

Delineation of Powers between the Federal and Regional Levels of Power in the Field of Tax Relieves: Fiscal Consequences

Milyausha R. Pinskaya¹ & Khaibat Magomedtagirovna Musaeva²

¹ The Federal State-Funded Educational Institution of Higher Professional Education, Financial University under the Government of the Russian Federation, 4th Veshnyakovsky pr-d, 4, Br. 214, Moscow, Russian Federation

² Federal state educational institution of higher professional education, Dagestan state University, Makhachkala, Gadjeva street 43 "a", Russian Federation

Correspondence: Milyausha R. Pinskaya, The Federal State-Funded Educational Institution of Higher Professional Education, Financial University under the Government of the Russian Federation, 4th Veshnyakovsky pr-d, 4, Br. 214, Moscow, 109456, Russian Federation. Tel: 79-16-120-0740. E-mail: MPinskaya@fa.ru

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Abstract

The article's objective is the research of delineation of tax powers with regard to stating tax preferences in the Russian Federation and their influence on the nature of tax competition and the consequences for budgets. It emphasizes that no analysis of the fiscal effect of tax preferences and control of the shortfall in tax revenues of the budget is performed on the government level. It is partially related to the unsolved state of the problem of tax relieves identification. It shows that the adopted in Russia mechanism of granting tax relieves for the regional corporate property tax includes excessive government control on the federal level, which incurs reduction of the level of vertical tax competition. As a result of such distortion, a shortfall in revenues of regional budgets emerges. Assessment of such revenues is neither made by the federal authorities nor by the regional are ones; and the respective losses of regional budgets not compensated by the federal budget. Through the example of the corporate property tax, it is illustrated that the main part of the shortfall in revenues relates to the preferences provided at the federal level. It is also revealed that the establishment of the institution of a consolidated group of taxpayers in the Russian Federation since 2012 had adverse impact on the powers of the regions of the Russian Federation in terms of their administration of the tax base of the territory. The distortion of the horizontal tax competition between regions for the taxpayer took place, as within a consolidated group of taxpayers, the net financial result of the group members suffers the tax, which contributes to erosion of the tax base (Base Erosion) with regard to the corporate profit tax. As a result, the amount of tax revenues to the regional budget does not depend on the actual contribution of each region to creation of favorable tax climate for investors.

Keywords: tax authority, tax relief, tax competition, corporate profit tax, corporate property tax, regional budget

1. Introduction

For modern Russia, high centralization of tax powers on the federal level of administration is typical. Regional authorities have minor powers regarding administration of the tax base, which is the source of their budgets' revenues. According to Article 12 Clause 3 of the Tax Code of the Russian Federation, the federal government states all essential elements of taxation with regional taxes and determines the taxpayers, and the limits of the power of the legislative (representative) authorities of the regions of the Russian Federation in the area of tax relieves are stated on the federal level. As a result, the opportunities of regions in creation of tax incentive mechanisms are rather limited. Nevertheless, regions try to actively use the tax relieves for attracting investors to their territories. Purposefully, the essence and the destination of tax relieves have been the object of focus of scientists and experts for a long period of history.

Perception of tax relieves has evolved from their total negation, which was substantiated by the statements that relieving the privileged categories from taxes contradicted the principle of the universality of taxation, and the tax was considered as a merely fiscal tool of replenishment of the public treasury, to their justification with respect to socially under-privileged people. There is a large number of scientific papers, which argue the practicability of tax relieves because they make the taxation system more complicated, provoke increasing costs

for ensuring compliance with the legislation by the taxpayers and for the tax administration (Toder, 2005; Toder et al., 2002; Estimates of Federal Tax Expenditures for Fiscal years 2009-2013, 2010; Tatarkin & Sidorova, 2010), increase the tax expenditures of the government (Shick, 2007, Kraan, 2004; Villela et al., 2010).

