

Modern Economic Conditions and Impact of the Tax Regime on the Legalization of Self-Employment: Russian and Foreign Experience

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Abstract: This article analyzes Russian and international experience in approaches to taxation of self-employed individuals and their impact on the legalization of activities based on modern economic conditions. The purpose of the study is to conduct a comparative characteristic of the criteria for determining self-employed persons and various forms of their taxation in Russia and abroad at the present stage. The special tax regime for the self-employed in Russia has been in effect since 2019 and is one of the youngest in the tax system, so the analysis of foreign experience in the taxation of self-employed persons is of particular practical interest. The authors analyze global statistics on the number of self-employed persons and identify trends in their changes not only in the Russian Federation, but also in some foreign countries, especially in the light of the development of digital technologies and the emergence of new opportunities for independent activity by individuals. The research made it possible to draw intermediate conclusions for Russia at this stage of the new regime implementation: whether modern tax regimes stimulate the development of self-employment, how optimal these regimes are for legalizing citizens' income, and what trends of foreign countries in the field of self-employed taxation may be relevant for modern Russia.

Keywords: Self-employment, tax on the self-employed, individual entrepreneur, professional income, shadow economy.

INTRODUCTION

Modern economic conditions in Russia provide many opportunities for the development of independent economic activity. The result is an annual increase in the number of individuals engaged in private business with state registration and in the status of self-employed persons without registration of activities shown in Figure 1.

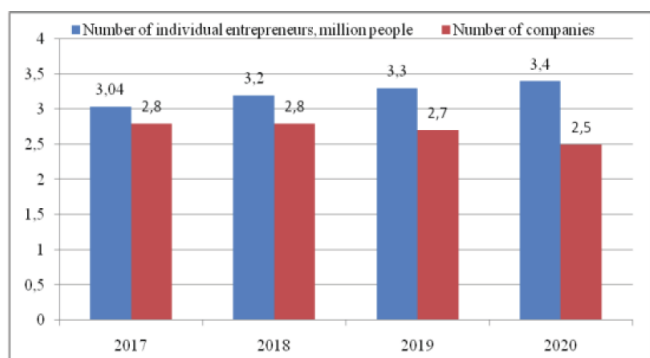


Figure 1: Dynamics of individual entrepreneurs and legal entities.

Official data from the Federal tax service of the Russian Federation shows the following results: as of January 1, 2020, the number of individual

entrepreneurs is 3.4 million people, with an annual tendency to increase while reducing the number of legal entities (Bolonina, 2019). Thus, at the moment, the form of private individual activity is more interesting for business development. Official statistics on the self-employed population are kept in the Russian Federation only since 2017, so the data is not significant yet and amounts to 4,676 people at the beginning of 2020. However, the increase in self-employed in 2019 was 52 % (1614 people). In addition, more than 330,000 individuals (self-employed and individual entrepreneurs) in four regions of Russia in 2019 chose an experimental regime in the form of a tax on professional income. Despite such a high growth rate over the past year, official data indicate a low involvement of individuals in legalizing their activities and declaring income (Lee *et al.* 2017; Kösters, and Smits, 2020). Thus, according to unofficial data and sociological surveys, the number of self-employed Russians is about 16-17 millions of people, or almost a quarter of all working citizens of Russia. Data from the Federal state statistics service shows an increase in informal employment in 2019 (Figure 2).

The reduction in the number of legal entities with the growth of individual entrepreneurs and informal employment allows us to draw the following conclusions: the population is moving either to the status of entrepreneur or informal self-employed. The situation is obvious - individuals do not seek to register

