

ASSESSING THE SOCIAL EFFECTS OF PERSONAL INCOME TAXATION AND THE NECESSITY FOR THEIR STRENGTHENING IN THE RUSSIAN FEDERATION

Khaibat M. Musaeva*, Basir Kh. Aliev*, Murad G. Isaev*,
Patina K. Gazimagomedova* and Dzhamilya A. Rabadanova*

***Abstract:** The main objective of the study was to examine the social effects of personal income taxation and assessment of the ways of enhancement these effects in the Russian Federation (RF). The scientific novelty of the work lies in the development of a set of proposals and recommendations of practical and scientific nature, aimed at improving the social effects of personal income taxation in Russia. The authors substantiate the necessity of assessing not only fiscal, but also social effects arising in the course of tax reforming. The study shows non-compliance of the present taxation mechanism in terms of calculation and collection of personal income tax in Russia with the principle of social orientation. The authors prove the expediency of a progressive personal income tax (PIT) system with regard to excess profits, as well as income from non-employment, and exemption from taxation of the incomes of some social strata to ensure the viability of the taxpayers and their family members at the regional subsistence level that will maximally allow fulfilling social potential of the tax to the greatest extent. The authors prove the need to reform the labor relations system and increase wages in economy sectors that will increase in future the revenues from the personal income tax, the value added tax (VAT), excise tax, as well as insurance contributions to state social extra-budgetary funds. They suggest also moving part of the tax burden from entrepreneurs to private persons. It is proved that the positive indirect effect resulting from the reform of the personal income tax calculation technique in the future will be able to compensate for the RF budget system possible negative direct effect.*

***Keywords:** Personal income tax, PIT, assessment, effects, social role, workplace relations, standard and social deductions, progressive tax, excess profit, reforming, Tax Code of the Russian Federation.*

1. INTRODUCTION

In world practice, the most common tax paid from the income of the population is a personal (individual) income tax. Personal income tax in the developed civilized countries plays not only fiscal, but also largely social role, and is used to implement social policy of the state. Personal income tax is adapted to the maximum extent to the implementation of the taxpayer's solvency accounting principle and is the most

* Eurasian National University named after L.N. Gumilyov, 2, Satpaev St., Astana, 010000, Kazakhstan

effective tool to carry out income redistribution (Remikhanova, 2016). At the present stage, the income tax is the main tax in the economy of more than 60 countries.

It should be noted that the social function of the personal income tax is poorly implemented in the Russian practice. This fact is primarily due to flat tax rate schedule, which has been used in Russia over the 16 years, the deficiency of non-taxable minimum, a high level of shadow incomes, and immaturity of the income declaring system among citizens. Thus, according to various expert estimates, the proportion of shadow wages of hired workers in Russia makes up from 20 to 30%. In many regions of the Russian Federation, especially in the regions of the North Caucasus Federal District, these figures are much higher. Thus, according to studies conducted by scientists of Dagestan, the shadow economy in the Republic of Dagestan reaches 60% of GDP (Akhmeduev, 2015).

The constraining factor strengthening the social effects of personal income taxation in the Russian Federation is also low income of the majority of the population, especially in the context of anti-Russian sanctions. In Russia, the proportion of taxes levied on physical persons, is around 4% of GDP compared to 8-10% in advanced countries. As a consequence, the tax burden on companies in Russia is higher than that in other countries by 4-6% (Panskov, 2015).

Assessing various options for tax reforming, many scientists and research organizations evaluate only direct effects resulting from the change in the tax collection mechanism that is manifested in the form of shortfall in income of budget system. In this context, we share the views of W.V. Ashmarina and believe that “the effects of tax reforms are multifaceted and any correction of the tax system will lead to change in the financial flows circulating between economic actors” (Ashmarina, 2016). For example, if reforming of PIT will lead to the increase in real incomes of the population, it is likely that these extra revenues will remain in the economy and will be used for consumption or savings that will lead to change in the amount of revenues from other taxes paid by the taxation agents. In this regard become actual issues related to both fiscal and social effects of the personal income tax reforming as an important tool of social regulator of economic processes.

The importance of increasing social effect resulting from the taxation of personal incomes in the Russian Federation makes it necessary to deepen the research in this area.

