Study of the Characteristics of Financial and Tax Consolidation under the Russian Rules

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Abstract

Background/Objectives: As the large integrated Russian companies enter into the international market, they shall be presented to potential investors as single economic entities. Companies’ financial and tax information can be consolidated.

Methods/Statistical Analysis: To conduct the study we used such methods applied in the science and practice, as systematization and generalization of scientific and practical material; methods of data analysis, synthesis and comparison, as well as graphical method. Findings: The rules governing the need to introduce consolidation norms, their scope of application, consolidation perimeter, peculiarities of the accounting policies, of consolidated database formation, rules for preparation and submission, publication and audit of the consolidated financial statements have been analyzed in the course of research. The results of the analysis revealed minor and fundamental differences in certain legal requirements on financial and fiscal consolidation and the conclusion was drawn that at present, despite the uniform global economic objectives (attracting the attention of foreign investors to Russian companies), the differences between the rules of accounting (financial) and tax consolidation are significant. Application/Improvements: To enable joint use of accounting and tax consolidation for assessment of the financial attractiveness of the consolidated group of companies, further work is needed in terms of the legal framework regulation.

Keywords: Accounting, Consolidated Financial Statements, Standards, Taxpayers

1. Introduction

Macroeconomic processes ongoing in the world community require obtaining timely and accurate information about the financial state and financial results of activity of large integrated business entities, including the information about the amount of corporate income tax calculated by consolidated groups of interdependent organizations. The purpose of financial statements, including the consolidated financial statements prepared as per IFRS is to provide such information to interested users. In the Russian Federation, normative regulation of the rules of the financial (accounting) consolidation has been provided since 2012 by the introduction of International Financial Reporting Standards (hereinafter IFRS) by the Order No. 160n of the Ministry of Finance of the Russian Federation dated 25.11.2011. Order No. 160n is a bylaw providing for the application of the Federal Law of July 27, 2010 No. 208-FZ “On Consolidated Financial Statements” (hereinafter the Law on CFS).

Since that time, the Russian legislation has stipulated the possibility of consolidating organizations in a Consolidated Group of Taxpayers (hereinafter CGT). It has been provided by the Federal Law of 16.11.2011 No. 321-FZ “On Amending Parts One and Two of the Tax Code of the

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Russian Federation, Relating to Creating a Consolidated Group of Taxpayers (hereinafter the Law on CGT).

Thus, since 2016 for the groups of companies that meet certain criteria and perform a set of homogeneous functions in a specific area of financial and economic activities, the law has fixed the requirement to draw up consolidated financial statements that would allow considering such a group as a single economic entity.

Economic literature includes comparative studies of different ways of implementation of a system of consolidated payments to the budget based on reviews of legislation in different countries conducted by the following authors: D. Friedel, in respect of the USA consolidation standards; Y. N. Emelin, A. Takasaki, O. Yujiiro analyzed the experience of Japan; studies of P. Sundgren, J. A. Edstrom and J. Skansk concerned Scandinavian countries; works of J. Kandel and S. Taylor related to Great Britain. The authors of these studies analyzed the degree of participation of the parent company in the subsidiary one, the possibility of the subsidiaries' losses carrying before and after joining the group and other issues. T. A. Shegurova and A. S. Kizimov, among other things, set out the history of the development and expansion of the foreign practice of budget payments consolidation in chronological order, discussed the principles and conditions for the introduction of this mechanism.

However, until today there has been no comparison made regarding standards of financial and tax consolidation under the Russian rules.

When considering the results of the introduction of mechanism of consolidated payments to the budget and assessing the benefits and the additional load placed upon the State and the companies upon the entry into force of these legislative initiatives, it is useful to consider how the principles of consolidation used in accounting may be applied during the formation of the system of budget payments consolidation and what additional loads will be associated to the preparation of the consolidated tax reporting.

### 2. Concept Headings

The purpose of the article is to identify features of financial and tax consolidation, to analyze the consolidation rules requirements, the scope of their application, the consolidation framework, specifics of the accounting policy, formation of consolidated base and rules for preparation, presentation, publication and audit of the consolidated financial statements.

#### 2.1 The Need for the Introduction of the Consolidation Standards

The introduction of standards the Consolidated Financial Statements (hereinafter CFS) and the Consolidated Tax Reporting (hereinafter CTR) is a reflection of the process of globalization of the world economy and the creation of large transnational corporations. Unification of accounting standards and reports on the results of financial and economic activities of such corporations should be stimulating and be favorable for investments, attracting the attention of foreign investors to the Russian business.