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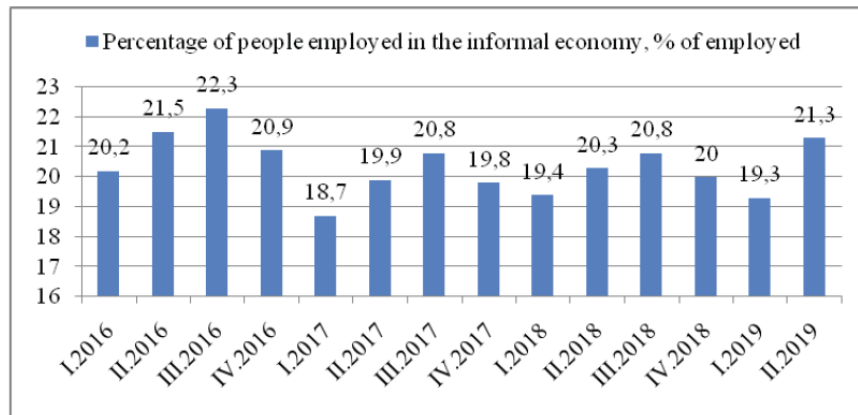


Figure 2: Dynamics of individual entrepreneurs and legal entities.

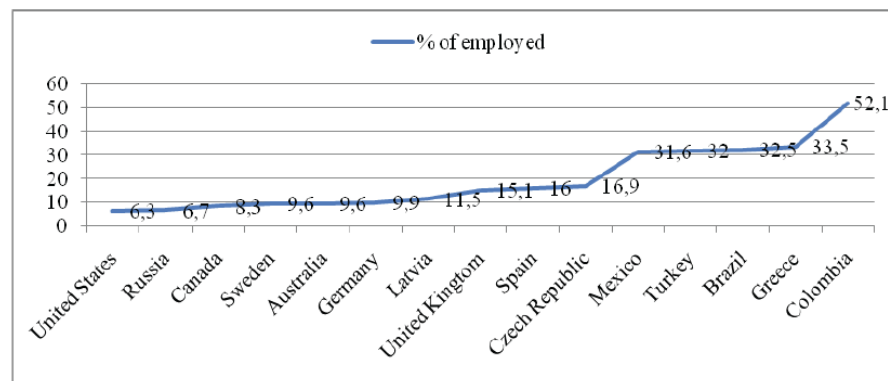


Figure 3: Self-employment rate in 2018 according to OECD data.

as self-employed. The developed mechanisms (primarily tax) are limited and do not increase individuals' interest to legalize private activities. According to experts, in General, the share of self-employed in Russia is significantly lower compared to economically developed and developing countries. According to the Organization for economic cooperation and development, the overall trend of self-employment in 2018 in various countries is shown in Figure 3.

Thus, the legalization of the self-employed in the Russian Federation is slow, since they are not yet ready or able to pay taxes on their income. Currently, Russia is conducting an experiment on new tax conditions for the self-employed, the results of which require assessment and analysis.

LITERATURE REVIEW

The problems of self-employment and their economic support measures are given much attention in scientific publications. Russian authors cover various aspects of self-employed persons' functioning: discussions on determining their status (Kostrova and

Shibarshina 2018), development of tax regulation measures and state support (Lvova 2019). The content of the concept of self-employment, its essential characteristics in the Russian scientific literature have not yet been studied; the authors often identify the concepts of «small business», «small business», «entrepreneurship», «business», «self-employment» (Enggartyasti, and Caraka, 2017; Smirnov 2018, Tsarkova *et al.* 2020). With the experiment on the new tax regime for the self-employed, a lot of attention was paid to the analysis of its effectiveness, especially its role in the fight against the shadow sector of the economy (Pankov 2019; Kurandina *et al.* 2019, Zagidullina and Kukresh 2019).

Foreign authors investigate the impact of digital technology on the growth of self-employment among the population, especially in the agricultural sector (Zhao 2020); consider tax non-compliance, concealment and understatement of income of self-employed in Europe (Kukk *et al.* 2020), reveal the concept of «false self-employment» - an artificial dissolution of employees and replacing them with self-employed individuals to reduce tax by employers

(Kosters *et al.* 2020); consider the effectiveness of tax reforms on self-employment. Thus, the range of issues related to self-employment is quite wide and interesting, while many aspects studied in Russian and foreign authors' publications coincide.

METHOD

The research used methods of analyzing tax legislation in various countries, analyzing official Russian and foreign statistical databases, as well as methods of comparison and generalization.