2. METHODOLOGY

In the Russian Federation since January 1, 2001, PIT calculation and collection technique is governed by Chapter 23 of the RF Tax Code. The social function of this tax is implemented through the use of such structural elements as tax rates, tax deductions, and tax exempt. As noted above, in the context of the Russian

Federation, there are significant problems in the use of the personal income tax as a social policy tool. This is due to the high level of shadow incomes and insufficient regard in the taxation mechanism of social or property status of the taxpayer, his actual ability to pay the tax.

The social orientation of the personal income tax consists not only in its direct but also indirect relation to human welfare because this tax generates revenues of regions and municipalities. Compliance with principles of social equity in taxation policy is particularly relevant for the Russian society, where the population is highly stratified on a scale of “poverty–wealth” (Mayburov and Ivanov, 2014). Continued social polarization not only inhibits formation of a healthy contemporary economy, but is also fraught with serious social conflicts, undermining the security of the country.

Tax rate is a key element in the tax calculation and collection technique. The necessity of returning back to a progressive taxation with regard to personal income tax, though based on a fundamentally different schedule as compared to that previously applied in the Russian Federation, has been discussed for years. However, Russia still uses a flat tax rate schedule for levying personal income tax. This is despite the fact that in the Russian Federation there is a significant stratification of the population by income level (that increases the feasibility of implementing a progressive taxation). Thus, in 2014, the Gini coefficient (income concentration index) characterizing the degree of deviation of the population’s actual total income line from the uniform distribution line, was 0.416, while in advanced countries it ranges from 0.23-0.36 (Bataev, 2015). In the Republic of Dagestan, the Gini coefficient has increased by 1.6 times during the period from 2010 to 2015. Thus, the current flat tax rate schedule increases the social differentiation of personal incomes.

Considerable potential of personal income tax as a state social policy tool is incorporated in the methodology for the provision of tax deductions. The current Russian legislation on personal income tax (Art. 218-221 of the Tax Code) foresees standard, social, property, and investment deductions. The latter was introduced in 2015. The deductions on the personal income tax, laid down by statute of the Russian law, as well as the purposes of these deductions are demonstrated in the Table 1.

Table 1
Personal income tax deductions in the Russian Federation

<i>Tax deductions</i>	<i>The purpose of the tax deduction</i>
Standard tax deductions	Reducing tax base, improving living standards of the population, promoting infant natality
Social tax deductions	Encouraging charitable activities, compensating part of expenses on training and medical treatment
Property tax deductions	Providing conditions to solve housing problems; development of housing construction and creation of the civilized real estate market

<i>Tax deductions</i>	<i>The purpose of the tax deduction</i>
Occupational tax deductions	Encouraging the development of personal entrepreneurship, science, culture and art
Investment tax deductions	Encouraging the investment activity, investing in securities

Note: Composed based on the Tax Code of the Russian Federation, Chapter 23 (Articles 218 and 221), Moscow, 2016.

The application of tax deductions are determined by the degree of their influence on the total amount of tax payments under the personal income tax. Comparative data on the types of tax deductions on personal income tax in absolute and relative terms for 2015 are presented in Table 2.

Table 2
The amount and structure of tax deductions with regard to personal income tax (PIT) in the Russian Federation in 2015

<i>Indicators</i>	<i>Total amount, bln rubles</i>	<i>Proportion, %</i>
Personal income tax at the basic rate (13%)	24724.8	100.0
Deductions on personal income tax, including:		
- standard deductions	334.8	1.5
- property deductions	79.0	0.4
- social deductions	7.9	0.0
- occupational deductions	5.4	0.0

Note: Composed based on the Federal Tax Service of the Russian Federation, Retrieved 16.05.2016 from www.nalog.ru

As is obvious from Table 2, in the Russian Federation, the largest proportion in the structure of incomes, taxable at the rate of 13%, are standard tax deductions, which account for 1.5%. Basically, they include deductions for children under the age of 18 years, as well as students in full-time education, graduate students, medical residents, junior physicians, and a cadets at the age of 24 until the income of the taxpayer for the tax period (year) reaches 350 (280 - since 2015) thousand rubles. Despite a slight increase in absolute terms, the amount of these deductions remains insignificant - just 1.4 thousand rubles per month for the first and second child, and 3 thousand rubles per month for third and succeeding children. At that, deductions are provided without regard to financial status of the taxpayer. It would be fair to implement the tax-exempt minimum for private persons, linking it to the regional subsistence minimum. Citizens, whose income is below the subsistence minimum, should be free from paying tax.

