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Improvement of Tax Regulation Arrangements for the Russian Stock Market

Mejora de los acuerdos de regulación fiscal para el mercado bursátil ruso

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Andrei V. Koren

Associate Professor, Department of Economics and Management, Vladivostok State  
University of Economics and Service

Email: [andrey.koren3@mail.ru](mailto:andrey.koren3@mail.ru)

ORCID: <https://orcid.org/0000-0002-1164-5897>

Tatyana E. Danilovskikh

Associate Professor, Department of Economics and Management, Vladivostok State  
University of Economics and Service

Email: [Tatyana.Danilovskikh@vvsu.ru](mailto:Tatyana.Danilovskikh@vvsu.ru)

ORCID: <https://orcid.org/0000-0002-0545-172X>

Artem A. Pustovarov

Vladivostok State University of Economics and Service

Email: [andrey.koren3@mail.ru](mailto:andrey.koren3@mail.ru)

ORCID: <https://orcid.org/0000-0001-8602-6989>

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## **Abstrac**

The paper discusses various options for taxation of transactions with securities issued by Russian companies. The study aims to solve the problem of low investor activity in the Russian stock market by transforming the current tax legislation. An assessment of the factors restraining the development of the primary public offerings market is given. The problems of the existing methodology for the formation of the tax base when calculating income tax and personal income tax on transactions with exchange-traded financial assets are analysed. A methodology for providing tax benefits and tax incentives for investors is proposed. An assessment of the effectiveness of tax benefits using an individual investment account is given. A comparative analysis of the amount of taxes paid is carried out depending on the status of an investor and the type of securities. A detailed description of the methods for calculating taxes on stocks, bonds and futures is given. The results of the study consist in substantiating theoretical and practical provisions that allow us to develop an effective mechanism for taxing financial transactions in the securities market. The need is theoretically substantiated and the significance of state support in the stock market for citizens of the Russian Federation is determined. Mechanisms are proposed for cancelling separate accounting for several types of tax bases. The main problems are found and ways to improve the mechanism of taxation of transactions made on the Russian stock market are developed.

**Keywords:** taxation, tax regulation, stock market, securities, stocks.

## **Resumen**

El documento discute varias opciones para la imposición de transacciones con valores emitidos por compañías rusas. El estudio tiene como objetivo resolver el problema de la baja actividad de los inversores en el mercado bursátil ruso mediante la transformación de la legislación fiscal actual. Se ofrece una evaluación de los factores que limitan el desarrollo del mercado primario de ofertas públicas. Se analizan los problemas de la metodología existente para la formación de la base imponible al calcular el impuesto sobre la renta y el impuesto sobre la renta personal en las transacciones con activos financieros negociados en bolsa. Se propone una metodología para proporcionar beneficios fiscales e incentivos fiscales para los inversores. Se proporciona una evaluación de la efectividad de los beneficios fiscales utilizando una cuenta de inversión individual. Se realiza un análisis comparativo de la cantidad de impuestos pagados según el estado de un inversor y el tipo de valores. Se proporciona una descripción detallada de los métodos para calcular los impuestos sobre acciones, bonos y futuros. Los resultados del estudio consisten en fundamentar disposiciones teóricas y prácticas que nos permiten desarrollar un mecanismo efectivo para gravar las transacciones financieras en el mercado de valores. La necesidad está fundamentada teóricamente y se determina la importancia del apoyo estatal en el mercado de valores para los ciudadanos de la Federación de Rusia. Se proponen mecanismos para cancelar la contabilidad separada para varios tipos de bases impositivas. Se encuentran los principales problemas y se desarrollan formas de mejorar el mecanismo de imposición de las transacciones realizadas en el mercado de valores ruso.

**Palabras clave:** fiscalidad, regulación fiscal, mercado de valores, valores, acciones.

## **Introduction**

In the period 2018-2019, not a single Russian company entered the stock market with an initial offer of shares. Companies are postponing the placement due to the limited attractiveness of Russian assets and the tightening of sanctions rhetoric. Experts believe that the problem is in the unfavourable economic situation and the low level of tax incentives for investments of individuals.

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The stock market can be described as a combination of financial relations between an investor and an issuer. In the unstable situation in the Russian Federation, most Russian assets have lost their former attractiveness. At present, the yield on deposits does not exceed 7 per cent per year, which weakly covers actual inflation rates. In this regard, the Russian state is trying to increase the investment activity of citizens within the country. This will attract the money of the population not only in government bonds, but also in bonds and shares of commercial enterprises that cannot take foreign loans due to sanctions from Western countries. In addition, the growth of investment activity will lead to an increase in tax revenues from the tax on personal income, as private investors receiving dividend income, interest on bonds or income derived from the difference between purchased and sold securities will have to pay personal income tax to the state.

