thousand US Dollars)

The amount of income is checked through the My Tax app. Once the income exceeds the established limit, a taxpayer will have to pay taxes stipulated by other taxation systems.

### **Integration with the banks and digital aggregators and marketplace platforms**

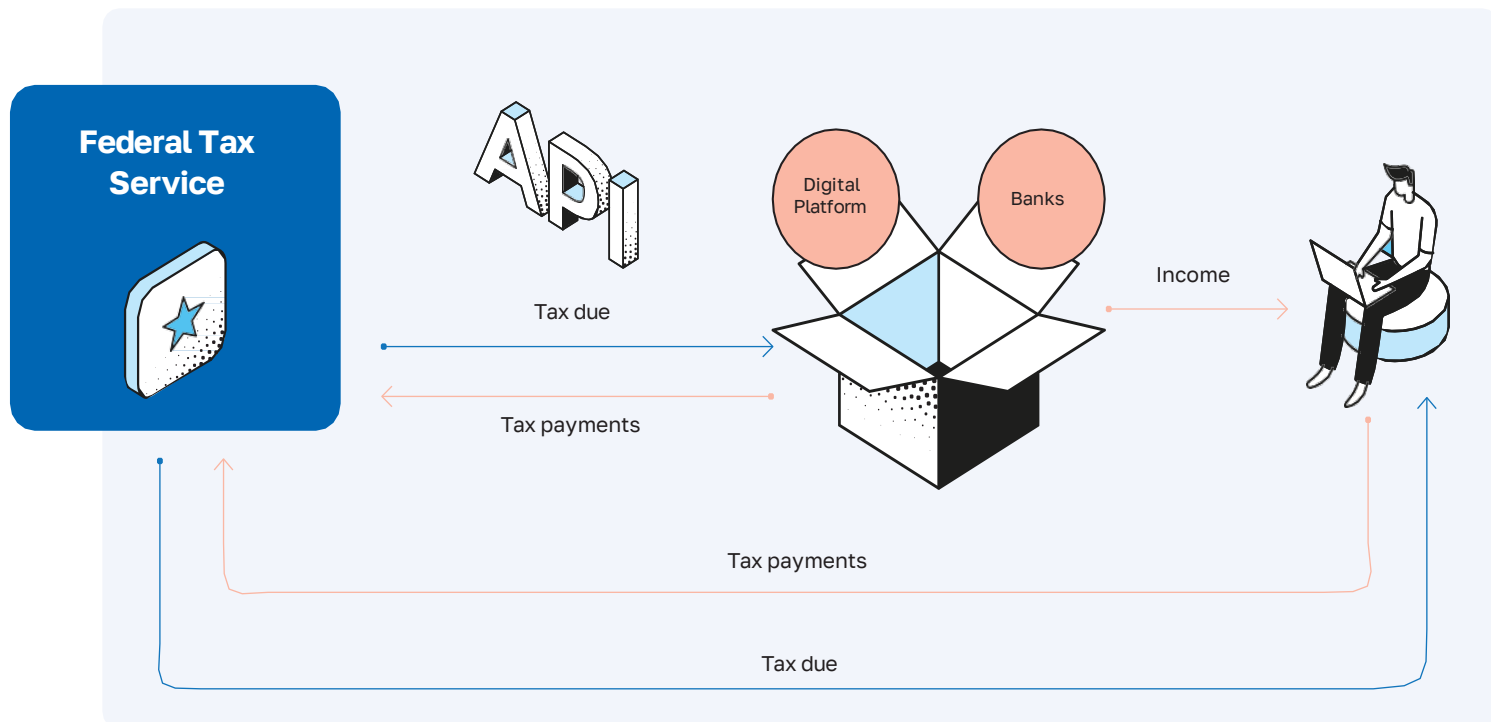
A key innovation of the project is an open API solution developed by the FTS enabling integration of the App's features with the digital marketplace and aggregator platforms (**digital platforms**) and banks that form the natural environment of the taxpayers.

The API allows banks and digital platforms to employ My Tax app capabilities in their applications.

Thus, taxation is integrated into the self-employed ecosystem. They apply the tax regime with the software products that are already familiar to them – through which they carry out transactions (digital platforms) or hold accounts for their business (banks).

Currently, 96 companies (Yandex Taxi, Sberbank of Russia, etc.) are connected to API, and 48% of the self-employed conduct business through standalone software products.

For example, if a self-employed taxpayer is a taxi driver when he completes a ride with the customer, the My Tax App would automatically generate a receipt and the transaction data would be provided to the tax administration.



**Figure 1.** My Tax Mobile App: Illustration of the Application's Processes

### **Establishment of legal status remotely and in real-time**

The digital tax regime for the self-employed means that individuals can start a business from anywhere, at any time, and with minimal effort (it takes 1-2 minutes from the emergence of the idea to become self-employed to completion of registration as being self-employed with the tax authorities). It is as easy as getting a social media account. This is facilitated by the My Tax mobile app which supports the process.