It should be noted that social standard deduction in the personal income taxation in Russia decreases from year to year because of annual increases in minimum

subsistence level at a constant indicators of tax deductions. Thus, for children these deductions still remain at the level of 2012 (Babenko and Lapshin, 2015). The most pronounced downward trend is observed in the proportion of standard deductions in the subsistence minimum for certain “eligible” categories of citizens (liquidators of Chernobyl disaster, veterans of the Great Patriotic War, Heroes of the Soviet Union and the Russian Federation, etc.) because these deductions (3000 and 500 rubles) have not changed since the enactment of Chapter 23 of the RF Tax Code (01.01.2001).

Calculation of specific rates when applying a progressive PIT scale is quite a challenging task associated with a variety of decisions, which depend on the current gradation in the levels of income, unevenness of income for various segments of the population, and the duration of the social inequality weakening process (Musaeva et al., 2015). Therefore, the transition to a progressive scale of taxation should be gradual and phased. At the present stage, it is advisable to carry out PIT reforming in the Russian Federation based on an intermediate option between flat and progressive scales.

The main content of the proposed changes in the personal income tax calculation and collection technique at the current stage is as follows:

- ensuring the progressive schedule of the personal income taxation by establishing tax-exempt minimum at the minimum subsistence level, as well as increasing standard deductions for children and dependents up to the subsistence minimum, rather than implementing rates differentiation;
- granting standard tax deductions to the taxpayer and all his dependents up to the month in which the income of the taxpayer calculated on an accrual basis from the beginning of the year will exceed twelvefold amount of average wage in the region.
- leaving flat the PIT base rate, though increasing base rate from 13 to 15% to compensate for shortfall in income due to the increase in the standard deductions, This approach allows implementing to the greatest extent the classic principle of taxation fairness. At that, the increase in tax liabilities for the wealthy citizens will be insignificant (just 2%) to trigger the growth in the number of evasions from payment of the personal income tax.

It should be noted also that a significant number of taxpayers do not have the ability to use not only standard, but also property and social deductions from personal income tax. This is evidenced by the fact that in 2015 most of the population (70.1%) had a per capita income not exceeding 30 thousand rubles per month (Musaeva, 2015). Meanwhile, 49.6% of total cash income accounted for 20% of the population with the highest income (Federal Service for State Statistics of the Russian Federation, 2016).

In the structure of social deductions, the most popular ones are those for education and medical care. According to the authors, the basic problem of social deductions in the context of Russia consists currently in providing mechanism not allowing the deductions to fully realize the social potential of the personal income tax, rather than the amount of these deductions. The provision of tax deductions on education in educational institutions as well as for treatment in medical institutions without considering the social status of the taxpayer (level of income, number of children and dependents in the family, etc.) does not allow implementing social function of personal income tax to the full extent. The contemporary system of social deductions for personal income tax in Russia is profitable in the fullest extent to wealthy citizens. According to the authors, the personal income tax calculation and collection technique should envisage the differentiation in amount of provided social deductions depending on the taxpayer's level of earnings.

3. RESULTS

To determine the outcome of the proposed development on adjustments to existing calculation and collection techniques of the personal income tax at this stage, it is necessary to assess their social and fiscal effects. The criterion for evaluating the effectiveness of personal income tax from the perspective of social implementation is its ability to solve the problem of optimal redistribution of income. The proposed approach obviously shows the positive social return from personal income taxation. As for fiscal effect, it can be conditionally subdivided into direct and indirect effect. Direct budget revenues from the personal income tax can remain unchanged at the initial stage, since losses from the implementation of tax-free minimum and growth of standard deductions can be offset by an increase in the base tax rate from 13 to 15%.