The purpose of the study is to consider options for improving the mechanism of taxation of transactions in the securities market, the development of the principles of taxation of profits from operations in the securities market and the development of optimal methods for creating a tax base for the acquisition and sale of securities on exchange markets.

## **Materials and methods**

The options for the transformation of taxation in relation to the conditions of modern transformations of the markets for goods, works, and services were reflected in the works of domestic and foreign researchers.

The current tax regulations in the field of financial instruments and their impact on investment income are discussed in detail in the works developed by Kh.Kh. Prozorov

(2016), G.N. Semenova (2017), O.A. Grazhdankina, S.V. Shaposhnikova (2017), A.A. Khachatryan, V.V. Mazy (2019). The authors note the importance of tax literacy as one of the most important ones for successful work with financial instruments.

The taxation of bonds was covered in the works by O.S. Belomytseva (2016), A.V. Koren and A.A. Pustovarov (2018), G.A. Efendiev, I.Yu. Gedgafov, A.B. Nagoyev (2018), A.E. Ushanov (Ushanov, 2019). The authors noted that the presence of significant benefits both within an individual investment accounts and additional preferences for securities of domestic issuers acted as drivers of growth in the domestic debt market along with macroeconomic and geoeconomic factors.

The problems of modelling the investment portfolio taking into account their taxation, as well as aspects of tax optimization were examined in detail in the works by T.A. Malinina (2016), S.M. Kamalova (2017), S.V. Bogachev and A.V. Gurnak (2017), D. Yu. Basalyko (2017), L.V. Polezharova (2019). The authors note the importance of tax considerations when creating and managing long-term investment portfolios to optimize taxation and maximize income. Taxation of a number of instruments helps to reduce speculative activity, which is reflected in the tax laws of several countries of the world.

The possibilities of improving tax policy for the benefit of all participants were described in the works by A.V. Grachev (2016), L.I. Goncharenko, D.Yu. Novikov (2019), L.S. Kabir (2016), N.Yu. Saibel, A.V. Kovalchuk (2018), A.N. Goloyad (2019). Finding a balance between the interests of investors and the amount of revenues to the state budget is a difficult topic, the solution of which is at the search stage from the beginning of the creation of financial institutions in each country. But due to the variability of external and internal factors, the legislation of countries is developing. For this reason, the discussion about the effectiveness and impact of fiscal policy measures on participants in financial transactions remains open.

Despite numerous fundamental works on the theory of taxes and the practice of taxing stock market transactions, there are still no works that discuss the legal arrangements for

taxing stock market transactions in relation to the conditions of the post-crisis recovery of the Russian stock market. The need for such studies determined the choice of the topic of the paper, the logic of disclosing and solving tax problems in the Russian stock market. The methodological basis of the study was a systematic approach, as well as methods such as comparison, classification and analysis, which allowed determining the priorities for the development of taxation arrangements for securities transactions. The methods used made it possible to determine the effectiveness of introducing tax benefits as a stage on the path of further transformation of tax legislation.

### **Analysis and Results**

In the securities market, an issuer places securities issued in order to take free cash from a wide range of people. In turn, an investor having free cash is looking for a way to invest these funds for a certain time in order to maximize profits. An investor buying a security from an issuer has certain rights to the issuer, and the issuer, in turn, has obligations to the investor. Mainly, the rights and obligations of the parties depend on the type of security (Prozorov, 2016; Semenova, 2017; Jenaabadi, & Issazadegan, 2014).

So, buying a part of the shares, the investor buys a share in the company, i.e. becomes the owner of the business. The shares give the investor the right to receive part of the profit in the form of dividends. In addition, since the investor becomes the owner of the business, it gains the right to vote at joint meetings. In the event of the issuer's liquidation, the shareholder has the right to receive part of the issuer's property in proportion to his participation share. A company selling its shares, i.e. share in the company, receives free cash, which can be used by it for free purposes.

Table 1 below shows the issuers who have successfully completed the initial public offering of their shares on the Moscow Exchange over the past 3 years.