Several developed and developing countries with high and low levels of self-employed people were selected for comparison. This wide range of countries allowed us to consider various conditions for the self-employed and assess the uniqueness and effectiveness of existing tax regimes for the self-employed.

RESULTS

The concept of «self-employment» is interpreted differently in the legislation of different countries. Despite its widespread use, it has not yet been officially established in Russia. However, signs or criteria for classifying as self-employed citizens appeared in the tax legislation in 2017: for example, self-employed citizens without registration as an individual entrepreneur can receive income and provide services for looking after and caring for children, sick people, tutoring, cleaning residential premises, and household management. Thus, the first official criterion for self-employment was the type of activity performed. Later,

in 2019, with the introduction of a special regime for the self - employed in four regions of the Russian Federation-a tax on professional income, such criteria were added to the fact of receiving income in the absence of an employer (while not acting as an employer himself), and income from the disposal of property. Thus, currently, for tax purposes in Russia, a self-employed citizen is an individual who receives income from activities without employees in various types of activities (however, the types of activities are not legally approved) (Fayzullina 2019; Kösters, and Smits, 2020).

The Organization for Economic Cooperation and Development defines self-employment as «employers, self-employed workers, members of production cooperatives, and unpaid family workers. All persons working in corporate enterprises, including company Directors, are considered employees. Self-employment can be seen either as a survival strategy for those who can't find any other ways to generate income or as evidence of an entrepreneurial spirit and a desire to be their own boss». In the UK, all citizens who start working for themselves are considered individual entrepreneurs, and they can work not only independently but in partnership. In South Korea, all self-employed people are individual entrepreneurs who must be registered with the tax authorities, an obligatory condition is that they own or rent an office. In Poland, the self-employed also have to register with the tax authorities and get a number; they can be employees. In the United States, it is necessary to file a simplified Declaration and obtain self-employed status (Sheredeko 2016). Thus, in world practice, the essence and content of «self-employment» often coincides with

Table 1: The Main Differences between "Individual Entrepreneur" and «Self-Employed» for Tax Purposes

	Individual entrepreneur	Self-employed citizen
Registration	Submitting an application to the tax authorities	Online registration in the app Providing a notification
Insurance premium	Pay	Don't pay
Tax regime	General taxation regime Special tax regimes Professional income tax (in 23 regions of the Russian Federation)	Personal income tax for certain types of activities Professional income tax (in 23 regions of the Russian Federation)
Hiring employees	Have the right	No right
Conclusion of employment contracts for the purpose of earning income	Have the right	No right
Reporting, tax accounting	Provides, leads	Does not provide, does not lead
Income limit, per year	no restrictions	2.4 million rubles (31579 \$)

the concept of «individual entrepreneur», and similar criteria and requirements are applied. In Russian legislation, the concepts of «individual entrepreneur» and «self-employed» are not identical. The differences between these statuses for tax purposes are shown in Table 1.

As you can see, the self-employed and entrepreneurs have many differences: it is easier to become self-employed, you do not need to keep labor-intensive accounting, provide reports; entrepreneurs have more responsibilities to the state to maintain tax records, submit reports. However, for the time being, the self-employed can only work in a few regions of the country and the payment of professional income tax is limited to the physical capabilities of the self-employed, while individual entrepreneurs can work throughout the country and operate in areas that are inaccessible to the self-employed.

As it was noted earlier, Russia has been testing new regimes for the past 3 years, in particular, an experiment in the field of taxation of the self-employed. Therefore, official statistics are only available since 2017. In 2019, the distribution of the self-employed by type of activity is shown in Figure 4 (according to the Federal tax service).

Statistics on the self-employed who apply the professional income tax in 2019 are presented only by General official data - more than 330,000 people registered in four regions over the year, mainly taxi drivers (18%), builders (7.1 %), tutors (5.7%), consultants (8.5%) and landlords (9.85). Thus, currently, we can talk about 2 categories of self-employed persons in Russia:

- Self-employed who are registered under a tax notice and pay income tax on individuals in

certain types of activities defined by tax legislation (the norm applies throughout the territory of the Russian Federation);

- Self-employed people who pay professional income tax (currently limited in 23 regions of the Russian Federation).