Indirect effects are caused by changes in the amounts of revenues from other taxes due to the reforming of concerned tax (Mikhailik, Ashmarina, 2013). The increase in the indirect effects due to reforming of personal income taxation technique will be caused by the growth of insurance payments to extra-budgetary state social funds (Pension Fund, Medical Fund and Social Insurance Fund), caused by the increase of wages first in the public sector and subsequently in other sectors of the economy, increase in revenues from excise tax, value added tax, customs duties, rising demand and increasing expenditure on consumption. In other words, there will be a ripple effect, which can be estimated at approximately 250-300 bln rubles annually. Thus, it can be argued that the positive indirect effect resulting from reforming of the personal income tax calculation and collection technique will be able to compensate in the future for possible negative direct effect to the state budget system.

The constraining factor of strengthening the social role of the personal income tax in the Russian Federation along with the lack of tax progression is also low

wages of the majority of the population, especially in the context of anti-Russian sanctions. A gradual increase in the minimum wage and the average wage in the public sector of the economy would entail an increase in reported wages in private organizations. This will allow in future increasing personal income tax as well as receipts of insurance contributions to the state social extra budgetary funds. The increase in incomes of the population will allow transferring part of tax burden from entrepreneurs to individuals, conducting a series of social reforms to improve the quality of living of the population, contributing to the sustainable economic development of the country, promoting the development of tax culture and raising the level of voluntary tax payments. In this context, famous foreign scientists note that the voluntary tax payment must be attained based on a minimum level of sanctions and restrictions that will allow in general creating a healthy macroeconomic environment (Gollwitzer, Sophia and Quintyn, Marc, 2010).

Thus, as shown by conducted study, the suggested approach to reforming the methodology of collecting personal income tax possesses significant advantages, which can be stated as follows.

- First, the proposed methodology implements the principle of social equity and social performance in the mechanism of levying the personal income tax due to the tax exemption of citizens, whose income does not exceed minimum subsistence level, as well as exclusion from taxation of amounts that ensure the simple reproduction and the preservation of the health of workers and members of their families;
- Second, the proposed methodology will increase revenues at various budget levels due to the growth of the indirect effects of taxation;
- Thirdly, the proposed methodology will contribute to the promotion of birth rate of children due to a substantial increase in standard tax deductions for children and dependents;
- Fourthly, the proposed methodology will ensure a differentiation in the tax burden depending on the regional differences in the level of wages and the subsistence minimum.

We have already noted the need to enhance in future in the Russian Federation the progressive personal income tax system, including the establishment of increased tax rates on high incomes. However, the growth of rates should not be excessive and quick in terms of their implementation. Studies of the International Monetary Fund have shown that the reduction of taxes in the amount of 1% of GDP reduces GDP by 1.3% for two years (World Economic Outlook, 2010). On the other hand, a similar fiscal consolidation by reducing public spending leads to a decrease in GDP by 0.3% for 2 years that is statistically insignificant.

4. DISCUSSION AND DEBATE

Personal income tax, as the most common tax in the world, has proved effectiveness and efficiency in the entire history of its existence. Personal income tax is one of the major taxes that allow implementing to the maximum extent such a major classic taxation principle as equity (generality and uniformity). In the Russian Federation, personal income tax is a crucial one in the structure of taxes levied on individuals. At that, in Russia, the amount of revenues from personal income tax tend to grow that is illustrated by the data presented in Figure 1.