It takes a few minutes to register through the My Tax app. No paper applications or visits to the front offices are required. There are several ways to register:

- » by presenting a passport for scanning and verification and a photo that can be taken on a smartphone camera
- » with TIN and password from the online Taxpayer Personal Account at the FTS website [www.nalog.gov.ru](http://www.nalog.gov.ru)
- » through the online account at the Public Services Portal of the Russian Federation

- » through the bank where a self-employed opens a business account
- » through a digital platform using which a self-employed sells goods and services

In the My Tax App and online account at the FTS website, a self-employed taxpayer can generate a tax registration certificate online.

Deregistration is also done online through the My Tax app, with no need to visit the FTS office.

A taxpayer after being de-registered with the tax authority as the self-employed is entitled to obtain this status online again.

No individual entrepreneur status is needed. The My Tax App can generate legally valid income statements for third parties (e.g., banks and visa centers).

### **Preferential provisions for the self-employed**

Under the digital tax regime for the self-employed, the tax base is the total amount of the sales revenue which makes it simple and convenient to assess.

Tax rates are the following:

- /1/ income received by the self-employed from the sale of goods (works, services, property rights) to individuals, is taxed at a rate of 4%
- /2/ income received by the self-employed from the sale of goods (works, services, property rights) to individual entrepreneurs and companies, is taxed at a rate of 6%

Information on accrued taxes is reflected in the My Tax app. The tax period is a month, at the end of which the amount of tax payable is calculated.

This allows avoiding accumulation of significant amounts of tax to be paid at the end of the longer tax period such as a year.

Taxpayers with a self-employed status receive 10 000 rubles (\$ 100 US Dollars) of tax deduction. The tax deduction is determined as follows:

- /1/ 4% tax rate with respect to income received from individuals, is reduced by 1%
- /2/ 6% tax rate with respect to income received from individual entrepreneurs and companies, is reduced by 2%

No pension insurance contributions are required to be made by the self-employed. However voluntary pension insurance plans are available for the self-employed.

Sales activity under the digital tax regime for the self-employed can be combined with employment under a labor contract. The salary is not considered when calculating the tax under the digital regime.

The law stipulating the digital tax regime for the self-employed provides for legal stability. The tax regime shall not be changed in the 10-year period upon implementation. The tax rates will also stay unchanged the same during this period.

### **No reporting and no online cash registers required**

The use of cash registers is not required for the self-employed. The receipts are generated and sent to the customers directly through the My Tax app.

A taxpayer shall only generate a receipt on each sales transaction and send it to the customer online.

No additional reporting is needed. Paying taxes with all accounting and calculations is done in the background by the App.

Accruals and tax payable are available at the App at any time throughout the month.

FTS calculates the tax amount itself monthly and informs the taxpayer through the App.

There is also an option to enable auto-payments through My Tax App. It can be done by granting the tax authority the right to send orders to the bank for debiting and transferring funds from the specified bank cards for tax payment.

## **RESULTS**

We witness high relevance of the digital tax regime for the self-employed.

More than 7 thousand people join it every day.

Currently, more than 8.6 million individuals are registered as self-employed under the digital tax regime which exceeds expectations before launching the project.

Notably, more than half of them have not previously declared their income at all.

Based on the above we believe that the digital tax regime for the self-employed appeared to be a successful tool for enlightening the shadow economy.

We aimed at constant improvement of the quality of tax services provided for the self-employed.

Currently, My Tax App demonstrates a story of success that is evidenced by user evaluation. The average rating of the App is 4.6 out of 5 (App Store, App Gallery).

The introduction of the digital tax regime enabled us to look ahead and move forward on the following:

- » establishment of a predictable and positive investment environment for the development of gig economy
- » evolution of legislation, revision of existing restrictions, elimination of barriers
- » increase of the SMEs' digitalization and as a result – increase of transparency

# AUTOMATED SIMPLIFIED TAX REGIME FOR SMEs

## PROBLEM STATEMENT

The next stage in the digitalization journey is to embed more taxation processes into the natural systems that SME taxpayers use to conduct their business, manage their finances, and interact with their customers and employees.

Implementation of the Automated Simplified Tax Regime for SMEs was preconditioned by the success story of digital tax regime for the self-employed as well as significant results of the online cash register system in Russia.

Starting from 2016 the FTS launched the use of online cash registers system (**OCR system**) where data transmission to the tax administration takes place in a real-time.

OCR system provides the FTS with large bulk of data across the retail sector. We receive and process more than 200 million receipts from more than 3.5 million online cash registers daily.

OCR system gives a capability to provide seamless taxation as soon as every transaction is automatically booked in the FTS system.

Therefore, these two solutions enabled us to establish the automated simplified tax regime for SMEs where reporting burden would be significantly reduced.

The purpose of the regime is to allow SMEs to devote as much of their time to business as possible, while a major part of tax administration is to be carried out by the FTS.

The idea behind the Automated Simplified Tax Regime is the centralized data approach ensuring that tax administration itself can capture as many business transactions from the source as possible in order to determine the right amount of tax to be paid with minimum information from the taxpayers.

In order to automatically prepare tax calculations, Automated Simplified Tax Regime is extended with the data on business transactions captured directly from the authorized banks.