*Table 1. The amount of funds raised by Russian companies through initial public offerings at the stock exchange (IPO)*

Issuer	IPO volume, billion roubles	Share fraction, %	Year of IPO
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Alrosa	41.3	16	2017	
Rusneft	32,4	20	2017	
Detsky Mir	18,4	29.3	2017	
Moscow credit bank	13,2	18.8	2016	REICE   561
FG Budushcheye	11.7	20	2017	
OVK	9	12.22	2016	

In 2017, the state placed its 16 per cent stake in Alrosa at the Moscow Exchange and earned 41.3 billion roubles for it. The Detsky Mir company issued shares in the amount of 29.3 per cent at the Moscow Exchange and earned 18.4 billion roubles; the purpose of the issue is to develop the company at a faster pace (Ushanov, 2019; Malinina, 2016).

In 2019, not a single initial placement was conducted on domestic trading floors. The last time an IPO at the Moscow Exchange was held in 2017, and since then, Russian companies have limited themselves to talking about a possible entry into the stock market. Thanks to the securities market, companies can attract capital not only from domestic investors, but also from foreign ones. So, the share of Russian buyers of Detsky Mir shares was only 10 per cents.

Taxation in the securities market is not a perfect system and it requires the elimination of a number of these problems. First of all, deficiencies in the legislative framework allow stock market participants to evade the full payment of tax payments for transactions with securities (Kamalov, 2017).

The state is trying to increase the financial literacy of the population and reduce the negative attitude of citizens towards banks, brokerage companies and the stock market as a whole using a variety of methods. Currently, the main instrument of tax incentives for the population can be considered an individual investment account (IIA) (Grazhdankina & Shaposhnikova, 2017).

An individual investment account is a contract concluded with a broker or a management

company in the stock market. An individual investment account can be opened since January 1, 2015 (Khachatryan & Mazi, 2019). It is intended for individuals, both for residents and non-residents of the Russian Federation. A key feature of the individual investment account is the preferential tax treatment. To receive tax benefits, it is required not to withdraw funds from the account for at least 3 years, but this program was launched indefinitely (Belomytseva, 2016; Tereso, et al, 2018).

In order to analyse the procedure for taxation of securities for individuals in more detail, the portfolio of an investor with various types of securities traded in financial markets was taken as an example (Koren & Pustovarov, 2018; Efendiev et al., 2018). Here, a taxpayer is an individual, who has acquired stocks, bonds or futures contracts. The quantity and value of securities are shown in table 2.

*Table 2. The structure of the investment portfolio of the individual taxpayer in roubles*

Security paper	Purchase price for 1 pc.	Quantity, pcs.	Total acquisition price	Selling price per 1 share	Total selling price	Income (loss) from sales	Dividends or income, %
Sberbank shares	100	1000	100000	165	165000	65000	1970
Norilsk Nickel Shares	8700	30	261000	9500	285000	24000	16560
Megaphone shares	850	200	170000	650	130000	-40000	24190
Federal loan bonds	1000	100	100000	990	99000	-1000	9000
Corporate bonds	1000	100	100000	1020	102000	2000	11000
Gold Futures	72000	5	360000	69000	345000	-15000	-
MTS Stock Futures	230000	2	460000	275000	550000	90000	-
Total	-	-	1551000	-	1676000	125000	62720

From the table, we see that the taxpayer purchased shares of Sberbank, Norilsk Nickel, Megafon, Federal loan bonds, corporate bonds, as well as futures contracts for the supply of gold and also purchased shares in MTS. Securities were purchased in the amount of 1,551,000 roubles, and sold in the amount of 1,676,000 roubles, thereby the taxpayer received an income of 125,000 roubles. REICE | 563

We consider the option of taxing an investor with the same investment portfolio if he acted as a legal entity. The data are presented in table 3.

Table 3. Investment portfolio of the investor as a legal entity In roubles

Security paper	Purchase price for 1 pc.	Quantity, pcs.	Total cost
Sberbank shares	100	1000	100000
Norilsk Nickel Shares	8700	30	261000
Megaphone shares	850	200	170000
Federal loan bonds	1000	100	100000
Corporate bonds	1000	100	100000
Gold Futures	72000	5	360000
Futures for the supply of MTS shares	230000	2	460000
Total	-	-	1551000

So, the investor has Megafon shares in its portfolio in the amount of 850 pieces, Norilsk Nickel in the amount of 30 pieces, Sberbank in the amount of 100 pieces. In addition, the company has federal loan bonds (Bogachev & Gurnak, 2017) and corporate bonds of 100 each.