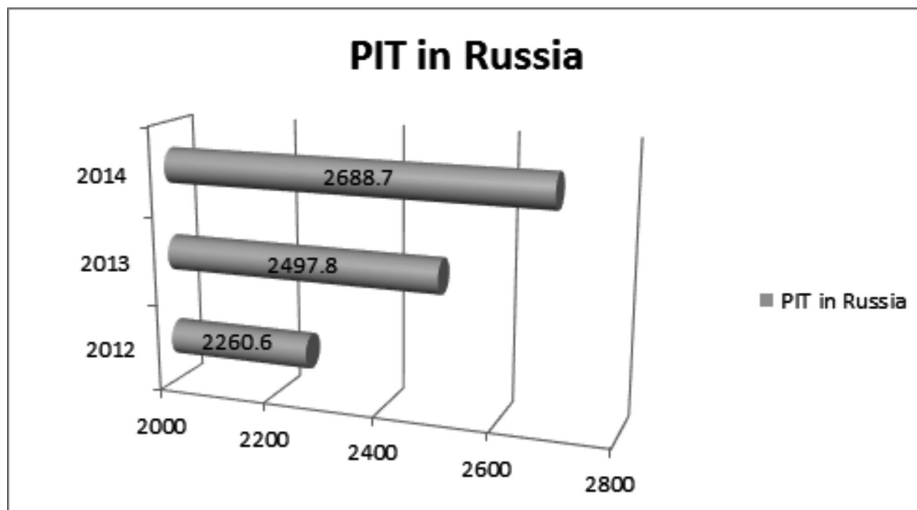


Figure 1: Changes in the amount of revenues from the personal income tax to the budget of the Russian Federation for 2012-2014.

However, despite steady growth trend, the fiscal role of the personal income tax in Russia is significantly lower than that in industrial countries. Thus, in the Russian Federation since the replacement of the payroll tax (from 1.01.2001) by the personal income tax up to now, the fiscal contribution of this tax does not exceed 15% of all revenues of the consolidated state budget (The Official Website of the Federal Tax Service of the Russian Federation, 2016). In the USA personal income tax provides more than 45% of all state revenues (Chkir and Saadi, 2011). This is not only due to high wages. In connection with the economic crisis, the maximum income tax rate in the USA has increased from 35 to 39%, in Denmark - from 55 to 65%. In China, there are 9 various income tax rates (minimum rate is 5%, while maximum rate reaches 45%).

Income received by a foreign taxpayer from the property in the US is taxed based on a special taxation model. This model differs significantly from taxation of other types of incomes received by a foreign taxpayer. In this case a foreign taxpayer will have to pay income tax from real estate similarly as the US investor. Moreover,

foreign taxpayer, like the US taxpayer, will have to pay tax on income from capital gains received from the sale of real property in the US (R.S. Lehman, 2004).

In France, the excess profit is taxed at 75%. The progression of tax rates should provide higher rates only for excess profits. Practical experience of foreign countries shows that the progressive scale allows withdrawing the excess profit and returning these revenues to the economy in order to create new jobs.

Resulting from the global economic crisis, fiscal policy in the European Community (EC) in 2011-2012 was aimed at restoring the sustainability of public finances. After a significant drop in tax revenues which have reached a minimum value over the past decade in 2009, tax revenues in relation to GDP in EU countries have stabilized, and in 2011 changed the trend towards growth. This positive trend has emerged largely through the tax policy measures implemented by EU countries to strengthen fiscal consolidation in 2011-2013 (S. Princen and G. Mourre, 2013). The majority of EU countries have increased the rate of personal income tax or social insurance contributions. But at the same time, tax deductions for specific groups of employees and especially for low-income individuals as well as children and dependants have been unchanged. In developed foreign countries the excess profits of population are represented not by their wages, but dividends and interest payments, such as a payment for the surrender of the property lease and income from the sale of property. Russian tax legislation is constructed in such a way that the proportion of this income is taxed either at zero or reduced rates, or allows for the possibility of reducing the tax base. At that, in some cases the resulting excess profits are not invested in fixed assets. A considerable proportion is invested in financial assets or taken out of the Russian Federation. In addition, because of the immaturity of the declaration system, incomes such as property rental in most cases escape from taxation.

As noted in the introductory part of the study, according to various expert estimates, the proportion of cash-in-hand salaries in the Russian Federation is about 20-30%. Cash-in-hand salaries (payments in envelopes) taking place in Russia, are not only due to the shortcomings of the existing personal income tax calculation and charging mechanism, but also due to the commonality of the tax basis to calculate PIT and insurance contributions to the state extra-budgetary social funds. Currently in the Russian Federation, in addition to personal income tax, there are also insurance contributions collected at a rate of 30%. They include premiums to the Pension Fund of the Russian Federation at the rate of 22%, Social Insurance Fund of the Russian Federation – 2.9%, and Federal Fund of Obligatory Medical Insurance – 5.1%. These insurance contributions must be paid by the employer producing payments to individuals, based on the accrued wage. Insurance contributions to the state extra-budgetary social funds are perceived by the employer as own labor costs, and therefore the employer tries to save on these costs. This results in violation of the employee rights to pension benefits and social insurance. This leads to a

multiplier effect - non-payment of not only insurance contributions to all kinds of extra-budgetary social funds, but the personal income tax as well.