When designing the regime, we tried to consolidate technological innovations and breaking-through decisions that we used in previous projects:



- » Re-use of the OCR system data for the assessment of taxes for SMEs.
- » Remote interactions through taxpayers' online accounts or specialized mobile application with advanced analytics capabilities
- » Wider use of Application Programming Interfaces which allow both to receive banking data and to integrate taxpayers' online account capabilities in banking applications.

FTS has started piloting newly developed the Automated Simplified Tax Regime since July 1, 2022, in Moscow, Moscow region, Kaluga region and Republic of Tatarstan.

## **CASE ANALYSIS**

The regime stipulates the following:

- /1/ Tax and social security contributions reporting is almost eliminated. Moreover, no reporting to government agencies is required for individual entrepreneurs with no staff.
- /2/ Tax is automatically assessed for the transactions settled through OCR system or the authorized bank accounts. On-site tax audits are no longer needed.
- /3/ Replacement of the social security contributions with the income tax rate charged at a higher rate.

The high tax burden on labor remains an obstacle for SMEs growth. Shifting the tax burden from labor to direct taxation being revenue-neutral could bring an increase in employment and investments in SMEs' businesses. At the same time, pension rights and social insurance are retained for employees of SMEs or individual entrepreneurs enjoyed the Automated Simplified Tax Regime.

- /4/ Cooperating with banks as the source of transactional data

Similarly to the Digital Tax Regime for the Self-employed open API developed by the FTS enables integration of the taxpayers' online accounts and mobile application features with digital banking products. This allows banks to facilitate end-to-end customer experience for SMEs with tax compliance and banking services.

Besides, the banks have started to work as the "agent" for both taxpayers and the FTS which include:

- » Mapping banking transactions for tax assessment
- » Acting as the agent withholding personal income tax on salary payments to SMEs' employees
- » Forwarding to the FTS information on income paid by SMEs to the employees, deductions, and personal income tax

Currently, more than 10 banks are authorized to partner with the FTS under Automated Simplified Tax Regime

- /5/ Customer-centric model of interactions between the FTS and taxpayers, which is ensured by conducting regular surveys of the user experience and the taxpayers' needs.

A taxpayer can opt for Automated Simplified Tax Regime with one click in the course of online registration with tax authority. The front-end development of the Automated Simplified Tax Regime is based on the findings made by User testing laboratory of the FTS.

- /6/ Taxpayers under the Automated Simplified Tax Regime can easily obtain bank credits due to their high transparency to the banks and automation of information exchange with the FTS, which ensures the completeness and reliability of information about the taxpayer.

### **Parameters of the automated simplified tax regime**

Legal entities and individual entrepreneurs are eligible for the Automated Simplified Tax Regime in case the following criteria are met:

- » Number of employees does not exceed 5 persons
- » Annual income does not exceed 60 mil rubles (\$ 635 thousand US Dollars)
- » Residual amount of the owned fixed assets do not exceed 150 mil rubles (\$ 1,58 mil US Dollars)
- » Keeping bank accounts at the authorized banks
- » Non-cash form of salary payments

Within the framework of the Automated Simplified Tax Regime, the taxpayer could opt for assessing tax base as "gross income" or "net income (gross income less deductible income-related expenses)".

Tax rate depends on the chosen option – gross income is taxed at 8% tax rate, whereas net income is taxed at 20% tax rate. VAT is not applied to the income of taxpayers under Automated Simplified Tax Regime.

Automated Simplified Tax Regime is not applied to the Controlled Foreign Companies income, interest and dividends, and any other specific types of income, e.g., winnings and prizes.

Some types of expenses related to investment activities or inherent to organizations with more complex business activities, staff, and corporate structure (for example, payment to the Board of Directors) are not considered.

Taxable income and deductible expenses are determined based on:

- » OCR system data
- » bank transactions mapped by authorized banks (for taxable/non-taxable transactions (e.g., return of goods))
- » Information that was submitted by taxpayers into the taxpayers’ online account

The taxpayers would only have to review the transactions mapped by the banks for the tax assessment on a monthly basis.

Upon taxpayers’ review of this data the tax administration subsequently issues a demand for tax payment to be paid in 25 days of the month following the month of income payment to the taxpayer.

### Elements of tax determination under the automated simplified tax regime

	Gross Income	Net Income (Income Less Expenses)
Tax Rate	8%	20%
Income	✓ Source: OCR, bank, online personal account	✓ Source: OCR, bank, online personal account
Expenses	✗	✓ Source: OCR, bank
Loss	✗ Not recognized	✓ Could be recognized in future periods
Minimum tax rate	✗ No	✓ 3% from the received income

## **RESULTS**

Currently, more than 10,000 taxpayers have joined this tax regime with total income of more than 10 bil rubles (\$ 107 mil US Dollars).

The results of the conducted taxpayers' survey demonstrate that the main advantages of the Automated Simplified Tax Regime are no need to submit tax reports (24.8%), no need to pay insurance premiums (22.3%) and automatic tax calculation (22.5%).

As disadvantages, taxpayers indicated high tax rates (50.3%), as well as thresholds on the number of employees (15.3%) and annual income (15.2%).

Further, we are going to scale the pilot project and extend it to the broad range of SMEs.