In competition with Western counterparts, Russian companies have to pay serious attention to the transparency and accessibility of their reporting for both foreign and domestic investors. The use of IFRS will allow evaluating and comparing the performance of the Russian and foreign companies.

Given the above, it is possible to notice the similarity of the reasons for the introduction of the CFS and the CTR standards (100% match).

#### 2.2 Scope of Legal Application

Both Laws, the Law on CFS and the Law on CGT only regulate the activities of Russian organizations as stipulated by cl. 1, Art. 1 of the Law on CFS and cl. 1, Art. 25.2 of the Tax Code of the Russian Federation.

The Law on CFS establishes general requirements for the drawing, presentation and publication of CFS of credit companies, insurance companies and other companies whose securities have been admitted for trading on stock exchanges and (or) other organizers of trade on the securities market. The CFS are also prepared by organizations, if such preparation and (or) representation and (or) the publication are provided for by federal law or the constitutive documents of the organization.

The Law on CGT has introduced in the Tax Code of the Russian Federation provisions containing the order, conditions of creation of a consolidated group, the formation of the tax base, preparation and presentation of reporting and tax payment.

Therefore, according to the author, the scope of the Law on CFS is quite similar to the scope of the Law on CGT (80% match).
2.3 Consolidation Framework

The consolidation framework is a list of companies, financial position and results of operations of which are to be included in the consolidated financial statements of the company. The consolidation framework includes the consolidating company itself, which undertakes to conduct consolidation procedures and to prepare and present the consolidated financial statements and the consolidated companies accounts (details) of which are included in the consolidated statements of the group.

According to cl. 12 of IFRS No. 27 “Consolidated and Separate Financial Statements”\(^{13}\), CFS shall include all subsidiaries of the parent enterprise, except for subsidiaries held for sale and accounted for in accordance with IFRS 5 “Non-current Assets Held for Sale and Discontinued Operations”\(^{14}\). The CFS includes all companies directly or indirectly controlled by the parent company. This criterion of control is not only the possession of more than 50% of voting shares, but also one of the following:

- Availability of more than half the votes received as a result of an agreement with other investors;
- Right to determine financial and operating policy of the enterprise according to its Statute or an agreement;
- Right to appoint (demote) the majority of the board of directors;
- Voting majority in the board of directors or other governing body.

It should be noted that, in the new IFRS standard 10 “Consolidated Financial Statements”\(^ {15}\) entered into effect on January 1, 2013, the definition of “investor’s control of the investment project” includes the following three components:

- Having the powers regarding the investment project;
- Exposure to risks associated with variable income from the participation in the investment project, or having the right to receive such income;
- Possibility to use the investor’s powers in respect of an investment project in order to influence the investor’s income volume.

Based on the IFRS concepts, the quota of participation of one organization in the other one is not the main criterion for inclusion in the consolidation framework when preparing the CFS. The control organization may have no voting shares of the controlled company at all. Such a descriptive definition of the framework of the fiscal consolidation, noticed by V. E. Deshin\(^ {16}\) as a disadvantageous feature of fiscal consolidation, requires additional management analysis.

It should be noted that modern vertically integrated structures include the organizations of different types of economic activities that are interrelated. These organizations have a different system for evaluating financial performance and financial state and it should be considered in the CFS analysis.

More clearly defined parameters to measure the framework of consolidation have been established by the Law on CGT in respect of budget payments consolidation. Thus, according to Art. 25.2 of the Tax Code of the Russian Federation\(^ {17}\), the CGT can be established by organizations on the condition that one organization directly and (or) indirectly participates in the authorized (share) capital of other organizations and the quota of such participation in each of these organizations is not less than 90%.

In addition, in contrast to the CFS consolidation framework there are some limitations provided for CGT regarding the industry: Taxpayers operating in various industries cannot be consolidated in one group.

The fiscal consolidation framework requires from all group members to pay corporate income tax at the rate established by cl. 1, Art. 284 of the Tax Code of the Russian Federation (20%).

In accordance with the law on CGT, the main burden related to the formation of a consolidated tax base for CGT corporate income tax, tax calculation, submission of the CTR to the tax authorities shall be borne by the responsible CGT member. The author adheres to the opinion of O. P. Grishina\(^ {18}\), according to which “it is advisable appoint the parent company to be a responsible member of the group, although according to the tax rules any member of the group can be appointed to be responsible. Otherwise, the creation of CGT makes no sense, as one of its objectives is the control by the parent company of financial flows of subsidiaries”.