Each category is assigned to an individual independently and voluntarily. Based on the fact that the legislative authorities decided to extend the experiment and Supplement the regions of introduction, the new tax regime showed positive results on the territory of the Russian Federation. This regime provides for the payment to the budget of 4% of income received by a citizen from other individuals and 6% of income received from individual entrepreneurs and legal entities. At the same time, the new regime releases the taxpayer from the obligation to pay insurance premiums for pension, medical and social insurance; it does not require filling in tax returns and using the cash register. The law does not contain a specific list of activities that can be used by nannies, housekeepers, family cooks, personal drivers, tutors, designers, typesetters, copywriters, journalists, illustrators, photographers, SMM managers, PR managers, marketers, programmers, developers, lawyers (except lawyers), accountants, etc.

The development of a new special regime in the form of a tax on professional income pursued the main goal: the legalization of income of small private businesses, the number of which has recently increased. The following advantages of the tax contribute to achieving this goal:

- Lowest income tax in the tax system;
- Automatic online registration as a payer;

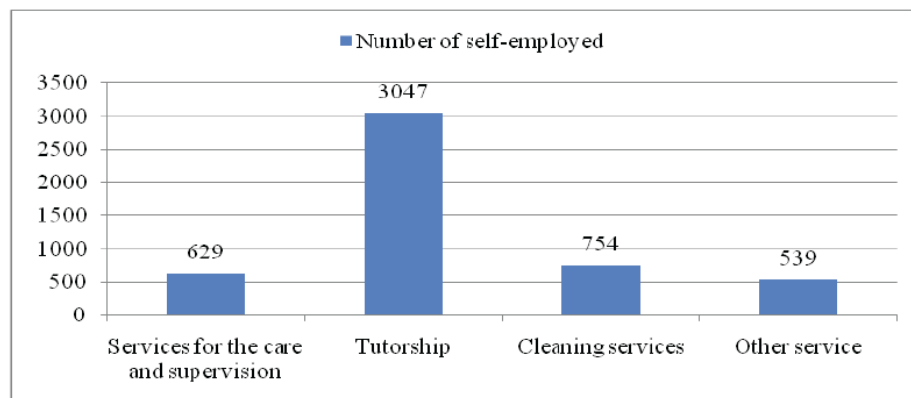


Figure 4: Distribution of the self-employed by type of activity in 2019.

- Lack of reporting and accounting requirements;
- The lack of compulsory insurance contributions.

A special feature of the Russian tax regime for the self-employed is its absolute digitalization. Such implementation of the regime has almost no analogs in the world. To register as a professional income taxpayer, you must download the «My tax» mobile app, which is available on GooglePlay and the App Store. The app automatically generates receipts for customers, and information about sales in online mode is sent to the tax authority. At the end of the month, the taxpayer receives a notification with the amount of tax and payment details also via the app. Self-employed status is also easily removed-without applying and filling out forms with the tax authority. The implementation of the regime in the digital field is a

significant step in the field of the legalization of taxpayers. Tax is automatically calculated on all income from professional activities that is credited to an individual's account. Tax administration is significantly simplified.

The results of the regime are as follows: for all the time since the beginning of the experiment, the self-employed have completed work for 37.5 million rubles (\$500,000), the average receipt was 1078 rubles (\$14.3), the total income of the self-employed exceeded 40.4 billion rubles (\$539 million), the tax on professional income was about 1.060 billion rubles (\$14.133 million). Unfortunately, there are no more detailed statistics on the Federal tax service's website for entrepreneurs and self-employed people. This data is not sufficient to assess how effective this system is, since such revenue to the budget may be mainly due to

Table 2: Comparative Characteristics of Self-Employed Tax Regimes in Different Countries (E. V. Sherede ko (2016), Vishnevskaya N. T. (2013), Nikiforova E. G., Hudaeva L. A. (2013))