The modern Russian society mainly understands tax relieves as certain privileges to certain categories of taxpayers offered in compliance with the current situational preferences and campaign promises (Bykov, 2013; Savina, 2013), however, no due analysis of the caused effects and the government control of the missed tax revenues are being carried out. It is necessary to study the delineation of powers of the federal center and the representatives of regional authorities in the area of tax relieves and evaluation of the consequences of such delineation for the revenues of budgets.

2. Materials and Methods

Because of the deficiencies of the sphere of delineation of the powers of the authorities levels with regard to tax relieves, the problem of distortion (decrease of the level) of the tax competition takes place.

Tax competition is commonly understood as a method of interaction of different levels of the government based on the intention of each level to expand its powers with regard to control of the mobile tax base created on a certain territory. In a federal state, it can be represented as vertical competition between the federal center and the federation subjects, and as horizontal competition between the federation subjects.

At the vertical tax competition, "concurrent use of tax bases" takes place when different levels of government set different taxes on the same tax base independently from each other. Russia experienced this in 2002-2003 when the tax system had simultaneously the federal value-added tax and the regional sales tax with a similar tax base (the cost of goods sold). Sometimes, the vertical tax competition can become unfair, when in violation of the principles of fiscal federalism, the federal center establishes tax relieves for regional taxes (in Russia, primarily on the corporate property tax). The result of that is distortion of the vertical tax competition in the tax base, as the federal government's sphere of influence extends to the tax base, the powers of management of which belong to the federation subjects. Expansion of federal government tax authorities negatively affects budget revenues of the territories, since there is loss of tax revenues because the tax relieves for regional taxes are stated by the federal center.

The horizontal tax competition means competition between the federation subjects with the purpose of attracting taxpayers in their territories by creating favorable taxation environment (allowing investment tax loans, an efficient regime of tax administration, etc.).

The problem of the tax competition distortion is further complicated by the following circumstance. A typical feature of the Russian tax legislation is the lack of unambiguous interpretation of a tax relief, which makes it difficult to identify it. Based on the essence of Article 56 of the Tax Code of the Russian Federation, tax relieves are granted in accordance with the legislation on taxes and duties; statutory provisions cannot be individual, the granting of relieves provides certain categories of taxpayers with advantages compared to others, including the opportunity to avoid paying tax or pay it at a lesser rate. At the same time, out of the 17 taxes and duties levied in the Russian Federation, the legislation provides for tax relieves within elements of taxation only for four of them (the state duty, the corporate property tax, the land tax, the personal property tax). As for the rest of taxes and levies, including taxes levied within the special tax regimes, different concepts are used to indicate the tax privileges: exemption from the duties of the taxpayer, not taxable income (operations) (exempt from tax), tax deductions, lower tax rates, etc.

The problem is that the same term in relation to different taxes may be used in different meanings: either as an advantage (a tax relief), or as a way of adjusting the tax base. For example, the social tax deduction on the personal income tax gives the advantage to taxpayers with children compared to childless citizens. And the tax deduction for the value added tax (VAT) allows reducing the amount of the tax accrued by the amount of the tax included by suppliers and contractors in the cost of goods and services purchased by the seller. If the amount of deductions exceeds the amount of the accrued value added tax, the organization may request the government to refund the VAT, but this compensation is not a tax relief (privilege).

Or another example. The legislation relieves the sale of goods, works, and services by public organizations of disabled persons, as well as services of gambling arrangement from VAT. Where in the first case the tax benefits granted to certain categories of people with disabilities are described, in the second case, it is about the avoidance of double taxation, as the organizers of games pay the gambling tax.

The unsolved state of the problem of tax relieves identification:

1) hinders fulfillment of tax audits, since the lack of the official status of tax relieves with the majority of the exemptions does not allow the tax authorities to require taxpayers to provide documents confirming their right to enjoy the privileges;

2) hinders separation from the amount of shortfall in tax revenues of the amount appearing in connection with providing certain categories of taxpayers with privileges, which ultimately distorts the assessment of the effectiveness of tax relieves.