Table 4 shows a comparison of the amount of taxes payable to the budget depending on the type of entity and the membership in tax residency.

Table 4. Comparison of taxes payable to the budget of individuals and legal entities

Tax base and tax amount	Tax resident - individual	Tax non-resident - individual	Tax resident - legal entity	Tax non-resident - legal entity
Tax base for % of income, roubles	11000	11000	9000	9000
			11000	11000
Tax amount in % of income, roubles.	1430	3300	3550	3550
Tax base on dividends, roubles	42720	42720	42720	42720
Tax amount on dividends, roubles	5554	6408	5554	6408
Tax base from the sale of securities, roubles	137 495	137 495	137 495	137 495
Tax amount from the sale of securities, roubles	17874	41249	27499	27499
Total taxes paid, roubles	24858	50957	36603	37457

The minimum tax burden affects individuals who are tax residents of the country (Basalyko, 2017; Polezharova & Berberov, 2019; Grachev, 2016). They will pay 24 858 roubles as taxes. The maximum tax burden is incurred by a non-resident individual, who pays 50,957 roubles, which is 2 times more than a resident. The legal entity has a medium tax burden, regardless of whether it is a resident or a non-resident of the country, as the amount of tax is almost the same: 36,603 and 37,457 roubles, respectively. The difference is due to different rates on income in the form of dividends.

Thus, it can be seen that the government of the country primarily stimulates the investment of citizens in the national economy, creating the most favourable conditions for them in the form of lower tax rates, as well as tax benefits (Goncharenko & Novikov, 2019; Matandare, 2018).

An analysis of the data allows us to establish reliably that the most effective tool to increase attractiveness of the stock market is an individual investment deduction, that is, the privilege provided to the taxpayer in the event of opening such an account and depositing funds on it (Saibel & Kovalchuk, 2018).

An individual investment deduction is governed by tax law. The taxpayer has the right to an individual investment deduction in two situations:

- 1) The taxpayer deposited funds in an individual investment account.
- 2) The taxpayer received income from operations with securities on an individual investment account.

Table 5 presents comparisons of taxpayer profitability depending on the type of brokerage account and the type of tax deduction for 3 years.

*Table 5. Analysis of the profitability of 3 brokerage accounts of the taxpayer In roubles*

Name	Regular account	1st option of investment tax deduction	2nd option of investment tax deduction
The amount deposited to the account for 3 years	1200000	1200000	1200000
Bond yield, %	357235	357235	357235
Personal income tax	46440	46440	46440
3 year tax deduction	0	156000	46441
Average net profit per annum, %	11,3	18,8	13
Total income	310794	466794	357236

Thus, investors who have opened an individual investment account will have the opportunity to save money more efficiently, more rationally, at a rate higher than the bank and with comparable risks for themselves.

An essential method of tax incentives for investments in the securities market is the adoption by the State Duma of the Russian Federation on March 22, 2017 of a tax credit for corporate bonds (Goloyad, 2019; Pustovarov, 2018; Krivoschapova et al., 2109; Vasilenko & Titova, 2019; Konvisarova et al.). According to this exemption, private investors are exempt from personal income tax in the amount of 13 per cent of interest income received on corporate bonds issued from January 1, 2017 to December 31, 2020. Thus, at present, investors are more interested in investing their savings in bonds than in bank deposits.

## **Conclusions**

Implementation by the state of a policy implementing transformations in these areas can provide a solution to only some of the problems associated with taxation in the stock market. To completely eliminate the shortcomings of the taxation of the stock market, an integrated approach to solving problems is needed affecting both the internal aspects of the securities market and the external factors affecting the market itself.

The government of the country should improve tax regulation of operations on the securities market in the following areas:

- 1) It is necessary to simplify the procedure for calculating the tax base on operations for the sale of securities and the procedure for calculating personal income tax on such operations. The simplest solution would be to abolish the interim calculations of the tax base and personal income tax withholding during the year (in case of partial withdrawal by an individual of funds from a brokerage or trust management agreement). This will significantly reduce the labour costs of professional participants in the calculation of personal income tax from individuals;

2) To provide for all professional participants in the securities market, regardless of whether they carry out or do not carry out dealer activities, the possibility of combining all three tax bases;

3) To ensure the optimal tax burden by improving the existing tax legislation, developing new arrangements to stimulate investment in national securities, as well as reducing the excessive tax burden associated with the “double” taxation on certain securities transactions.

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