Country	Tax rate	Mode features
USA	15.3 % of revenue: 12.4 % - income tax 2.9 % - medical insurance	registration with tax authorities submitting a Declaration deductions that reduce income unexpected tax audits
Germany	7.7 % - health insurance Progressive scale: Up to 8,000 euros-0% 8 000-52 800 euros-14-42 % 52 800- 250 700 euros-42 % 250 700 euros-45%	registration with tax authorities submission of the Declaration, filled in on the website
South Korea	VAT-10% Progressive scale: Up to \$ 7,173 : 8% 7 714 – 28 000\$: 560\$+17% 28 001 -56 000 \$: 4 173\$+ 26% From \$ 56,00: \$ 11560+ 35%	registration with tax authorities submission of the Declaration, filled in on the website deductions that reduce income
Australia	2 % - medical insurance Progressive scale: Up to \$ 18 200: 0 % 18 200 -37 000 \$: 19 % 37 000- 90 000 \$: 3 500\$+32.5 % 90 000-180 000\$: 20 800\$ + 37 % From 180 000: 54 000\$+45%	online registration with tax authorities online Declaration submission
Poland	Insurance and pension insurance - optional Progressive scale: Up to \$ 20 340: 18% Over \$ 20 340: \$ 3 661 + 32%	registration is not required submission of the Declaration, filled in on the website deductions that reduce income
Latvian	Self-employed tax: 23% The tax of an individual entrepreneur: 9%	registration with tax authorities submission of the Declaration, filled in on the website deductions that reduce the income of the self-employed

payments from individual entrepreneurs who have switched to this mode in order to reduce the tax burden. Thus, the new tax mechanism designed check self-employed begun, will increase, and the tools to assess their effectiveness are not developed, and measures the correlation between two large objects (individual entrepreneurs and self-employed citizens) is not considered.

The tax on professional income in Russia is not unique. The world practice of taxation of the self-employed has a long and wide application. The comparative characteristics are presented in Table 2.

Based on the results of a study of the taxation conditions of self-employed citizens in other States, the following main features can be identified: standard registration procedure, the obligation to provide reports, a progressive tax scale, and high rates. In comparison with foreign countries, the tax regime for the self-employed in Russia is very different, and looks simpler and more convenient. It is obvious that such attractive conditions are created at the testing stage to increase the interest of as many self-employed citizens as possible. In the current Russian economic reality, there is probably a no more effective way to encourage this category of taxpayers to leave the shadow sector.

DISCUSSION

Based on the results of a study of the Russian and international experience of taxation regimes for self-employed individuals, the following main conclusions and recommendations can be made:

- For the Russian budget, informal employment and its legalization is a significant problem that has received a lot of attention over the past few years: an important step in actively working on this issue was the launch of a pilot project to introduce a special tax regime for the self-employed;
- Professional income tax is still the lowest income tax in Russia, which is designed to help people legalize income from small businesses or unofficial activities, the official status of a taxpayer increases responsibility to the state and makes life easier for citizens;
- Despite all the attractiveness of the new tax regime, the legalization of the self-employed is very slow, and it is still very early to talk about a real mass exit of this category from the shadow

economy: according to sociological surveys, the population is afraid of the lack of guarantees of maintaining a low rate for several years and the lack of guarantees in the sphere of health, pensions and social protection;

- Growth of income in the Russian budget from tax on professional income, in our view, until important other forms of small business, including individual entrepreneurs will use the new regime as a way to minimize the tax burden, the growth of revenues from self-employed will be adjusted by lower revenues from individual entrepreneurs;
- In order to improve the tax on professional income interest is the experience of financial support for self employed Australia, Germany: in countries, a minimum non-taxable income, subject to tax income only after a certain value; this exemption limit is advisable to install and at the level of the subsistence minimum in the Russian Federation;

Thus, the tax on professional income is an extremely ambiguous decision of the state. Its further improvement, the creation of a carefully developed and economically sound legislative framework, and attractive conditions that encourage self-employed persons to transfer their activities to the legal sphere will increase the budget system's revenues and increase the level of employment and welfare of the population of the Russian Federation.

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