Given the stated principles of formation of the CGT framework, it can be concluded that the tax option of association in the consolidated group differs significantly from the consolidation framework for the purposes of the external financial reporting. In accordance with IFRS, the consolidation framework includes all subsidiaries and jointly controlled entities, while the CGT will include only subsidiaries and only with equity stakes of at least
90% (at least at the first stage of its implementation). Although the Finance Ministry of the Russian Federation, when planning the introduction of the mechanism of fiscal consolidation to the Russian legislation expected a further liberalization of the requirements of the Law on CGT\textsuperscript{19}, but all of these seem to be far away in the future.

In addition, on the basis of cl. 1, Art. 25.1 of the Tax Code of the Russian Federation, the creation of CGT shall be carried out on a voluntary basis, i.e. there is no obligation for the parent company to include in the group all of its subsidiaries. In practice, this might mean that large companies having taken the decision to establish CGT will be able to determine the framework of the CGT by choosing the appropriate companies. For example, the priority will be given to obviously unprofitable organizations involved solely in the creation and maintenance of assets, for the purpose of reducing the size of tax payments to the budget. If the certain unprofitable companies no longer meet the criteria for inclusion in the CGT (in terms of net assets), the carrying out by the parent company of the necessary procedures (transfer to the money-losing companies of additional assets, revaluation, liabilities downgrading) will solve this problem. The ambiguity of the situation in which “the parent company’s management keeps the right to choose the companies that will be included in the CGT” has been also noted by S. Titova\textsuperscript{19}.

It should be noted that the time and estimated costs of preparation of the consolidated financial statements are directly dependent on the number of companies that will be included in the consolidation framework and from the location of the companies the data of which needs to be collected and analyzed. And it is a pity that the different approaches to defining the frameworks of the consolidated groups for the purposes of financial and tax reports preparation do not facilitate the current activities of the companies themselves, nor regulatory bodies, nor external users such reports (according to the author, the match of the framework of CFS and CTR consolidation is 50%).

### 2.4 Accounting Policy

In accordance with cl. 24 of IFRS No. 27\textsuperscript{13}, the CFS shall be prepared using uniform accounting policy for the similar transactions and other events in similar circumstances. If the company of the group uses accounting policy other than the one adopted for the reflection in the CFS of similar transactions and events in similar circumstances, the financial statements of the Company shall be appropriately corrected when preparing the CFS.

According to cl. 2, Art. 321.2 of the Tax Code of the Russian Federation\textsuperscript{12}, the procedure of CGT tax accounting shall be established in the accounting policy for CGT taxation purposes. Although when harmonizing the Law on CGT the legislator refused to fix the rules regarding the requirements for the formation of uniform accounting policies for CGT taxation purposes, the unification of tax accounting approaches must be a priority task for the participants of the consolidated group, as the discrepancies in the tax records of CGT members will distort the consolidated tax base and will not present a truthful picture of income tax of CGT organizations.

So, the legal requirements regarding the need to fix the basic provisions on the CFS and CTR in the relevant accounting policies are similar (100% match).

### 2.5 Consolidated Base

The initial stage of the calculation of the CFS and CGT consolidated base is the same: Arithmetic summation of the corresponding indicators of organizations included in the consolidation framework. Thus, according to IFRS No. 27, in the preparation of the CFS, the company combines the financial statements of the parent company and its subsidiaries line by line by adding together similar items of assets, liabilities, equity, income and expenses and in accordance with cl. 1, Art. 278.1 of the Tax Code of the Russian Federation the responsible member shall determine the CGT tax base by arithmetic summation of revenues and expenditures for all members being accounted for tax purposes.

However, after that, in contrast to the rules established for fiscal consolidation, in order that the CFS present financial information about the group as a single economic entity, it is necessary to exclude the carrying amount of the investment of the parent company in each subsidiary and the share owned by the parent company in the capital of each subsidiary and completely exclude the intercompany balances, transactions, incomes, expenses, dividends, gains and losses that may result from intra-group transactions and are recognized in the value of assets.

Among the specifics of the definition of a consolidated tax base, it is important to note the following:

The consolidated tax base does not include the revenues of members being subject to taxation at the source of
income payment. In addition, the definition of the CGT tax base shall be carried out at the tax rate specified in cl. 1, Art. 284 of the Russian Tax Code: 20%. CGT members independently determine the tax base, to which the different tax rates are applied and such a base is not taken into account when calculating the CGT tax.