In the Russian Federation, evaluation of the impact of tax relieves on the generation of budget revenues is not of a systemic nature. In most regions of the Russian Federation, regulations on the procedure of evaluation of the fiscal efficiency of tax relieves were developed. The Moscow Region pioneered in this tendency, having adopted in 2004 respective evaluation procedures. In 2005, four subjects of the Russian Federation followed it (the Republic of Mari El, the Republic of Sakha (Yakutia), and the Belgorod and Smolensk regions). In 2006, the number of such subjects of the Russian Federation increased by seven more, in 2007-by ten more, in 2008-by six more, in 2009-by nine more, and in 2010-by five more. As of 2013, 13 of 83 subjects of the Russian Federation did not perform evaluation of the efficiency of tax relieves or performed them in a declarative manner.

In the majority of regions of the Russian Federation, the development of the budget law and the performance report is accompanied by assessment of the revenue budgets of territories that are lost as a result of tax relieves and exemptions. This is the reason why the amount of the tax base for each type of tax subject to the tax relief is determined: as of the year of application of the tax relief and as of the year preceding the year of application of the tax relief.

As a rule, the existing methods of evaluation differ, which makes it difficult to provide for monitoring of relieves on the entire territory of Russia. Probably for this reason, in September 2013, the Ministry of Economic Development of the Russian Federation prepared a draft Guideline for monitoring and evaluating the effectiveness of tax relieves, which can be used both for existing tax relieves, as well as for the newly introduced ones. In addition to the Methodology of Economic Development, the Audit Chamber developed a draft Guideline for fulfillment of the expert-analytical evaluation of tax relieves effectiveness and their stimulating effect on the economy. After all, it can be argued that it was the first time a mechanism of social control and monitoring of the effectiveness of tax relieves was developed.

The Guideline of the Ministry of Economic Development is developed for concerned federal executive authorities of the Russian Federation, executive authorities of subjects of the Russian Federation, and local self-governments. The Guideline of the Ministry of Economic Development allows estimating the loss of budgets, which is especially important at forecasting revenues and assessing financial and economic parameters of state programs of the Russian Federation.

The Guideline of the Chamber of Accounts mainly focuses on the methodological aspects of determining the criteria and the indicators of efficiency of tax relieves. Similarly to the Ministry of Economic Development, it is assumed that the amount of lost tax revenues of the budget corresponds to the amount of tax expenditures, and, therefore, the principle of efficient use of budget funds (economy and efficiency) set forth by Article 34 of the Budget Code is extrapolated to the tax relations. In assessing the efficiency, a tax relief is associated with an alternative measure of governmental support that affects the dynamics of the target indexes, depending on various macro- and microeconomic parameters.

Developers of both Guidelines a priori base on the fact that tax relieves are tax expenditures of the budget and consider them the shortfall in budget revenues because of the use of tax preferences. Despite the coincidence of the numerical values of the volume of tax relieves, tax expenditures, and shortfall in tax revenues, their equation is methodologically wrong with far-reaching consequences. The shortfall in tax revenues includes not only the amounts of granted tax relieves, but also the amounts of overdue arrears and other fees. In addition, the presence of tax expenditures can serve as a basis for initiating inspection by the Chamber of Accounts of the Russian Federation, which means probable occurrence of one more supervisory authority for taxpayers. The use of tax relieves in the form of reduction of the taxable income or the property, reduction of the tax rate, deferral (an installment plan), and other preferences does not cause transformation of the taxpayer's property. And the equation of tax relieves to tax expenditures conceals the danger of causing attempts of state and municipal authorities to claim the proceeds or property derived or obtained from the use of the tax relieves.

Despite the effective regional regulations on the procedure for evaluating the fiscal efficiency of tax relieves and draft Guidelines of the Ministry of Economic Development and the Chamber of Accounts of the Russian Federation, the process of creation of methodological support of quantifying the fiscal efficiency of tax relieves on the state level has not yet been completed. It is necessary to establish a mechanism of monitoring the shortfall

income of not only the sub-federal budgets, but of the federal budget as well. And taking into account the fact that the use of tax relieves and fiscal subsidies can lead to the same result because of their interchangeability, it is advisable to perform their comparative assessment aimed at identifying the most efficient incentive tools and at prioritizing the use of a certain tool.

