Russia: Thinking higher income tax for top earners

The Russian government is reportedly thinking of raising the personal income tax rate from 13% to 15% for its top-earners. It's potential financial effect would be equivalent to just 0.4% of annual budget revenues and salary pool, but that's how the government is signalling that high-income households will be co-financing the post-Covid recovery

Source: shutterstock

According to the media, the Russian government is considering to increase the personal income tax rate from the currently uniform level of 13% to 15% for annual income exceeding RUB2-3 million (US$29,000-43,000) per year. With entrepreneurial income accounting for only 6% of total income, and property income (including from deposits and dividends) - for another 4%, the income tax story in Russia is relevant mainly for the income coming from salaries.

For now we have the following initial observations.

- **This is not the first time a shift to a de facto progressive personal income tax scale is**

being discussed. An increase in the tax rate for the top earners while removing it completely for those earning below 1.0-1.5x the subsistence level has been contemplated in previous years. We have already discussed the general implications of such a move, including potential easing of some social tensions at the expense of higher costs of administering a progressive scale.

- **Covid-19 outbreak may have catalyzed the earlier inclinations.** The first list of measures in response to Covid-19 ahead of the nation-wide lockdown at the end of March included clear signs that higher-income households and businesses would have to co-finance the recovery. As an example, the president announced that individual holders of bonds and retail deposits of over RUB1 million (US$14,000) would start paying income tax on the accrued interest.
- **The proposed income tax hike would have a very limited financial impact…** Even though the newly proposed salary threshold for the income tax rate hike has been lowered from the initially guided US$100-115k to US$29-43k per year, its financial impact is unlikely to be significant. According to our estimates, up to 5% of employees would fit the criteria, and a 2 percentage point hike in their income tax rate would result in an extra RUB150bn (US$2.1bn) of annual tax. This corresponds to up to 2% of the top earners' salary pool and around 0.4% of the total Russia salary pool. A 2 pp increase in the tax rate for them can potentially boost annual personal income collection by 4% and the total consolidated budget revenues by 0.4%, assuming no tax evasion.
- **…but the range of ultimate parameters is wide.** The financial impact could become significant if needed. For example, a stronger increase in the tax rate for the top earners (which contribute to around 25% of the RUB4 trillion annual personal income tax revenues) would make the measure more attractive to the regional budgets hit by the Covid-19 outbreak. For reference, personal income tax assures around 36% of the regional tax revenues and 10% of consolidated budget. Conversely, supplementing the increase in tax rate for the wealthy with removing it for the low-earners could reduce the net effect for the budget but may significantly boost the income of low to mid-earners. For example, according to our estimates, the previously discussed removal of income tax for those earning under 1.0-1.5x of subsistence level may result in 15-35% of employees receiving an 11% boost to their salaries. In absolute terms it means potential extra annual income in a wide range of RUB150-550bn for low- and mid-earners.
- **Likelihood of actual change in the personal income tax uncertain.** The limited financial effect for the budget and high administrative cost of the proposed changes are the arguments against implementation. The timing of the media leak – during the post-lockdown (which may have disproportionately affected the lower-income households) recovery and ahead of the national voting on the constitutional amendments proposed by the president – makes it unclear whether it is intended as an actual tool of economic policy. At the same time, this proposal does follow the trend set by the previous governmental communication, suggesting that the likelihood of implementation is still above zero. The newsflow on this subject is worth following by the investment community.

Author

Dmitry Dolgin
Chief Economist, CIS
dmitry.dolgin@ing.de

Disclaimer