When determining the tax base, the following is not taken into account: Income (for the receiving party) as per sub cl. 44, cl. 1, Art. 251 of the Tax Code of the Russian Federation and expenses (for the transferring party) as per cl. 48.14 Art. 270 of the Tax Code of the Russian federation in cases of fund transfers made by:

- CGT members to the Responsible Member of this group for the tax payment (advance payments, penalties, fines) in the manner prescribed by the Tax Code of the Russian Federation for the CGT;
- Responsible CGT Member to a member of this group for clarification of the amount of tax (advance payments, penalties, fines) to be paid in connection with this CGT.

CGT Members do not form in respect of transactions with other Members of this group the following provisions:

- Doubtful debts provisions (Art. 266');
- Reserve for warranty period repairs and service (Art. 267');
- For banks: Loan loss provision and similar debt, including debt on interbank loans and deposits (Art. 292').

These provisions must be restored by organizations - CGT members starting from the beginning of the tax period in which they became members of this group, - in terms of operations (debts, sale of goods, works) with other members. Appropriate adjustment amounts shall be included in non-operating income of the tax period preceding the period of affiliation of the specified organization to the CGT.

As can be seen from the provisions of the law defining the characteristics of different types of consolidation, by contrast with the financial consolidation, the intercompany balance of transactions between CGT Members in the case of consolidated taxation are not excluded. Although, of course, this fact increases the amount of revenues and costs indicated in the tax return for income tax of CGT companies, but this feature of fiscal consolidation will have no impact on the final result: The amount of the income tax for CGT organizations. The interested users pay attention in CTR to the amount itself of corporate income tax paid by the Group to the budget, while when analyzing the CFS, the most important are its individual parameters (revenue, cost), which are then used in the calculation of economic indicators permitting to make decision regarding the investment in this group of companies.

Considering the above, the differences in the approaches to the determination of the CFS and CTR consolidated base show that indicators used in the calculation of different types of consolidation are not interchangeable (20% match).

2.6 Specific Features of the Consolidated Statements Preparation

CFS shall be prepared in accordance with IFRS and the CGT tax reporting is prepared in accordance with the norms of the Tax Code of the Russian Federation.

According to cl. 2, Art. 3 of the Law on CFS, the consolidated financial statements of the organization shall be made along with the financial statements of this organization, prepared in accordance with the Accounting Law, while CGT members, except for the Responsible Member of this group, do not submit tax declarations to the tax authorities where they are registered if they do not receive income not included in the consolidated tax base of the group and if they do not apply to the tax base the rate other than 20%. Thus, only the tax consolidation exempts under certain conditions the ordinary members of the group from the preparation of reports on their organization.

In accordance with clauses 22, 23 of IFRS No. 27, the financial statements of the parent company and its subsidiaries used in the preparation of the CFS shall be prepared for the same reporting date. However, fiscal consolidation rules make provision for the situation of mismatch between the reporting dates of the subsidiary and the parent company for a period not exceeding three months. In this case, the subsidiary must prepare additional financial statements at the end of the reporting period of the parent company, except in cases where this is not practicable. Subsidiary shall make corrections in order to fix significant transactions or events that occur between that date and the date of the financial statement of the parent company.
The Tax Code of the Russian Federation has not provided for the possibility of divergence between dates of CTR preparation by CGT members. Just like for the ordinary taxpayers of corporate income tax, the tax period for income tax of CGT organizations shall be the calendar year, reporting periods shall be the first quarter, six months and nine months of the calendar year and when calculating the monthly advance payments based on actual profits: one month, two months, three months and so on until the end of the calendar year (Art. 285). In these conditions, according to Art. 6.1 of the Tax Code of the Russian Federation, the term calculated in years shall expire on the corresponding day and month of the last year of the term; term calculated quarters, expire on the last day of the last month of the period; the term calculated in months shall expire on the corresponding month and day of the last month of the period.

Obligation to prepare the consolidated statements in the case of the financial and fiscal consolidation shows that there is sufficient comparability of these standards (80% match).

2.7 Presentation and Publication of Reports

Article 4 of the Law on CFS provides for the submission of the annual CFS by the members of the organization, including shareholders. Annual CFS shall be submitted by the organization to the authorized federal body of executive power and credit organizations present their CFS to the Central Bank of the Russian Federation. Interim CFS shall be submitted by the members of the organization, including shareholders only when such submission is provided by its constituent documents. Credit organizations shall also present their interim CFS to the Central Bank of the Russian Federation as provided. CFS shall be presented in the manner determined by the constituent documents of the organization.