3. Results

Let us consider the effects of distortion of the vertical and horizontal tax competition caused by the deficiencies in the delineation of the power levels of government with regard to tax relieves.

Despite the fact that the executive authorities in the Russian Federation carry out calculation of performance indicators of tax benefits, they do not generalize the data for the tax relieves granted by the federal law. This prevents us from receiving a complete and objective picture of the extent of influence of delineation of tax powers with regard to preferential taxation in the circumstances of the vertical tax competition. At the same time, there are reasons to believe that excessive government regulation at the federal level entails distortion of the vertical tax competition. The negative effect of such distortion is the appearance of the shortfall tax revenues of regional budgets, caused by the loss of control by the regional authorities over the management of the tax base of the territory.

Let us illustrate this thesis through the example of tax relieves for the corporate property tax. The amount of the shortfall in tax revenues due to granting the tax relieves for the corporate property tax is shown in Table 1.

Table 1. The shortfall in tax revenues for the corporate property tax in connection with granting tax relieves, in thousands of rubles

Indicators	Years			
	2009	2010	2011	2012
The amount of tax that has not been received by the budget in view of granting tax relieves to taxpayers (p. 030) including:	284.296	306.320	324.639	364.447
1) related to the tax relieves established by the federal government (in accordance with Article 381, Article 7, Clause 7 of Article 346.35 of the Tax Code of the Russian Federation) (p. 040)	168.042	184.005	193.178	227.518
2) related to the tax relieves established by legislative authorities of the regions of the Russian Federation (in accordance with Clause 2 of Article 372 of the Tax Code of the Russian Federation) (p. 050)	116.254	122.316	131.460	136.929

Source: The tax reporting statistics of the Federal Tax Service, Form # 5-NIO (pp. 030, 040, 050)-The official website of the Federal Tax Service. URL: www.nalog.ru (Date Views: 15.07.2014).

As you can see, the main part of the shortfall in revenues has fallen to the tax relieves granted at the federal level in accordance with Article 381, Article 7, Clause 7 of Article 346.35 of the Tax Code of the Russian Federation. The dynamics of structure of the shortfall in revenues by the types of tax relieves gets worse every year: whereas in 2009 the share of federal relieves equaled to 59.11%, by 2012, this proportion rose by 3.32% and reached 62.43% (see Figure 1).

It seems that the problem of the shortfall in tax revenues due to the abolition of federal tax relieves will lead to a significant increase in the tax burden and in the cost of services of natural monopolies, which are the main recipients of tax relieves for the corporate property tax. According to estimates, total abolition of tax relieves will need indexing freight railway tariffs by 5-6% (Recommendations of the meeting of the Federation Council Committee for Budget "Tax Incentives: analysis of application and methods of assessing their efficiency", 2011).

In deciding whether to maintain or revoke relieves on regional taxes, a sort of compromise should be made between the interests of the federal government and the regions. If the federal government grants certain tax benefits on regional taxes, it must compensate the shortfall in tax revenues of regional budgets at the expense of the federal budget.

Distortion of the horizontal tax competition in the form of loss of control over the management of the tax basis of the territory at the regional level can be observed in contemporary Russia in connection with the creation in 2012 of the institution of the consolidated group of taxpayers (CGT).