Formulated and analyzed reasons, alongside with a low level of minimum rate of labor payment, failure to comply with the requirements of the Labour Code of the Russian Federation concerning conformity of wage to a minimum subsistence level, the low level of tax administration of the personal income tax, and the immaturity of tax culture of the population lead to the weakening of the social role of personal income tax and the growth in differentiation of incomes of the population.

In the US, 80% of personal income tax revenues account for 20% of the richest citizens of the country (Stiglitz, 2011). In the Russian Federation half of cash earnings are concentrated among persons with the highest income (the ratio of the average wage of the workforce with the highest wages and the average salaries of 10% of the workforce with the lowest wages is 20%). Excessive polarization of incomes of the rich and the poor people is a provocation to the sense of social equity, and may result in conflict. In the Russian Federation, the R/P 10% ratio, which is determined as the ratio of the average income of the richest 10% to the poorest 10%, amounted to 17.2 in 2015 despite the fact that the recommended value is 6.8 (Federal Tax Service of Russia, 2016).

A direct consequence of the significant differentiation in the household income is not only the growth of social tension in society, but also deformations in the industrial structure, market demand structure and consumer preferences of the population (Kusch and Inokov, 2015). Currently, the low income of most of the population is insufficient for savings, pension savings, payments of insurance contributions, health, education and utility services payments, as well as house-buying. Private companies have a low level of remuneration, taking lead from the public sector.

Based on the foregoing, it can be stated that the present status of the social sphere in Russia does not correspond to the set strategic objective of economic development, i.e. enhancing the living standard of the population. In addition, low wages reduce the incentives to increase labor efficiency. Under current legislation, we can expect a further increase in the income gap between poor and rich segments of the population, the weakening of the social effects of personal income taxation and exacerbation of systemic crisis in the Russian Federation.

5. CONCLUSION

Thus, summing up, we note that the system of personal income taxation in the Russian Federation is not perfect and needs qualitative transformation. On the one hand, taxation system must serve a tool for social policy aimed at performing economic tasks while, on the other hand, it must provide the state with financial resources. The experience in the collection of the personal income tax, available

in Russia, shows that the flat tax rate schedule does not contribute to increased tax exemption from high incomes and their fair redistribution. Being beneficial to the wealthy citizens, it violates social solidarity of society and increases its social stratification. The Tax Code of the Russian Federation contains a rather broad list of tax deductions with regard to the personal income tax. However, social effect in the existing mechanism of deductions is pronounced very weakly.

The need for achieving not only fiscal, but also social effect in the course of personal income taxation in the context of the Russian Federation, determines the feasibility of implementing the following set of recommendations:

- To exempt from taxation the incomes of the citizens needed to ensure life-activities of the taxpayers and their family members at the minimum subsistence level. Given that minimum subsistence level varies depending on regions, it is necessary to make decisions with regard to the reform of the personal income tax individually for each entity of the Russian Federation;
- To grant standard tax deductions to the taxpayer and all his dependents up to the month in which the income of the taxpayer calculated on an accrual basis from the beginning of the year will exceed twelvefold amount of average wage in the region.
- To differentiate the amounts of provided social deductions under the personal income tax depending on the level of taxpayer's earnings. The contemporary system of social and property deductions under personal income tax in the Russian Federation is to the greatest degree beneficial to wealthy citizens;
- To strengthen the control over the formation of the wage fund. In this regard the Federal Tax Service of the Russian Federation should give additional impetus to the activities of the commissions on legalization of tax base with regard to wages at unprofitable organizations, as well as involve in this work more closely the authorities of the Russian Federation entities;
- To reform the system of labor relations, increasing salaries in the state sectors of the economy.

The above-mentioned measures on reforming the existing mechanism of personal income taxation will help to fully implement not only fiscal, but also social function of PIT, contributing to positive social return in the course of personal income taxation at the present stage of the Russian Federation.

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