Annual CFS shall be submitted before the General Meeting of the organization members, but not later than 120 days after the end of the reporting year covered by such statements.

Article 7 of the Law on CFS requires from the organization within 30 days after the presentation of the CFS to users to publish annual consolidated financial statements via public information systems and mass-media available to interested persons or to make it available to all interested parties in any other way.

Publication of the CGT tax return is not required by the Tax Code of the Russian Federation. In accordance with cl. 8, Art. 289 of the Tax Code of the Russian Federation, the Responsible Member shall submit tax declarations to the tax authority at the place of registration of the CGT Agreement in the manner and within the time limits established by this article for the ordinary taxpayers of corporate income tax, i.e. no later than 28 calendar days after the end of the reporting period and at the end of the tax period it shall be done no later than March 28 of the year following the expired tax period.

According to the Law on CFS, there is no responsibility for the failure of submission of the financial statements.

Failure to submit the CTR in terms specified by the Tax Code of the Russian Federation entails a fine penalty of 5% of the unpaid tax for each full or partial month of delay, but not more than 30% of this amount and not less than one thousand rubles (Art. 119 of the Tax Code of the Russian Federation). The CGT Member shall incur responsibility for the failure to report or the report of inaccurate data to the Responsible Member of this group, which led to the non-payment or partial payment of CGT corporate income tax, a fine in the amount of 20% of the unpaid tax and if these acts have been committed intentionally, the fine is 40% (Art. 122.1 of the Tax Code of the Russian Federation). Match of order and publication of CFS and CTR is 60%.

2.8 Consolidated Financial Statements Audit

The process of the CFS preparation is not simple, therefore the Art. 5 of the Law on CFS require a mandatory audit of the annual consolidated financial statements. The auditor’s report is presented and published together with the said statements. Audit of the consolidated financial statements can only be carried out by audit organizations (cl. 3, Art. 5 of the Law on Auditing).

Audit of the CGT consolidated tax reporting is carried out by the tax authority which registered the Responsible Member of this group. The auditors check the correctness of calculation and timely payment of CGT income tax of organizations. The Tax Code of the Russian Federation provides for a whole procedure of tax control measures in respect of CGT, as per the results of which the tax authority shall make an audit report and the Responsible Member in the event of disagreement with the audit results may appeal to the Federal Tax Service of the
Russian Federation and later in court (Articles 89, 89.1, 93, 100, 101, 101.2 and 138). Thus, the similarity of the regulations regarding the rules of audit of the CFS and the CTR is not great (match is about 20%).

3. Results and Discussion

To visualize the similarities and differences of the financial (accounting) and tax consolidation, the author has plotted a chart of relationship on the basis of comparison of the main characteristics of the two types of consolidation using a 100% correspondence scale (larger value of the parameter corresponds to the greater similarity) (Figure 1).

Figure 1 shows that the matching characteristics of the analyzed consolidation types are basically the ones allowing comparing them by form and structure: Similar reasons for the introduction of the consolidation rules, comparable scope of distribution and similar form of presentation. Indicators of these characteristics are located in the upper part of the chart and allow us to consider the CFS and the CTR as the separate types of consolidation of the information of interdependent organizations.

Differences between the inner content of the CFS and the CTR are considerable: The consolidation framework of the quota of participation of one organization in another one in the case of CFS is almost twice bigger than the framework provided to the CTR; calculation of the consolidated tax base is the same only in terms of the first stage content (the arithmetic summation of the corresponding indicators of organizations included in the consolidation framework) and after that the structure of the indicators and the rules for their determination for CFS and CTR are different: Values of these parameters are presented in the lower part of the chart.

4. Conclusion

With regard to the practice of information consolidation following the requirements of the financial (accounting) and tax law it is possible to make a conclusion that, despite the common global economic goals (attraction of the attention of foreign investors to the Russian companies), rules of accounting and tax consolidation differ a lot. Given the differences in the definition of the consolidation framework and the approaches to the formation of a consolidated base, it is difficult to compare the com-

Figure 1. The relationship of basic characteristics of the financial and fiscal consolidation.
panies’ performance indicators. However, taking into account that this is only the initial stage of the implementation of the legislative consolidation rules, perhaps in the future the competent regulation of regulatory framework will allow sharing the consolidated accounting and tax indicators to assess the financial attractiveness of the consolidated group of companies.

5. References