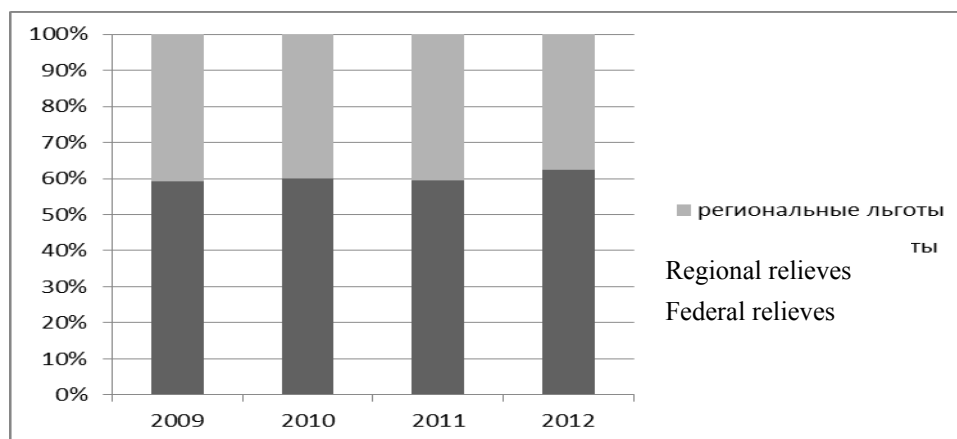


Figure 1. The structure of the shortfall in tax revenues for the corporate property tax in connection with granting tax relieves, %

The CGT is a voluntary association of taxpayers of the corporate profit tax based on a contract with the purpose of calculation and payment of the corporate profit tax taking into account the gross financial result of the economic activity. In the CGT, a responsible participant is appointed who is charged with management of consolidated financial statements, calculation, and payment of corporate profit tax.

The CGT participants gain an advantage compared to other taxpayers, since they are entitled to reduce the tax base by offsetting profits and losses. Following the general rule, the organization has the right to reduce the deferred tax base by the amount of losses incurred during 10 years. For the consolidated group, the loss of one of the members reduces the overall consolidated tax base directly in the current tax period, but not in future tax periods, as it would be in case the member would calculate the tax individually.

Some regions of the Russian Federation provide reduced rates of the income tax for the members of a CGT in the part of taxes paid to the regional budget. The condition for application of such exemptions is the organization's belonging to a specific industry or activity type; in several regions, the benefits are time limited. For example, since 2012 the Leningrad region reduced the regional tax rate by 4% for organizations involved in the production, processing, transportation, oil and gas; production and sale of petroleum products, and the Khanty-Mansi Autonomous District reduced it for organizations providing services to oil and gas extraction. So the regional tax rate is now equal there to 14% (the total tax rate is equal to 16% with account of the 2% federal rate) (the Regional Law of Leningrad Region dated 19.07.2012 # 64-OZ; the Law of the Khanty-Mansi Autonomous District (Yugra) dated 30.09.2011 #87-OZ). Since 2014, the Arkhangelsk region reduced the regional tax rate by 4.5% for organizations involved in diamond mining and wholesale trade of precious stones, which is now equal to 13.5% (the total tax rate is equal to 15.5% including the 2% federal rate) (the Law of the Arkhangelsk Region dated 02.07.2013 #708-41-KO). This reduced income tax rate is set for the period of 2014-2017 in the Nenets Autonomous District for organizations involved in production of crude oil and oil (associated) gas, transportation of oil by pipeline, storage and warehousing of oil and products of oil processing (the Law of the Nenets Autonomous District dated 08.10.2013 #88-OZ).

The CGT operation contributes to migration of the tax base between regions, in particular in 2012, the corporate profit tax decreased by 44.6 billion rubles in 23 subjects of the Russian Federation (28% of the total number of regions), and in 60 subjects of the Russian Federation (72% of the total number of regions), there was an increase in the corporate profit tax revenues by 29.1 billion rubles.

The accomplished by us clustering of the subjects of the Russian Federation by the share of the corporate profit tax in the amount of tax revenues of the consolidated budgets of the Russian Federation revealed that profit organizations play an essential role in shaping the tax base of territories. More than a dozen regions generated a quarter of their tax revenues from the corporate profit tax, and for a third of the regions, it was one fifth of the revenues. In 2011, three of the subjects of the Russian Federation (the Lipetsk Region, the Tyumen Region, and the Chukotka Autonomous District), and in 2012 two subjects of the Russian Federation (the Sakhalin Region and the Chukotka Autonomous District) generated almost half of the tax revenues from the corporate profit tax.

The CGT institute had adverse impact on the management of the tax base of the territory in the circumstances of

the horizontal tax competition, as it contributed to the following factors of tax risks for the regions:

1) the CGT operation leads to erosion of a substantial portion of the tax base of the regional budgets, which reduces the accuracy of planning and forecasting of the volume of shortfall in tax revenues of the territories. A serious problem for the regions could be a one-time and sudden outflow of significant volume of income, which may occur within the redistribution of tax revenues from the CGT;

2) subjects of the Federation have become more vulnerable to possible manipulations by taxpayers aimed at moving the tax base from one region to another, as the current rules state that as of the end of a tax period, the operating profit and loss of the members of the CGT are subject to offset. For instance, the Republic of Karelia, in the tax revenues of the budget of which the revenues from the corporate profit tax of the JSC "Severstal" prevailed, faced difficulties. Since 2012, this company became a responsible member of the CGT, and the amount of the income tax to the budget of the Republic of Karelia is now dependent on the size of the aggregate income of the CGT calculated taking into account balancing of the financial results of all group members. Not by accident, amendments to the Tax Code of the Russian Federation were adopted during 2012, which perpetuated stage-by-stage transition to the new system of distribution between the regional budgets of the corporate profit tax payable by the members of the consolidated group, which consists of organizations that own facilities of the Unified Gas Supply System (JSC "Gazprom"). Application of correction factors to the formula for calculating the share of profit attributable to each of the CGT members with account of the level of tax payments to organizations before their joining the CGT allowed to level off the adverse effect caused by the sharp loss of substantial amounts of revenues from the budget of the City of Moscow (about 150 billion rubles, which is equal to 10.67% of the total tax revenues of the budget). However, in relation to other CGTs, including those to be created in the future, the problem persists and may cause undesired significant share of the shortfall in budget revenues of some subjects of the Russian Federation;

3) the scope of tax revenues to the regional budget does not reflect the real contribution of each region to creating favorable conditions for investors and does not encourage regional authorities to create additional conditions for increasing their tax competitiveness.

4. Discussion

Division of tax competition into the vertical and horizontal ones is not new: M. Keen & S. Kotsogiannis modeled tax competition between the federation and jurisdictions (the vertical tax competition), as well as between jurisdictions (the horizontal tax competition) (Keen & Kotsogiannis, 2002; Keen, 1998). However, their model did not address the distortion of tax competition in the form of loss of control over the tax base created in a particular area. The research of M. Köthenbürger dealt with the horizontal tax competition for mobile capital, but he studied the taxation of capital in relation to the two different systems of fiscal equalization: redistribution (equalization) of revenues from the capital tax and redistribution through the mechanism of the tax base formation (Köthenbürger, 2002). According to the model of tax competition developed by G. Zodrow & P. Mieszkowski (1986), and J. D. Wilson (1986), insufficient taxation of capital leads to insufficient provisioning of public amenities. At the same time, the publications of these authors do not focus on the delineation of powers between the federal and regional levels of government with regard to granting tax relieves.

The idea of assessment of tax relieves for the analysis of budget losses was expressed by S. Surrey (Surrey, 1976), but it concerned only personal income taxes and corporate profit taxes. Analysis of budget losses caused by granting tax relieves has been extended by including property taxes and consumption taxes (Auerbach & Summers, 1979; McIntyre, 1980).

The typical features of recent researches are the shift in emphasis to the study of the theoretical nature of tax relieves, the analysis of the problems of their tax administration, the increase in detailing directions and applications of tax relieves (Fleming & Peroni, 2010, Tax Incentives. Theory and Practice, 2014).

5. Conclusion

Disadvantages of tax powers delineation between the federal and regional levels of government in the field of tax relieves determine the reduction and the distortion of tax competition. This can occur under the influence of primarily such factors as excessive and unprofessional government regulation and unfair competition, the participants of which violate rules and regulations of tax competition in effect in the marketplace. The current procedure for granting relieves from the corporate property tax and the corporate profit tax in the Russian Federation determines the loss by regional authorities of the control over the management of the tax base of the territory and occurrence of shortfall in tax revenues of regional budgets.

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